

PREM 19/2925

33/89

PART 3

SECRET

CONFIDENTIAL FILING

PSA Restructuring

CIVIL SERVICE

Wardale Enquiry

PT1: July 1982

PT3: March 1988

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
8.3.88							
13.5.88							
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7.8.89							
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7.6.90							
2.8.90							

PREM 19/2925

PART
END

PART 3 ends:-

MGS DOE to Mandle MP

27-7-90

PART 4 begins:-

AT to BP 6/8/90



Minister for Local Government
and Inner Cities

Prime Minister

Subject: Treasury news...
agree with his premise that
closure of furniture supply business,
retaining only the Buying Agency,
is the best option? Ranges of
outcomes are given in the attached
table. You should be aware of
the ~~impact~~ possible complaints from
skilled workshops

Department of the Environment
2 Marsham Street
London SW1P 3EB

Telephone 071-276 3000

Agreed with
27 JUL 1990

Dear Mr Maude

AT 6/18

PRIVATISATION OF THE CROWN SUPPLIERS: FURNITURE BUSINESS

Peter Lilley, Christopher Chope and the Private Secretary to the Prime Minister have been in correspondence about the outcome of the sale competition for the Crown Suppliers' IDS and transport businesses, and the further work for which the Prime Minister has asked is being done. I am now writing with my conclusions on the furniture business, which incorporates two TCS divisions, Product Supply and Services, which is a furniture supplier, and the Buying Agency, which provides a procurement service to the public sector.

Samuel Montagu & Co Ltd, the merchant bank advising on the sale, tested the market widely. Nevertheless, the sale competition generated only 2 bids for the furniture business (from Melton Medes Ltd and from a buy out team of senior TCS officials led by Mr Bob Ethrington, an ex partner of Coopers and Lybrand).

- ✓ The bids are summarised in the attached matrix. An estimate of the relative net present value to the Government of the bids and that of the realistic alternative options of retaining the profitable part of the business (The Buying Agency) in Government or closing the business down are summarised in the table also attached. I must stress that these are the comparative costs - some costs and proceeds common to all options are excluded from the comparative costs.

Generally the sale options look more expensive than the closure or retention options. But on some assumptions there is a slight overlap.

The most optimistic cost of selling to the MBO is less than the pessimistic cost of total closure or retention of the Buying Agency. Nevertheless, there are additional grounds for declining to sell to either bidder. Generally, as both bidders acknowledge, the TCS furniture business faces a particularly difficult period as the Government's purchasing initiative begins to bite against a background of recession in the furniture industry. There must be doubt whether either bidder can make the business succeed. A business failure would cast doubt on the rationale of the privatisation which was to assist suppliers and



offer job prospects to the staff by providing the circumstances in which the business could continue in something like its present form. It would be particularly embarrassing for the Government if it had paid a larger sum of money to achieve the privatisation than it might have paid to close it or retain the profitable part.

Furthermore, there are particular worries attaching to each of the bids. On the one hand there is real doubt about the MBO's ability to provide the management leadership and strength required in these difficult circumstances. On the other hand, we do not have adequate assurance that Melton Medes will make sufficient funds available to meet further planned or unplanned redundancies on civil service terms. This is contrary to the Government's assurances that we would only sell to a purchaser with adequate resources to fulfil its obligations to the staff.

Financial, operational and political considerations therefore point to not selling the furniture business now. We cannot justify retaining the Product Supply and Services Division in Government. It is a purely commercial operation which it is our policy not to carry out in Government. Furthermore, I have concluded that it cannot be turned round within Government so as to give an acceptable rate of return and/or an improved prospect of sale in the future. Indeed, officials advise that the business could collapse completely if it were subjected to any further period of uncertainty.

Complete closure and retention of the Buying Agency remain realistic options. There is little doubt that both options will cause an outcry from some suppliers, including the sheltered workshops, who despite untying are still heavily dependent on TCS' Product Supply and Services Division for their business. But whatever action we take we cannot avoid putting suppliers at risk as TCS customers increasingly buy direct from manufacturers. The remedy is in suppliers' own hands - to market direct to final customers, whose demand for furniture will not be affected by the closure, instead of relying solely on TCS. Some suppliers are already doing this.

I should therefore like your agreement to the proposal that we close Product Supply and Services Division, which constitutes the bulk of the furniture business. I recommend strongly that we retain the Buying Agency, based in Liverpool, as part of Government. The TBA can provide a procurement service not widely available from the private sector and is particularly useful for smaller Departments and, in the short term at least, to PSA and MOD. Although the financial viability of TBA is fairly marginal, with appropriate management there is a reasonable prospect of it providing a better return than closure. (It will have to be transferred out of PSA Services.)

The quantifiable costs of closure (taking account of the costs and proceeds excluded from the comparative costs) have been estimated by our advisers, Coopers & Lybrand Deloitte, as falling in the range £21-40m. There may also be unforeseen or other unquantifiable claims where, for example, Government may be under a moral obligation to certain suppliers who have incurred costs in anticipation of TCS orders which because of the closure will not have materialised. The total costs will constitute a claim against the Reserve in 1990/91. In addition, PSA Services' own need to bid for restructuring costs in-year will be increased by the extent to which TCS administrative and executive staff who opted for secondment add to the numbers of surplus staff who cannot be found alternative civil service employment.

Once a decision to close PSSD has been taken, it is essential to announce it immediately, in order that TCS can act accordingly. Otherwise the Government would be fraudulently misrepresenting the true position in its business dealings with suppliers and customers. The announcement is therefore likely to have to be made during the recess by way of a press statement. Our officials should urgently discuss a draft.

I am sending a copy of this letter to the Prime Minister, to Tom King, since his Department is a major customer of TCS, to Michael Howard in view of his sponsorship of the sheltered workshops, to Geoffrey Howe and to Sir Robin Butler, and would ask colleagues to bear in mind the extreme sensitivity of the topic.

Yours sincerely

T. Beattie

PP MICHAEL PORTILLO

*(Approved by the Minister
and signed in his absence)*

The Hon Francis Maude MP



OS FOR TCS CONTRACT FURNISHING LTD

The key features of the two bids are summarised in the matrix below:

	Melton Medes	Furnishing MBO
Price	Most costly	Costly, but could be best option if business successful
Going Concern	Yes	Yes
TUPE/secondment	Accepted	Accepted
Comparable pensions.	Negotiations not concluded. Comparable pensions agreed in principle but current proposals would require £4m- payment to Melton Medes so that employer/ employee contribution rates were unchanged	Negotiations not concluded. Current proposals likely to require detriment payments to staff of £1.5m (£5115/ person)
Management strength/ Track record	Good	Poor
Financial robustness	Fair	Unproven
Employee prospects (assuming success)	Fair	Fair
Expansion potential	Reasonable	Unknown
TU Support for bid	Hostile	Satisfactory, subject to acceptable outcome to pensions negotiations
EC State Aid	Possible problems	Possible problems
Security of Redundancy Terms	Some doubts	Propose escrow A/C

SUMMARY TABLE

(All figures £ millions based on 6% discount rate, 1990 £ prices)

FURNITURE

£m

Sale to Furniture MBO	(49.0) + X to (59.0)
Sale to Melton Medes	(60.7) to (67.1)
Closure of PSSD and TBA	(34.0) to (50.5)
Closure of PSSD/ Retention of TBA	(31.6) +/- Y to (46.8) +/- Y

In the furniture MBO option, X represents deferred consideration that could be earned in 1994, based on 1993 profits.

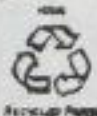
In the Closure of PSSD Retention of TBA option, the Y represents the net value of the ongoing profits or losses of TBA.

Footnotes

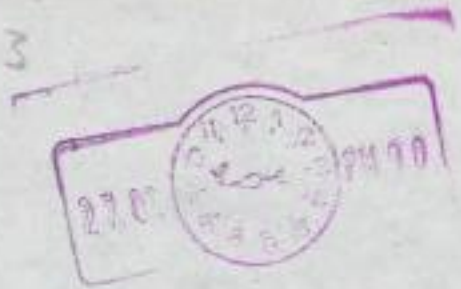
1. The figures are not absolute. They have been calculated purely for comparison purposes and exclude costs that are common to all alternatives. They are only estimates, particularly in the area of costs of closure and losses up to the date of closure. They include provision for all the quantifiable and foreseen costs of closure and also, to a limited extent, for the unforeseen costs of closure, which experience of liquidation suggests always arise. However unforeseen costs are by their nature unquantifiable.

2. The figures above have been normalised to an assumed level of trade debtors of nil. To the extent that the value of trade debtors exceeds nil, the cost of each alternative would be reduced by the same amount and so the relative costing would be maintained.

3. Additional important caveats are contained in the attached extract from Coopers and Lybrand Deloitte's report.



CIVIL SERVICE: PSA Pt 3



KK



10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

9 July 1990

Dear Stewart,

PRIVATISATION OF THE CROWN SUPPLIERS

The Prime Minister has seen your Minister's letter of 13 June to the Financial Secretary proposing that the Transport and Interdepartmental Despatch Service (IDS) businesses of the Crown Suppliers should be privatised by means of a management buy-out. She has also seen a copy of Mr. Lilley's letter of 6 July to Mr. Chope.

The Prime Minister has noted that all the other options for the transport and IDS businesses in the table attached to your Minister's letter are better in terms of net present value than the proposed management buy-out. She appreciates that there may be limits to the strict comparability of the figures in that table. Nonetheless, the Prime Minister considers that, against the background of these figures, it might be difficult to defend the proposed management buy-out to the public and to Members of Parliament on the basis proposed - that the sale was necessary to maintain the momentum of the privatisation programme.

Accordingly, the Prime Minister would be grateful if your Minister, in consultation with the Financial Secretary, could consider further the proposed management buy-out and, in the light of a comprehensive and fair appraisal of the options, the justification for proceeding with the privatisation. In the light of that analysis, she would also be grateful for the views of the Chancellor of the Exchequer and the Secretary of State for the Environment.

I am copying this letter to Tancred Tarkowski (HM Treasury), Alan Ring (Department of the Environment) and Steven Flanagan (Financial Secretary's Office).

*Yours,
Barry*

(BARRY H. POTTER)

Stuart Hoggan, Esq.,
Mr. Chope's Office,
Department of the Environment.

KW

PRIME MINISTER

PRIVATISATION OF THE CROWN SUPPLIERS

Discussions have been underway for some time about the privatisation of the three businesses within the Crown Suppliers:

- transport;
- Interdepartmental Despatch Service (IDS);
- furniture.

I attach at Flag A a letter from Christopher Chope to Peter Lilley describing the options.

The table is most important. It shows that selling the transport and IDS businesses to a management buy-out earns a positive return. But the sale also earns a lower return than could be realised by closing the transport services altogether and retaining IDS within the public sector. Indeed, all other options considered are better in terms of net present value than sale to a management buy-out.

Nonetheless, Christopher Chope proposes that the sale should go ahead. And the letter at Flag B from Peter Lilley accepts this proposal.

Mr. Lilley's argument is that the sale is necessary to maintain the momentum of the privatisation programme - particularly since sale of the other Crown Supplier business - furniture - is unlikely to produce acceptable bids. Accordingly the furniture business will not be privatised.

There is an issue of financial propriety to consider. Should the Government privatise the transport and IDS businesses, when other options, including retention within the public sector, offer a higher financial return?

One would need to be certain that all the costs had been fully taken into account in the comparison presented. Risk and uncertainty considerations are not easily handled in the public sector. But the grounds for the sale - maintaining the privatisation programme - look slim, against the figures on net present values of other options. There could be difficulties with the PAC or the Treasury Select Committee if and when the numbers emerged.

One way forward would be to seek more information from Treasury and DoE about the justification for proceeding with the privatisation. It might also be useful if the Chancellor were to consider the matter.

Content for me to minute out on the above basis?

Yes not

Or

Content to accept Mr. Chope's proposals?

BHP

BARRY H. POTTER
6 JULY 1990



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Christopher Patten MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London
SW1P 3EB

6 July 1990

Dear Chris

PSA SERVICES (PSAS) AS A GOVERNMENT-OWNED COMPANY

Thank you for your letter of 11 June. I have also seen, since my interim letter of 25 May, letters from David Waddington of 29 May, David Hunt of 1 June, James Mackay of 6 June, from the Prime Minister's office of 7 June and from Tom King of 21 June.

2. As I said in my earlier letter, I share the objective of making a success of the privatisation of PSAS. There is much to be done to create a viable business, or set of businesses, from what exists at present. But it seems highly risky to bring forward the move to GOCO status from April 1992 to April 1991.

3. I set out my concerns in my letter. The first, the issue of management capacity, is still one that concerns me and which I assume Coopers, who are carrying out a feasibility study of privatisation for you, will address in their report due in August. I am content to address the second, the control arrangements (including pay) and protection of the Government's interests as vendor, in the light of developments over the Summer, including Coopers' report, as you suggest. The fourth, that arrangements for GOCO status must not be allowed to close options for a sale of the business in parts, remains; you did not address it in your letter, but I understand from my officials that there are major doubts over the suitability of PSA International and Specialist Services for privatisation. However, your officials have indicated to mine that the options would remain open. On that basis, I come to my two remaining concerns.

CONFIDENTIAL

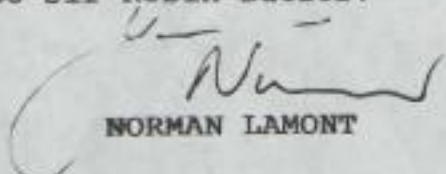
4. First, propriety. Our officials have discussed this further. While PSAS is a Government Department, it is acceptable that customers rely on it to assure them of efficiency and economy in supplying works services. However, it is important to be clear what this means. It means that customer Departments in effect rely on PSAS to pay bills for them by deduction from deposits held by PSAS, and to tell them that they have charged the correct amounts. Part of the process of introducing payment and untying is to make Departments "intelligent customers" of PSAS. But in many Departments including some of PSAS's largest customers, and in PSAS itself, the systems do not yet exist to enable customers to check for themselves that the amounts they have been charged are correct, even on a satisfactory sampling basis, and they will not exist by April 1991. This could leave Departments without adequate safeguards against mismanagement. The potential for Parliamentary criticism is obvious. I am not yet satisfied that these difficulties can be resolved before April 1991.

5. Moreover, I understand that the new financial systems being introduced in PSAS will not start to generate invoices until shortly before April 1991. This will not allow adequate time for testing. I am mindful of the experience you have had with TCS, where a new system produced invoices which customers did not recognise and which they have not paid, leading to a request for write-offs. I believe that these are powerful arguments for taking PSAS's own transition to GOCO status at a more realistic pace.

6. My second outstanding point was the need for a firm assessment of the financial implications. Your letter of 11 June did not provide this, and I have still not received your Survey bid. However, your officials have indicated possible bids of £400 million for severance, more than half of which would be in 1991-92, partly reflecting assumed acceleration of GOCO status, £250 million for working capital and over £50 million for other restructuring, to say nothing of the PSBR effect of the possible need to fund a pension scheme for transferred employees. I understand moreover that the underlying assumption about redundancy costs may be changed in the current review of business plans, further increasing the prospective bid. Until I have your formal bids I cannot reach conclusions on them. But the sums your officials have mentioned, which I would judge are most unlikely to be recovered in sale proceeds, must urge the most careful review of the plans for sale. I shall want to address these with you when your consultants' report on the feasibility of privatisation is available at the end of July. It may be appropriate to look again at the pace of untying and market-testing, to see whether the implementation of present policy is likely to deliver the optimum balance of cost to Government.

7. My conclusion therefore is that we are not in a position to decide now to aim for GOCO status in April 1991. I believe that it would be much preferable to review our plans for PSAS, including the issue of GOCO status, in the light of the consultants' report in the late summer.

8. I am copying this letter to the Prime Minister, to Cabinet colleagues and to Sir Robin Butler.



NORMAN LAMONT

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG

Christopher Chope Esq OBE MP
Parliamentary Under Secretary of State
Department of the Environment
2 Marsham Street
LONDON SW1P 3EB

6 July 1990

Dear Minister,

PRIVATISATION OF THE CROWN SUPPLIERS

Thank you for your letter of 13 June.

WILL REQUEST
IF REQUIRED

I have very carefully considered the schedule in the attachment to your letter, comparing the net present values of the alternative options of closure, retention and sale of the TCS Transport business. The financial options point strongly to closure of Transport and retention of the IDS. However, I understand that the round of bidding for the Furniture business is unlikely to produce acceptable bids. In the circumstances, I accept that the need to maintain the momentum of the privatisation programme justifies accepting the Transport MBO bid, on which you have fully tested the market and which your merchant bank advisers judge is acceptable. I am concerned, however, at the possibility that the Transport MBO team might proceed themselves to close the business down in relatively short order, given the substantial margin of capital assets over the price paid. I must ask that in the detailed negotiations on which you are about to embark, you should incorporate adequate safeguards against the risk of embarrassment of this sort.

I am copying this letter to the Prime Minister.

Yours sincerely,

PP PETER LILLEY

CONFIDENTIAL (approved by the Financial Secretary and signed in his absence)



celp

*n.b. P.M.
BTP
22/6*

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALING 01-218 2111/3

MO 10J

21st June 1990

Chris Patten

PSA SERVICES: GOVERNMENT OWNED COMPANY STATUS

Thank you for sending me a copy of your letter of ~~14th~~ ^{*P100*} May to Norman Lamont.

I have much sympathy with your proposal. It represents a further step in the PSA's exposure to commercial disciplines and so increases the pressure for efficiency, in which MOD, as PSA's biggest customer with two thirds of their business, has a strong interest. And I can readily see the particular advantages which you spell out.

On the other hand, there are risks from the customer's point of view in cutting corners, if that is what an accelerated timetable were to entail. I take the points made by Norman Lamont in his letter of 25th May. We in MOD have been building up our customer capability. Careful and systematic market testing is a crucial element of our approach. But although in the maintenance field we have an ambitious programme, only a limited proportion of our establishments will have been covered by April next year. In the projects field, although new projects are being exposed to

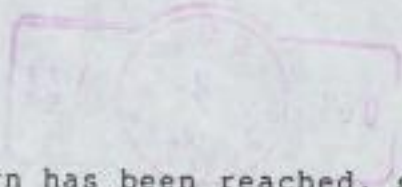
7
The Rt Hon Chris Patten MP



competition we will still be effectively tied to the PSA for the very large number of existing ones. We therefore need to be satisfied that the change to company status will not result in cost and risk to us, particularly in relation to that work for which PSA will still have no effective competition, at a time when PSA's accounting and commercial systems, and our own capability as an intelligent customer, will still be less than fully developed. In particular I would want to review the number of projects left with PSA and to be sure that our relationship could be translated into sufficiently rigorous contract terms; that redundancy costs would not be passed directly or indirectly on to the customer; that pricing and profit arrangements would not work to our disadvantage; and that suitable arrangements were made to provide protection to the Accounting Officers of customer departments, a point mentioned in the Annex to your letter and stressed, I see, by James Mackay as well as by Norman Lamont.

There will also be decisions to be made over the treatment of PSA's work for MOD in Germany and elsewhere overseas, work for the US Forces in the UK, and for MOD in Northern Ireland, all of which have been identified as raising particular issues in the context of privatisation.

Most of these points are already under discussion between officials. I suggest that while the formation of a Government-owned company in April 1991 should be accepted as an aim, this aim should be subject to very early satisfactory resolution of the points I have mentioned. Planning should therefore proceed from now on this basis; but we should call for a report from officials in



October, before the point of no return has been reached, so that we can assure ourselves that the problems have been resolved satisfactorily.

I am copying this letter to the Prime Minister and Cabinet colleagues and to Sir Robin Butler.

A handwritten signature in black ink, consisting of a large, stylized 'T' followed by a horizontal line and a vertical stroke that curves to the right, resembling the name 'Tom King'.

Tom King

Civil Service: PSA P3



75



n.b.P.M.
BTR 19/6
cc/pt

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Christopher Patten Esq MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

19 June 1990

Dear Chris,

PSA SERVICES: CREATING OF GOVERNMENT-OWNED COMPANY

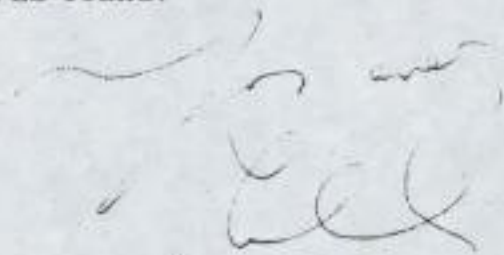
Thank you for sending me a copy of your letter of 14 May to Norman Lamont on your proposed timetable for PSA services to become a Government-owned company.

I can well see the advantages of making progress in this way as quickly as possible; but the practical implications of the work needed between now and 1 April 1991 need to be looked at carefully. We do not use PSA greatly in relation to the Scottish Office's own Departmental Estate, so the problems of converting agreements with PSA into commercial contracts would not impinge on us seriously. The Scottish Courts Administration is however responsible for a considerable estate of specialised court buildings. The requirement to re-negotiate agreements with PSA and convert them to commercial contracts before April 1991 would impose an additional burden on that Department as it seeks to gear up its capability to act as an intelligent customer in the provision of its accommodation. Undoubtedly an enhancement to its resources will be needed to cope with these changes, which cannot be secured within current running cost provision, and I hope that Norman Lamont will consider an approach on this sympathetically. I entirely agree too with Tony Newton and James Mackay that the arrangements for the protection of Accounting Officers will need very careful consideration.

As far as our Common User Estate is concerned, we are, in the main, dependent on the arrangements which Property Holdings have made with PSA services, and the work involved in moving from these arrangements to commercial contracts would fall on Property Holdings. I would want to be assured that you are fully confident that both Property Holdings and PSA will be able to cope with this task fully and adequately in the time scale envisaged, for although the main responsibility lies with Property Holdings, any disruption to works and maintenance programmes stemming from overloading the system would have a damaging effect on the accommodation occupied by client Departments.

The PES implications of what you propose are not entirely clear. Some means will presumably have to be found to provide the Government-owned company with working capital, since pre-funding will no longer operate. I would be most unhappy with any arrangement for this which reduced the amount of resources available to individual Departments for provision and maintenance of accommodation. This will no doubt have to be pursued in the discussions in the current PES round.

*Copy to Prime Minister
Cabinet Colleagues*

A handwritten signature in dark ink, appearing to read 'M Rifkind', written in a cursive style.

MALCOLM RIFKIND

CIVIL SERVICES : ISA 173





DEPARTMENT OF THE ENVIRONMENT
2 MARSHAM STREET LONDON SW1P 3EB
01-276 3000

My ref
Your ref

13 June 1990

Dear Mr Lilley,

PRIVATISATION OF THE CROWN SUPPLIERS

I am writing to report to you the outcome of the sale competition for the transport and IDS businesses of the Crown Suppliers, the results of our evaluation of the bid for these two TCS businesses, and to seek your agreement to the way forward which I propose. I shall write again very shortly on the furniture business, where some issues still need clarification. At this stage I need only say that sale of the furniture business looks unlikely.

Samuel Montagu, the merchant bankers advising on the sale have tested the market for the transport and IDS businesses widely. Nevertheless, the sale competition generated a disappointing response. A buy out team of civil servants bid for the Transport business and the Inter-departmental Despatch Service. The National Freight Corporation bid for the IDS alone.

The bids are summarised in the attached matrix. Figures showing how the net present value to the Government of the bids compares with that of the alternative options of retaining the profitable parts of the businesses in Government or closing the businesses down are summarised in the table also attached. Samuel Montagu recommend that the Transport MBO's bid for the Transport and IDS businesses is acceptable.

I think that we should endeavour to sell the transport business to the MBO. Although the estimates show that the net return from the bid is not as good as that from other options, the estimates for closure options do not include non-quantifiable items such as disruption to Government Departments and could prove wide of the mark. The estimates of the retention options assume that both Transport and IDS would continue to be profitable in the public sector. That cannot, of course, be guaranteed. In view of these uncertainties there must be advantage in trying to secure a sale on these terms. There would also obviously be great advantage presentationally if we could succeed in pulling off at least part of the privatisation.

But the bid may require restructuring. The MBO had proposed to establish a trust fund to protect employees'

entitlement to redundancy compensation in the event of things going wrong in the early years following privatisation. The unions have threatened to wreck the business if such protection is not provided and the MBO's bankers have apparently said that they will not back the bid if industrial trouble threatens. In the course of negotiations with the MBO we had removed the element of deferred payment that they had proposed and their £12m bid will not allow them to provide the level of opening funds in the trust fund which the TUs seek.

I should therefore like to propose to the MBO that a reduction of £1m in their bid to around £11m plus a deferred payment of £2m would be acceptable to the government. This would be on the clear understanding that any trust fund established by the MBO was entirely a matter for the company.

Such an outcome would not be ideal. But it looks like being the best deal available and is one recommended by Samuel Montagu. It allows the Government to fulfil its undertaking not to sell to an organisation without adequate resources to fulfil its obligations to its staff, whilst, at the same time, selling to a buy-out team.

I should be grateful for a quick decision so that we can press ahead with the MBO, if appropriate, and manage an announcement before the Recess. May I therefore have your agreement to the course proposed in the next day or two and anyway by close on 15 June.

I am sending a copy of this letter to the Prime Minister.

Yours sincerely,

Stuart Hoggan

pp CHRISTOPHER CHOPE

(Approved by the Minister and signed in his absence.)

Peter Lilley Esq MP



SAMUEL MONTAGU'S CONCLUSIONS

The nine key features of the two bids for Transport/IDS are summarised in the matrix below:

	<u>Transport MBO</u>	<u>NFC</u>
Price	Reasonable	Very low
Going concern	Yes	Yes, but will integrate
TUPE/Secondment	Accepted	Accepted
Comparable pensions (detriment payment required)	£100k max £578/person	£400k £4,706/person
Management strength	Fair	Strong
Financial robustness	Fair	Strong
Employee prospects (assuming success)	Very good	Good
Expansion potential	Fair	Good
TU relationship	Good	Potentially problematic

SUMMARY TABLE

(All figures £ millions based on 6% discount rate, 1990/91 prices)

TRANSPORT AND IDS

1.	Sell to MBO	+ 11.8
2.	Close Transport & IDS	+ 15.7
3.	Close Transport & sell IDS to NFC	+ 16.1
4.	Close Transport & retain IDS	+ 17.5
5.	Retain Transport and close IDS	+ 13.7
6.	Retain Transport and sell IDS to NFC	+ 14.1
7.	Retain Transport and IDS	+ 15.5

TRANSPORT ONLY

1.	Close	+ 16.2
2.	Retain	+ 14.2

IDS ONLY

1.	Close	- 0.5
2.	Retain	+ 1.26
3.	Sell to NFC	- 0.05

Footnotes

1. The figures are only estimates, particularly in the area of costs of closure and losses up to the date of closure. They include provision for all the quantifiable and foreseen costs of closure and also, to a limited extent, for the unforeseen costs of closure, which experience of liquidation suggests always arise. These unforeseen costs are by their nature unquantifiable.

2. There are other unquantifiable costs of closure: eg, disruption to Government services; / possible increase in claims for unemployment benefit amongst staff of TCS and their suppliers; /; the increased cost of having to find alternative employment for a large number of people at the same time.

3. The closure options assume that departments can obtain their requirements from other sources at the same prices as they currently pay to TCS. This may or may not be the case: for example departments may pay more or less to hire vehicles from a vehicle hire company than they currently pay TCS.

4. There may be additional costs which apply to all options. For example displaced AEG staff are as likely to be found alternative posts/made redundant under each option, and there is no reason to differentiate between options on account of these costs.

5. Options that include retaining either or both the Transport and IDS businesses depend crucially on the estimated future profitability of these businesses. The following assumptions have been made

Em	Future Profitability	Compared with <u>Actual 1989</u>
Transport	0.5	0.8 (including
IDS	0.2	0.2 workshops)

Coopers & Lybrand Deloitte have not examined the future forecasts of profitability for these businesses, so these figures should be treated with great caution.



n.b.p.m.
at 10:30g
BHP
12/6

CCPU

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:
Your ref:

The Rt Hon Norman Lamont MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

11 June 1990

Dear Chief Secretary

PSA SERVICES: GOCO STATUS

Thank you for your letter of 25 May. *Play*

As you say there is much to be done in a short time if we are to privatise PSA Services successfully. This is why I see early incorporation as so important. It is the one really effective way we have of concentrating both management's and staff's minds on the steps necessary to transform PSAS into a genuinely commercial organisation. We are not yet in a position to take a decision on many of the key sale issues. For that we need our advisers' report, which will not be available before the Recess, but which will mean that the GOCO can be structured in the best way for sale.

But we cannot wait that long if we are not to lose the impetus that Patrick Brown has already brought to the process of change. Nothing we need to do for an early GOCO would not be required in any amount either this year or next. One lesson we have learnt from the Crown Suppliers experience is the need to move quickly and decisively, well in advance of the proposed sale. Getting the GOCO in place this year will leave PSAS to concentrate on competing successfully next year, thus demonstrating its viability as a commercial organisation.

I am entirely at one with you on the need to have proper control arrangements in place. As you say, Property Holdings will act as sponsor department, and we should need to consider very carefully the structure and composition of the Board. There are clearly potential conflicts of interest; we should know better in the summer how strong an option an MEBO is. And PSAS will clearly need an injection of commercial and financial expertise if it is successfully to manage the transition to the private sector. I would not have thought that establishing a sensible control regime was that difficult; we have spent much time in recent years on this with the



RECYCLED PAPER

nationalised industries and we can take this forward in parallel with our advisers' exercise. Officials have similarly made good progress in establishing arrangements to provide assurances to customer departments on the accounting officer issues.

I shall, as you say, be covering the issue of PES provision in my survey bidding letter. But I must emphasise that the main redundancy costs arise now, not because of the early GOCO, but because it is imperative to make savings at the outset in order to come competitive, rather than run the risk of entering a spiral of decline. This is a very real danger, and over time the costs would prove horrendous. I do not believe that the risk could be justified.

It is not easy. But if we do not go for an early GOCO now we may not be able to make up the ground later. Nothing that we do not will inhibit our ability to achieve a successful sale. The fact remains that there are parts of PSAS that are much further down the commercial road than others. My aim is to bring them all on as fast as I can. Patrick Brown is convinced that he needs this external stimulus to do so. I think he is right.

I am copying this letter to the Prime Minister, to our Cabinet colleagues and to Sir Robin Butler.

CEJ Bosh

PP CHRIS PATTEN

(Approved by the Secretary of State → signed in his absence)



CIVIL SERVICE :

PSA PL 3.

CONFIDENTIAL



file
KW

10 DOWNING STREET

LONDON SW1A 2AA

7 June 1990

From the Private Secretary

Dear Phillip,

PRIVATISATION OF PSA SERVICES

The Prime Minister has seen a copy of your Secretary of State's letter of 14 May to the Chief Secretary, proposing that PSA services should be transformed into a Government owned company on 1 April 1991. She has also seen the letters on this subject from the Chief Secretary (25 May), Industry Secretary (18 May), Home Secretary (29 May) and Welsh Secretary (1 June).

Subject to any comments from the Defence Secretary (as one of PSA's largest customers), and satisfactory resolution of the important propriety and financial aspects raised in the Chief Secretary's letter, the Prime Minister would be content to proceed as proposed by the Environment Secretary.

I am copying this letter to the Private Secretaries of all members of the Cabinet and to Sonia Phippard (Cabinet Office).

Yours ever,
Barry

BARRY H. POTTER

Phillip Ward, Esq.,
Department of the Environment

CONFIDENTIAL

KW

FROM THE RIGHT HONOURABLE THE LORD MACKAY OF CLASHFERN

ccp
n.b.p.m.
BHP
7/6



HOUSE OF LORDS,
LONDON SW1A 0PW

6 June 1990

The Right Honourable
Norman Lamont MP
The Chief Secretary
HM Treasury
Parliament Street
London SW1

Dear Norman,

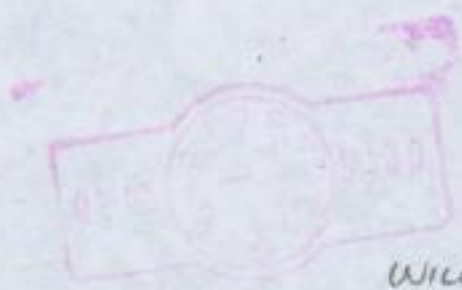
Chris Patten sent me a copy of his letter to you of 14 May in which he seeks agreement to setting a target date of 1 April 1991 for vesting PSA services (PSAS) as a government-owned company (GOCO).

I readily recognise the advantages for PSAS in making such an early change, particularly in terms of gaining experience of operating on a commercial basis. As Chris acknowledged, the change will require the co-operation of all customer departments. As you know, my Department has a particular interest because of the role of PSAS in support of our major court building programme, and in the management of my Department's large and complicated Departmental Estate.

The move to GOCO status for PSAS will of course mean a significant change in Accounting Officer responsibilities, particularly in terms of the efficiency and economy with which the supplier meets the customers' requirements and embracing value for money aspects of both the court building programme and other expenditure on accommodation. I have noted the arrangements suggested in the annex to Chris's letter for providing protection to Accounting Officers and I understand that these are under detailed consideration between officials in your Department and the PSA. Subject to what emerges from these discussions, I see a need, assuming a vesting date of 1 April 1991, to develop rapidly our expertise in contractual matters and our intelligent customer capability. I do not propose to seek any significant expansion of our professional in-house capability. However, this is at present very limited and some enhancement will undoubtedly be needed to cope with the more commercial atmosphere that will prevail after April 1991. There is a lot of work for us, as a customer department, if we are to have any hope of achieving a successful change in this timescale and I do not believe that this task should be underestimated. The major issue that will need resolution - and quickly if we are to be ready for April 1991 - is that of accountabilities and I shall certainly want to ensure that my officials are involved in the discussions on this aspect of the matter at the appropriate stage.

I am copying this letter to the Prime Minister, Chris Patten and other Cabinet colleagues.

Yours ever,
James



Will request if possible

PRIME MINISTER

PRIVATISATION OF PSA SERVICES

It is agreed policy that PSA services should be privatised - and that the earliest practical date is Autumn 1992.

In his letter of 14 May (Flag A), the Environment Secretary proposed that PSA services should be transformed into a Government-owned company at 1 April 1991. This is designed to help achieve the target privatisation date - essentially by exposing PSA services earlier to a more market oriented approach.

A number of colleagues including Mr. Ridley, Mr. Hunt and Mr. Waddington have written endorsing this approach.

But the Chief Secretary wrote on 25 May expressing one or two reservations (letter at Flag B). The most important of these are:

- i) A concern about propriety. It is proposed that PSA services be set up as a Government-owned company under the control of a Board whose Chairman and Chief Executive have expressed a wish to participate in a management and employee buy-out (to achieve the privatisation). Their personal interests are necessarily somewhat at variance with those of the Government as vendor. (A possible way out is to appoint a Chairman alongside the Chief Executive who would not be part of the management and employee buy-out).
- ii) Concern about the public expenditure consequences of this change in status.

The PSA's biggest customer - MOD - has still to respond. But the general view seems to be that this proposal is worthwhile. Nonetheless, the Chief Secretary's concerns about propriety and

spending are very real.

Content to accept the Environment Secretary's proposals,
subject to comments from MOD and satisfactory resolution of
the propriety and financial aspects?

BHP

BARRY H. POTTER

6 June 1990

dca c:privatisation

Y
ls
nr

CCM



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GWYDYR HOUSE
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Oddi wrth Ysgrifennydd Gwladol Cymru The Rt Hon David Hunt MBE MP

From The Secretary of State for Wales

CT/2073/90

1st June 1990

Dear Chris

will request
if required

Thank you for sending me a copy of your letter of 14 May to Norman Lamont. I fully endorse your proposal to set the target date for vesting PSA Services as a Government-owned Company on 1 April 1991.

The advantages from such a move are obvious and for its part my Department will co-operate in any way it can to help to ensure a smooth transition.

Your officials will no doubt be in touch with mine soon to discuss details of the changes that will be necessary to the existing arrangements.

I am copying this letter to the Prime Minister and Cabinet colleagues.

Yours ever

The Rt Hon Christopher Patten MP
Secretary of State for the Environment
2 Marsham Street
LONDON
SW1P 3EB



DEPARTMENT OF SOCIAL SECURITY

Richmond House, 79 Whitehall, London SW1A 2NS

Telephone 01-210 3000

From the Secretary of State for Social Security

CCFV
 N.B. P.M.
 BHP
 9/6

The Rt Hon Chris Patten MP
 Secretary of State for the Environment
 Department of the Environment
 2 Marsham Street
 London
 SW1P 3EB

31st May 1990

Chris

PSA PRIVATISATION

Thank you for sending me a copy of your letter to Norman Lamont of 14 May. I very much appreciate the reasons for wanting to vest PSA Services as a Government-Owned Company (GOCO) at 1 February 1991. The advantages you list in your letter seem to me to be entirely valid. Not only is a major change in ethos at PSA Services essential, but also I am convinced that cultural change in departments towards taking on increased responsibility for our own property management will be given an important impetus by your proposal.

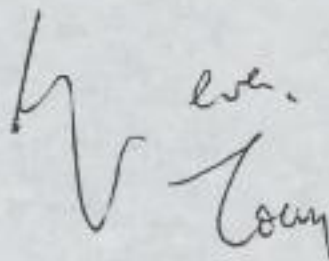
My main concern, though, is what you describe in your letter as the advantage of allowing PSAS and customer departments time to sort out teething troubles in the formulation of works contracts during the year in which the GOCO is in existence. As a department which is actively seeking to take as much responsibility for our own property management as possible, we shall need to be quite certain that our position in terms of public accountability is secure. If, as you say in the Annex to your letter, PSAS would, on incorporation, cease to be a Government department and its staff would cease to be Civil Servants, we would need to ensure that proper commercial arrangements, supported by a full set of contractual and other relationships were in existence by April 1991 to ensure that departmental Ministers and the accounting officer were secure in the event of Parliamentary or other scrutiny. While we as a department have some experience in contracting for works and maintenance, we would if at all possible want to avoid having to do the same for all our work with PSAS. We should also have to consider seriously whether to test the market across the whole range of the works and maintenance for which we are responsible. Not only would this involve us in an enormous amount of detailed and specialised work for which we are by no means prepared, but also it could lead to a real risk of our diverting a greater part of our work from PSAS in 1991-91 than we had planned, thereby at the same time depriving PSAS of the opportunity to work commercially with us during that key phase of its development. I doubt if any of us would want to see that.

*will request
 why required*

E.R.

I would therefore urge you to ensure that arrangements and safeguards are developed as quickly as possible to protect departmental Ministers and Accounting Officers from having to assume full public accountability without support from PSAS. I think we are likely to need an adequate set of auditable commercial-type standard contracts with the GOCO which could form the basis of agreements with individual departments. Subject to that, we would be content with what you propose for 1 April 1991, particularly if it heralded a major cultural change both in PSAS and in departments. But if safeguards were not available, I am sure that we would have to consider very seriously whether our best course would be to insist on full set of commercial-type contracts with PSAS and possibly market testing, despite the very substantial additional burden which this would carry.

I am copying this letter to the Prime Minister and to Cabinet colleagues.

A handwritten signature in black ink, appearing to read 'Tony Newton'. The signature is stylized and written in a cursive-like hand.

TONY NEWTON



QUEEN ANNE'S GATE LONDON SW1H 9AT

29 May 1990

PRIVATISATION OF PSA SERVICES

Thank you for copying to me your letter of 14 May to the Chief Secretary seeking agreement to setting a target date of 1 April 1991 for vesting PSA Services as a Government-Owned Company (GOCO) as an essential step towards privatisation.

I see no difficulty in endorsing the proposal to privatise PSA Services and I see merit in reaching an early decision to enable officials to proceed with the detailed arrangements. As you have indicated, however, the timing could be a problem for Departments, who need to build up their own technical capability within a reduced timescale. There is a small number of vacancies for technical staff in the Home Office Directorate of Works. Our Personnel Management officials will no doubt make arrangements with their counterparts in PSA Services to see if any of these could be filled by PSA staff. This would contribute in a small way to easing the problems of redundancies which you mentioned.

I am copying this letter to the Prime Minister, Sir Robin Butler and Cabinet colleagues.

The Rt Hon Christopher Patten, MP.
Secretary of State for the Environment
Department of the Environment
2 Marsham Street, S.W.1.

will require if required

CCPV



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Chris Patten MP
 Secretary of State
 Department of the Environment
 2 Marsham Street
 LONDON
 SW1P 3EB

25 May 1990

Dear Secretary of State

PSA SERVICES: GOCO STATUS

Thank you for your letter of 14 May.

will request if required

2. I share your objective of making a success of the privatisation of PSAS. There is a great deal of work to be done in a short time, which will impose a heavy burden on the management of PSAS. Against that background, let me set out my main concerns.

3. In the last resort, I would not wish to second guess your judgement, and that of PSAS's chief executive, about whether early incorporation is likely to facilitate the commercial development of PSAS. On the other hand, it is clearly the case that early incorporation could divert the time of PSAS senior management from the urgent tasks of increasing efficiency, introducing commercial accounts and management information systems, revising the regional organisation, developing pricing and marketing policies, preparing a satisfactory business plan and establishing suitable personnel policies. Senior management time is finite. Is the effort involved in early vesting the best way of using it? You yourself mention the heavy workload involved in an accelerated timetable - customer contracts, contracts of employment, a pension fund, financial structure, Articles of Association, Memorandum of Understanding, control arrangements.

4. Second, I am concerned about the arrangements for control of a GOCO and in particular protection of the Government's interest as owner and vendor. We clearly risk criticism if we set up PSAS as a Government owned company, a year and a half before privatisation, under the control of a board whose chairman and chief executive has expressed the wish to participate in a MEBO, and whose personal interests are necessarily somewhat at variance

with those of the government as vendor. The enclosure to your letter draws attention to some aspects of the relationship between a Companies Act company and the government as owner. We should, I think, need to go out of our way, with the help of our legal advisers, to provide in the GOCO's Articles of Association for the necessary degree of Government control after vesting. It would also, in my view, be appropriate to appoint a Chairman, alongside the chief executive, who would not be part of the management and employee buy-out and who will face none of the conflicts of interest of those who are part of a MEBO. I take it that Property Holdings would exercise the function of sponsor department in advising you on matters relating to PSAS.

5. Third, customer Departments need to be confident about the necessary safeguards in PSAS' accounting systems, to ensure propriety and to guard against fraud and corruption by contractors employed by PSAS. I understand our officials have made some progress with this, developing your proposal for PSAS to contract to provide the necessary checks and to make arrangements for audit. But colleagues will want to see detailed proposals before giving a firm view.

6. Fourth, it will be important to ensure that any decision on incorporation does not impose a straitjacket on the decisions that will have to be taken about how PSAS is sold. It may well be that a sale of the business in parts is a better option, from the point of view of the vendor, than a sale of the whole.

7. Fifth, I note your reference to the fact that early GOCO status would bring forward redundancy and other costs which you would wish to be met from earlier DES provision. I should like to consider the implications of this on the basis of the figures which you did not include in your letter. No doubt you will be covering this in your Survey bidding letter shortly. We clearly cannot reach a firm decision on early GOCO status without a full assessment of the financial implications.

8. I am copying this letter to the Prime Minister, to our Cabinet colleagues and to Sir Robin Butler.

Yours sincerely

Norman Lamont

NORMAN LAMONT

Approved by the Chief Secretary
and signed in his absence.

dti

the department for Enterprise

The Rt. Hon. Nicholas Ridley MP
Secretary of State for Trade and Industry

Rt Hon Christopher Patten
Secretary of State for the
Environment
2 Marsham Street
LONDON
SW1P 3EB

Department of
Trade and Industry

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Direct line 071 215 5623
Our ref JW4AGP
Your ref
Date 18 May 1990

*Dear this request
will be required*

On your letter of 14 May to Norman Lamont, I fully endorse your proposals to set a target date for vesting PSA Services as a Government-owned Company on 1 April 1991 and my Department will of course do all in its power to help the PSA meet this target.

As you say, the move to a commercial basis of operation with legally binding contracts and a reduction in overheads should benefit client Departments as well as the PSA.

On the staff reduction needed, my personnel management people are already in touch with yours. We have taken some PSA staff and shall, insofar as possible, play our part in helping to ease the transition.

I am copying this letter to the Prime Minister and Cabinet colleagues.

Jones
Niandra



Recycled Paper



CEPU

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

The Rt Hon Norman Lamont MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

14 May 1990

Dear Chief Secretary

I am writing to seek your agreement, and that of colleagues, to setting the target date for vesting PSA Services as a Government-Owned Company (GOCO) at 1 April 1991. This is an essential step on the way to privatisation. The earliest possible date for sale would be autumn 1992, by when all the changes needed would have to be in place. But I am satisfied that there are strong advantages in making the change as early as possible.

I recognise that this will require the cooperation of all Departments - and may need some rephrasing of their own plans for procuring works services. However, I believe that - given goodwill and commitment from colleagues - suitable transitional arrangements can be put in place to solve any particular problems. And of course once the GOCO is established, the customer Departments, as well as PSA Services, will benefit from the experience they gain of operating on a fully commercial footing well in advance of the actual privatisation.

The advantages of an early GOCO are:-

- (1) A Clear and unambiguous message to assist management in achieving a major change in the ethos of PSA Services.
- (2) Rapid action to get the pain of rationalisation over quickly, so that PSA Services can face rising prospects, not a declining market.
- (3) Clarity in the relationships with customer Departments - which will allow time for them to sort out any teething troubles in the formulation of their works contracts while the Government is still the owner of PSA Services.
- (4) A longer track record for PSA Services as a fully commercial organisation, which will add to the confidence of potential buyers.

/ The attached annex discusses in more detail these advantages.

To achieve these benefits a good deal of work undoubtedly needs to be done, eg in agreeing contracts with customers in place of supply and services agreements; in agreeing contracts of employment for staff; in establishing a separate pension fund; in agreeing the control arrangements for the relationships between the GOCO and their sponsor Department and Treasury, and in agreeing the financial structure of the company. But all these steps are in any case required: it is only their timing that is in question.

I believe that the best way to achieve complex changes of this kind is to set a realistic target date and drive towards it. I am confident that April 1991 is realistic, and will bring forward as far as possible the benefits which we foresaw in the decision to untie from PSA and to establish it as a competitive commercial organisation.

I am copying this letter to the Prime Minister and to all Cabinet colleagues and I hope that all my colleagues will join in endorsing that target, so that officials can proceed on that basis. I would be happy to arrange for officials to meet to discuss any particular problems.



PP CHRIS PATTEN

(Approved by the Secretary of State
and Signed in his Absence)

PSA PRIVATISATION : VESTING OF PSA SERVICES AS A GOVERNMENT OWNED COMPANY

- 1 This Annex discusses in more detail the advantages of incorporating PSA Services (PSAS) as a Government owned company (GOCO) on 1 April 1991, rather than, as previously assumed, shortly before privatisation.
- 2 On incorporation, PSAS would cease to be a Government department and its staff would cease to be Civil Servants. It would be able to operate much more like a private sector company, with the Secretary of State as sole shareholder. It would thus be operating in a more commercial environment, with greater freedom and flexibility than a Government Department.
- 3 There are four advantages of the early introduction of commercial disciplines which are of particular importance:
 - a. the end of the uncertainties about terms and conditions of employment outside the Civil Service which have afflicted staff in PSA. These have depressed morale and led some good staff to leave. Others will follow if they do not see early evidence of PSA Services' determination to succeed as a private sector body;
 - b. the opportunity to motivate staff to greater efforts through greater flexibility to reward them for good performance (within guidelines agreed with Treasury) and to provide management with greater control over the human resources which constitute far and away the most important asset possessed by PSA Services;
 - c. the end of the management of PSA Services under civil service practices, of which obvious examples are vote accounting, central pay negotiations and departmental

archives. Vesting would enable PSA Services to drop these non-commercial activities though there would be some continuing work in winding up PSA Services as a civil service department. Control would be exercised by a Memorandum of Understanding with the Department and of course through the Department's ultimate sanctions as shareholder;

d the establishment of legally binding contractual relationships between PSA Services and Departmental clients. This will instil clarity about the respective roles and commercial disciplines into both PSA Services and other Departments. Vesting will also provide the opportunities for PSA Services to operate more freely in wider markets which is essential given that PSA Services will lose Government business to competitors. It must be in the interest of all Departments that PSA Services under the commercial disciplines and incentives of a GOCO should make rapidly the necessary changes to become a viable and competitive business, so that PSA Services does not go into a spiral of decline which could rule out a sale in late 1992 without guarantees of future workload and which could imply larger redundancy costs.

4 The case for early vesting is in principle strong. The question is whether it is feasible, whether it would have overwhelming disadvantages from the viewpoint of customer departments, and whether it would still be possible to protect the Secretary of State's interest as vendor.

5 DOE have examined the practicability of vesting by 1 April 1991 to provide PSA Services with more than a year of full commercial operation prior to the sale. A great deal of work will be required to ensure that the commercial accounting and management information systems are in operation, that the major elements of the preparatory work required to take advantage of greater personnel flexibilities are in place and that terms and conditions

for staff including pension arrangements are settled in time. Such a timetable would be tight but realistic. Contractual relationships will need to be established with departmental clients in a manner that protects both parties' interests. Clearly extensive use will need to be made of standard forms of contract, especially for work in progress, and there may need to be provision for renegotiation. But given the volume of Governmental business currently undertaken by PSA Services the same would largely be true for a later vesting. The contractual issues raised by the early vesting are not different in kind, only in degree, from those posed by later vesting.

6 Departments have concerns that early vesting will leave them exposed in terms of accountability for their Votes and for VFM with the period for building up their intelligent customer capability halved. PSA Services could, however, continue to provide bill paying and advisory services during 1991/92 on a contractual basis with NAO as auditors. This should provide protection for Accounting Officers. Some Departments argue for an increase in market testing to establish whether or not PSA Services has had time to cut costs. This will lead to a loss of business which might have been retained by the slimmed down business, and would give rise to increased costs of redundancy and thus cost to the taxpayer. It should similarly be possible to devise arrangements to minimise these concerns and give adequate protection to Departments.

7 The substantial reductions in staff needed before privatisation cannot be fully implemented by April 1991, but the number and identity of the staff without a longer term future in the PSA Services must be established before then. Whatever the date of vesting considerable assistance will be required from other Departments to place staff in Civil Service jobs. To the extent that redeployment cannot be achieved provision will need to be made for the ensuing redundancy payments for identified staff to be met by Treasury. Thus the mechanics of reducing staff will be

affected by whether or not there is early vesting, but the overall numbers and costs will be largely unaffected.

- 8 Similarly the establishment of a GOCO by 1 April 1991 will require earlier PES provision. A bid in the forthcoming PES round and a supplementary estimate for 1990/91 will be required to enable us to bring forward expenditure which would otherwise have been incurred later.

- 9 The establishment of PSAS as a GOCO would change the nature of their relationship with the Secretary of State. With PSAS as a GOCO, the duty of the directors would be to company rather than to the shareholder. However, for all practical purposes there is no distinction between the interests of the company and the Secretary of State's as sole shareholder. As sole shareholder, the Secretary of State would have the ultimate sanction of dismissal of the Directors. More important would be the power to establish a suitable monitoring regime, requiring the company to supply him with information or to put certain contracts or other decisions to him for approval. This he would be able to do by a written shareholder's resolution amending the Articles of Association. Such a regime will differ from and may well be looser than that imposed on a Government Department. This is the counterpart of the greater flexibility and freedom available to management under a GOCO. Although the details remain to be worked out, it should be possible to establish appropriate arrangements to ensure that the vendor's interests are protected. These arrangements would be needed in the case of a later GOCO anyway; earlier vesting is simply bringing the task forward, not changing its nature.

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3A B

PRIME MINISTER

MEETING OF E(A): 27 SEPTEMBER

You saw over the weekend the main papers for tomorrow's E(A) meeting. The full set is now available.

There are two items, and the papers for each are grouped in dividers 1 and 2.

Essential Services and Unofficial Action - Folder 1

This is the major item. It will be an important, and possibly difficult, discussion.

The papers are:

- Flag A Norman Fowler's main paper which you saw over the weekend.
- Flag B A further minute he has sent in this evening, in which he seeks to spell out the arguments in favour of a cooling-off period for essential services, and to counter some of the arguments that have been put forward against this proposal.
- Flag C Cabinet Office brief, which you will want to use to steer the discussion.
- Flag D A note from Andrew Dunlop in the Policy Unit. Andrew argues that the proposals on essential services are questionable and should be re-considered, whereas those on unofficial action are too weak and should be strengthened.
- Flag E A short note from Kenneth Baker, who is unable to attend the meeting, supporting Norman Fowler's proposals (and the PSA proposals under Item 2).

B

Flag F A note from Kenneth Clarke, flagging up the need to consider the publication arrangements for Norman Fowler's proposed Green Paper alongside the handling of the ambulance dispute.

Privatisation of PSA Services - Folder 2

This should be a less difficult discussion, although you may find that a number of Ministers are concerned about the implications for their Departments of the proposed accelerated programme for PSA privatisation.

The papers are:

Flag G Chris Patten's paper that you saw over the weekend.

Flag H Cabinet Office brief.

Flag I A further letter from Chris Patten to the Lord President spelling out his arguments for including the PSA privatisation measure in next Session's Legislative Programme.

KR.C.G.

PAUL GRAY

26 September 1989

PRIME MINISTER

P 03537

PRIVATISATION OF PSA SERVICES

[E(A) (89)25]

DECISIONS

1. Mr Patten seeks E(A)'s agreement to privatise PSA Services as soon as practicable, probably in 1992-93 as recommended by a recent study by PSA, the Treasury and Price Waterhouse. Early privatisation will require legislation and will mean that Departments have to move more rapidly than planned to obtain all their property services from private suppliers. You will wish to reach a decision on early privatisation of PSA services.

2. If E(A) agree to early privatisation, decisions will be needed on a number of subsidiary issues:

i. access to wider markets. Mr Patten proposes to give PSA Services immediate freedom to seek new work outside its traditional markets, subject to safeguards to ensure fair competition. You may wish to invite the Financial Secretary, Treasury, to comment. We understand that he is likely to say that the details need to be agreed before any announcement is made.

ii. effect on civil servants. Mr Patten refers to "assurances". You may wish to ask what he has in mind.

iii. legislation. Mr Patten seeks agreement to include the necessary provisions in The Crown Suppliers Bill, which has a place in the programme for the forthcoming Session. QL has agreed, subject to policy approval. The Lord President is reviewing this and other commitments in view of the pressures on the programme. You may wish to ask the Lord President to comment.

iv. special cases. In three cases - UK forces in Germany,

US forces in the UK and Defence works in Northern Ireland - there may be objections to property services being provided by a private company. Mr Patten proposes an official study led by MOD to resolve these issues. You will wish to check that the Secretary of State for Defence is content with this proposal. We understand that he is likely to be.

3. Finally, there is the question of timing. Mr Patten proposes an immediate announcement, followed by a Parliamentary statement as soon as the House of Commons returns. You will wish to decide whether there should be an immediate announcement.

BACKGROUND

4. From April 1990 Government Departments will be untied from using the PSA for property services. Part of PSA, "Property Holdings", will transfer to DOE Central, where it will be a candidate for designation as a Next Steps Agency. The largest part of PSA - accounting for 90% of staff - will become a commercial organisation, "PSA Services". The previous assumption was that PSA would operate as a Trading Fund for a number of years to develop a financial track record, before privatisation in the mid 1990's.

MAIN ISSUES

Early privatisation

5. The main argument for early privatisation is that it offers the best chance for PSA Services to become a successful company in the private sector. The study carried out by PSA management, Treasury and Price Waterhouse concluded that if PSA Services could not compete for new work in the private sector after it lost its role as sole supplier of property services to Departments it would suffer a serious decline in turnover with serious effects on staff numbers, quality and morale. The study therefore concluded that the best option was privatisation at the earliest practicable date, probably during 1992-93. It also

concluded that this should maximise gross proceeds from the sale, although the net benefit to the Exchequer might be minimal given the extra costs of meeting pension liabilities.

6. The team recognised that this was an ambitious timetable. The only financial results which would then be available would be one year's audited memorandum accounts for 1991-92. They therefore recommended privatisation through a management buy-out or trade sale. They also noted reservations by PSA senior management about the practicability of the proposed timetable. You may wish to check that Mr Patten is confident that the proposed timetable is realistic.

7. Early privatisation will mean that Departments will have to be ready to obtain all property services from private companies (including PSA Services) by 1992-93. This may have cost and staffing implications although extra competition may also reduce the costs of the services themselves. The paper suggests that PSA Services would be able to help Departments to make the transition. You may want to invite Ministers responsible for PSA's main customer Departments for their views.

Effect on civil servants

8. The paper says (para 9) that management will need to "reassure staff about their concerns over future conditions of service", but does not expand this. You may wish to ask Mr Patten how the terms and conditions of PSA civil servants will be affected, and what reassurances he has in mind.

Access to wider markets

9. Mr Patten proposes to allow PSA Services immediate freedom to seek work in wider markets in the run up to privatisation. The intention is to allow it to establish a foothold in these markets, and offset the loss of business from Departments after April 1990. The Financial Secretary is likely to stress that the details need to be agreed before any announcement is made,

particularly to avoid PSA Services running substantial risks, eg in relation to litigation over services provided to the private sector. You may wish to ask Mr Patten to agree the details urgently with Treasury Ministers.

Legislation

10. Mr Patten wishes to expand The Crown Suppliers Bill, which has a place in the 1989-90 legislative programme, to cover privatisation of PSA Services. He estimates that this should increase the number of substantive clauses only from 2 to 3. QL agreed to this extension of the Bill before the Recess, subject to policy approval in E(A). The Lord President is however reviewing this and a number of other commitments in the light of the severe pressure on the programme, and QL is to discuss them on 4 October. You may wish to ask the Lord President to comment.

Special cases

11. It is not clear whether the other governments involved would find it acceptable for property services for UK forces in Germany or US forces in the UK to be provided entirely by a private company. There is also a question about Defence works in Northern Ireland. Mr Patten suggests that MOD should lead an official study to resolve these issues. You will wish to ask Lord Arran whether he is content with this proposal.

ANNOUNCEMENT

12. Mr Patten proposes an immediate announcement of early privatisation, mainly to allow PSA management to counter union opposition. He then proposes to make a Parliamentary statement as soon as the House of Commons returns. You may wish to seek the views of the Business Managers on the proposal not to wait Parliament's return. You will probably want to ask Mr Patten to clear the terms of any statement with colleagues, particularly Treasury Ministers.

HANDLING

13. You may wish to invite the Secretary of State for the Environment to introduce his proposals. The Financial Secretary, Treasury, could then be asked to outline any Treasury concerns (eg on assurances to staff). Ministers from client Departments, in particular the Ministry of Defence, could be invited to comment. Finally, the Lord President could be asked about the legislative aspect and Parliamentary handling.

R.T.W.

R T J WILSON
Cabinet Office
25 September 1989

ORIGINAL ON JND POL. ^{up.}
Relations Register
R16

PRIME MINISTER

MEETING OF E(A): WEDNESDAY 27 SEPTEMBER

2A-B

You may like to take a first look over the weekend at the main papers for next Wednesday's meeting of E(A). Briefing material will be available later.

There are two items:

- Flag A - Paper by Chris Patten on the privatisation of PSA Services.
- Flag B - Norman Fowler's paper on industrial action in essential services and unofficial industrial action.

PSA Privatisation

You saw some private exchanges earlier in the year in which DoE Ministers set out their proposals for the future of PSA. These involved:

- A clear separation between functions which would remain in Government and those which were genuinely commercial.
- Converting the Governmental organisation into a Next Steps agency.
- Turning the commercial organisation into PSA Services, and aiming to privatise it at the earliest possible date of 1992/93.

These papers were not copied to other departments. You agreed that the issue should be brought to E(A) after the summer holidays.

Chris Patten now proposes:

B

- Pressing ahead with privatisation of PSA Services as soon as practicable.
- Including legislative cover in next session's similar Bill for the Crown Suppliers.
- Further study of how to handle future provision of services for sensitive defence functions.
- Making an early announcement of the plans in order to bolster staff morale.

Some departments may be concerned at the proposed pace of change, but I doubt if discussion of this paper will prove too controversial.

Essential Services and Industrial Action

This will be more controversial. Norman Fowler's paper at Flag B proposes:

- on essential services, the introduction of a cooling off period of 42 days in relation to proposals for industrial action in a specified list of public services and utilities.
- as regards industrial action, the removal of present restrictions on selective dismissal or re-engagement of employees taking unofficial action; and making unions liable for inducement of industrial action by any of their officials unless the union repudiates this inducement in writing individually to all members.
- All these proposes should be in a Green paper to be published on October 11/12 (ie. Party Conference week), before consultation until 4 December, and with a view to legislation in next session's Employment Bill.

PR CG.

PAUL GRAY

23 September 1989



CONFIDENTIAL

I C.C.P.O. *W. Bailey*

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

The Rt Hon Sir Geoffrey Howe QC MP
Lord President of the Council
Privy Council Office
68 Whitehall
LONDON
SW1

22 September 1989

Dear Lord President,

PRIVATISATION OF PSA SERVICES

Christopher Chope tells me that when he spoke to you on Monday about how best to announce a decision to privatise PSA, you told him of the growing pressure on next session's legislative programme, and your wish to review a number of commitments made earlier by QL. These include the decision to find time for a widened Crown Suppliers Privatisation Bill covering the remaining commercial activities of the Property Services Agency, if E(A) agrees to the early privatisation of PSA at its meeting on 27 September.

I thought I should write to you in advance of E(A) setting out my case in more detail than may be possible at the meeting.

I entirely accept the need to keep the legislative programme within reasonable bounds. I know that with this in mind you will be looking keenly at our previously expressed aspiration to move the Planning Bill from the reserve category into the programme. In the light of your concern, I have reviewed the case for proceeding with a PSA/TCS Privatisation Bill. I have concluded that there are good reasons for sticking to our present plans.

First, it is essential that we have a TCS Bill next session. Our decision to privatise TCS was announced as long ago as February 1988. But until QL decided next session's programme this February and we knew we had a place for the necessary bill, we were unable to determine a timetable for the sale and start planning the competition. This should now be launched in the middle of next month. The uncertainty about what was going to happen to TCS and when has created major problems for its management, and affected its commercial prospects. If I lose the TCS Bill and the sale has to be postponed for another year or more, I doubt we shall have a viable undertaking left to sell.

CONFIDENTIAL

Because PSA Services will not be ready for sale before 1992/93, in theory that legislation could wait until 1990/91 or 1991/92. But I know that you could not guarantee me Parliamentary time that far ahead. And there must be a real risk that a PSA Bill would be squeezed out by other more important legislation before or after the next General Election. Moreover, in view of the experience with TCS I believe it would be wrong for us to take an early decision to privatise PSA without providing at the same time for the necessary legislation.

The practical point is that expanding the TCS Bill to cover PSA Services should only marginally increase its length. It will still be a short bill. The TCS Bill will not be without controversy, not least because of the attitude of the Trade Unions. Extending it to cover PSA will add to the controversy but only because PSA will take longer than TCS to get into shape for privatisation. And we can answer that by pointing to the substantial amount of work in hand to put PSA on a commercial footing. Moreover controversy cuts two ways. As I have said in the E(A) paper, I believe a PSA Privatisation Bill will be widely welcomed on our side of the House.

Finally, given that the legislative requirements for privatising PSA and TCS services are virtually the same, I believe it would be wrong to ask Parliament to enact almost identical primary legislation twice to cover two parts of the same organisation. And there are precedents for such enabling legislation allowing parts of an organisation to be privatised in sequence as and when they are ready.

You also discussed with Christopher the timing and terms of an announcement if E(A) agrees to my proposals. For the reasons set out in the paper, I would want to make the announcement immediately after E(A) next week, and follow it up with a Parliamentary statement as soon as the House resumes. I am attaching a form of words for an announcement which should avoid pre-empting the Queen's Speech.

I hope in the light of this letter you will feel able to support my proposals at E(A). Copies of this letter go to the Prime Minister, the Chancellor and to Sir Robin Butler and Sir Henry de Waal.

Yours sincerely


PP CHRIS PATTEN

(Approved by the Secretary of State
and Signed in his Absence)

DRAFT ANNOUNCEMENT

Christopher Patten, Secretary of State for the Environment, today announced that the Property Services Agency is to be privatised.

Mr Patten said: "PSA has made good progress towards becoming a commercial organisation as announced by my predecessor in May 1988. I am convinced that the best prospect of securing its future lies in it making unimpeded progress towards privatisation with all the freedoms that will offer. The Government therefore intends to promote legislation at the earliest opportunity that would allow the privatisation of PSA as soon as the business is ready for it. In the meantime I will be giving PSA some freedom to compete for work in new markets immediately so that it will have an opportunity to demonstrate its ability to secure a foothold in these before privatisation."

Those parts of PSA which perform the Government landlord function and other long-term Government functions will move across to DOE(Central), and will not be involved in the privatisation proposal. Executive agency status will be considered for those activities relating to ownership and management of the property portfolio.

CIVIL SERVICE #3

PSA Restructuring





10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

7 August 1989

PSA: MACHINERY OF GOVERNMENT CHANGES

The Prime Minister has seen your Secretary of State's minute of 28 July on this subject.

The Prime Minister is content with the proposal that Property Holdings should transfer to DoE (Central) from April 1990, pending a later review of the right long term location for these functions. She welcomes your Secretary of State's proposal to consider the core landlord function as an Agency candidate (as some other Property Holdings functions may be) and hopes it will be possible to set up this Agency by April 1991, or April 1992 at the latest; the announcement which will be needed in due course on PSA privatisation and the transfer of Property Holdings to DoE (Central) should refer to the core landlord function becoming an Agency candidate. She would like to receive a further report on the timetable next spring, once the transfer to DoE (Central) has taken place.

The Prime Minister has also noted from the Chief Secretary's letter of 21 July that some other PSA Service Business functions (notably the property and works requirements of USAF and BAOR) may not be suitable for privatisation. She would be grateful if your Secretary of State's paper for E(A) on PSA privatisation could set out clearly any case for retaining such PSA functions in Government. She will then want to consider where any such retained functions should be located within the Government.

I am copying this letter to Carys Evans (Chief Secretary's Office) and to Trevor Woolley (Cabinet Office).

PAUL GRAY

Roger Bright Esq
Department of the Environment

RK

Ref. A089/2165

MR GRAY

Prime Minister's

Content to respond to Mr.
Patten's minute below in the
terms of the attached draft.

y
is not

RCC6

PSA: Machinery of Government changes

4/8

The Secretary of State for Environment's minute of 28 July proposes that the PSA functions which will need to remain in government after the service businesses are privatised should transfer to DOE (Central) from April 1990; and that they should be considered for Next Steps Agency status in parallel with the privatisation process (which will conclude at the earliest in late 1992).

2. Your letter of 5 May, in a previous round of correspondence on this subject, recorded the Prime Minister's view that positive consideration should be given now to the form in which the PSA landlord function could be established as a Next Steps Agency within Government. As foreshadowed in my minute of 8 June, I have since discussed this question and the related machinery of government issue about the future location in government of this function with the Permanent Secretaries at PSA and DOE.

3. It is clear that PSA's function as landlord for the Government's "common user" estate will need to remain within Government as will a handful of other less significant functions. These employ in total no more than 2,000 staff out of PSA's current total of some 20,000. It is also clear that the immediate priority is to separate these functions out from the rest of PSA, as proposed in Mr Patten's minute. On practical grounds, the only sensible location for these functions in the

short term is DOE (Central); in the longer term other possibilities ought to be examined too. So I recommend that the Prime Minister approves Mr Patten's proposals for a transfer to DOE (Central) in April 1990, with a later review of the right long-term location.

4. As regards Agency status, my discussions with PSA and DOE suggest that a launch date of April 1991 ought to be possible, or April 1992 at the latest - ie earlier than the earliest feasible date for privatisation of the service businesses of late 1992. But the prospects here should become clearer once Property Holdings has been formed next spring. I therefore suggest that the Prime Minister expresses the hope that brisker progress will be possible than is implied in Mr Patten's minute, and seeks a further report next spring as a basis for firmer decisions on the timetable.

5. Finally, the report attached to the previous Secretary of State's letter to the Chief Secretary of 11 July, and the Chief Secretary's reply of 21 July, which mainly concern the options for privatisation, also reveal that some other parts of PSA, notably those that service BAOR and (possibly) USAF, may also need to stay within government. Mr Patten needs to be pressed to make a fuller case for this; if he can, consequential decisions will be needed on their future location in government.

--- 6. I attach a draft letter for you to send to PS/Mr Patten covering these points, if the Prime Minister agrees.

R.R.B.

ROBIN BUTLER

4 August 1989

T

DRAFT LETTER FROM MR GRAY TO PS/SECRETARY OF STATE FOR ENVIRONMENT

SAMISAP

PSA: Machinery of Government changes

The Prime Minister has seen your Secretary of State's minute of 28 July on this subject.

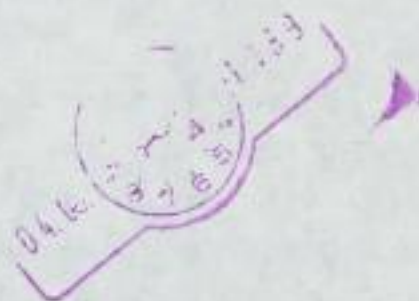
The Prime Minister is content with the proposal that Property Holdings should transfer to DOE (Central) from April 1990, pending a later review of the right long term location for these functions. She welcomes your Secretary of State to consider the core landlord function as an Agency candidate (as some other Property Holdings functions may be) and hopes it will be possible to set up this Agency by April 1991, or April 1992 at the latest; the announcement which will be needed in due course on PSA privatisation and the transfer of Property Holdings to DOE (Central) should refer to the core landlord function becoming an Agency candidate. She would like to receive a further report on the timetable next spring, once the transfer to DOE (Central) has taken place.

The Prime Minister has also noted from the Chief Secretary's letter of 21 July that some other PSA Service Business functions (notably the property and works requirements of USAF and BAOR) may not be suitable for privatisation. She would be grateful if your Secretary of State's paper for E(A) on PSA privatisation could set out clearly any case for retaining such PSA functions in government. She will then want to consider where any such retained functions should be located within the government.

I am copying this letter to Carys Evans (Chief Secretary's Office) and to Trevor Woolley.

C. S. P. G.

Civil Service - [redacted] Pr 3





MANAGEMENT AND COMMERCIAL IN CONFIDENCE

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

The Rt Hon Norman Lamont MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

mbsp
(cancel OLC on the 21/7 letter)

AKG

21/7 31 July 1989

Dear Chief Secretary

at Prop
I am replying to John Major's letter of 21 July to Nicholas Ridley about the options for privatisating PSA.

I agree that the case for privatising on a faster rather than a slower timetable is a balanced one and that in particular we need carefully to consider the implications for customer departments. I will ensure that the points John makes are covered in the E(A) paper and that this is discussed with your officials before it is circulated. I accept the case for widening the consultation list to include PSA's largest customers (which does not now include FCO who handle all their overseas work themselves).

Copies of this letter go to the Prime Minister, to John Wakeham and to Sir Robin Butler.

CEJ Bush

*pp*CHRIS PATTEN

(Approved by the Secretary of State
and Signed in his Absence)

CIVIL SERVICE : PSA Restructuring

P. 3



CONFIDENTIAL



PRIME MINISTER

Not

Your Private Secretary's letter of 17 July, recorded that you were content with my predecessor's conclusion in favour of early privatisation for the service business of the Property Services Agency. I am now writing to seek your agreement to a Machinery of Government change affecting PSA which will facilitate the preparation for privatisation.

From April 1990, the Chief Executive of the PSA will need to devote his energies to preparation of the two service businesses for privatisation. In any case, the establishment of proper client/customer relationships means that the service businesses and Property Holdings (the landlord for the common user estate) should be separated at Accounting Officer level. I therefore propose that from 1 April 1990, Property Holdings (including other long term in-government functions) should transfer to DOE(Central). Later, probably in the second half of 1990, we shall need to consider whether DOE(Central) is the right long term location for these functions.

Property Holdings functions will include the QEII Conference Centre which became a Next Steps Agency on 6 July. Once the new structure of Property Holdings is fully in place, I shall wish to consider whether the core landlord function should become an Agency candidate, on a timetable which would see this achieved in parallel with the privatisation of PSA Services. I shall also examine the other functions of Property Holdings as possible Next Steps Agency candidates.

I am copying this to the Chief Secretary and to Sir Robin Butler.

C P

28 July 1989

CIVIL SERVICE : PSA Review Pt 3



cc [initials]

CoF
NBBM at his case. B/F
4/9/89 to [unclear] X
acted.
RSC
2/17

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley AMICE, MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London SW1

21 July 1989

Dear Secretary of State,

see flag 'A'

PSA CORPORATE STRATEGY

Thank you for your letter of 11 July enclosing the report of the working party which considered the options for privatising PSA Services on the fastest available timetable (probably 1992-93) as against a slower timetable (1995-96 or later). The working party report seems to me, if I may say so, to be extremely clear.

I have also now seen Paul Gray's letter to you of 17 July recording that the Prime Minister supports early privatisation but wishes colleagues in E(A) to be consulted in early September before a final decision is reached.

General approach

The premise which underlies all the recent work is that there is no need to retain the PSA Services businesses in the public sector and that they should therefore be privatised at the appropriate time. I continue to support that judgment.

The question of when to privatise seems to me rather more difficult. On balance I take the view that the early option looks better than the later one. In my view however the issue is not as clear-cut as your letter or the working party report imply, and I would arrive at similar conclusions by a somewhat different route.

Your letter focuses particular attention on the question of what will be best for the PSA Services businesses. Important as this question is, I would attach no less weight to two other questions:

- First, what will be best for Government Departments and the Government's management of its property generally?
- Second, what will be best from the point of view of public expenditure and the taxpayer?

Implications for Government Departments

Early privatisation is certain to cause problems for Departments. The question is whether, with early privatisation, Property Holdings and the other departments concerned will be able to manage their property-related obligations and expenditures effectively over the next few years and in particular to obtain value for money.

Departments are likely to respond to early privatisation by trying to develop their market testing and intelligent customer capabilities faster than previously planned. The scope for sensible acceleration will necessarily, however, be limited. Many Departments will in effect be captive customers of the privatised PSA for much of their business over a considerable period of years, probably longer than the projections in the working party report assume. Property Holdings will face these problems as well as other departments.

To the extent that Departments succeed in developing their market testing more quickly than otherwise, they may find (as you say) that they can get work done more economically than PSA has been able to manage. The evidence suggests that PSA has been uncompetitive over a wide range of its business.

So far as continuing business with PSA is concerned, the risk is that the privatised PSA might in principle exploit captive customers by charging high prices and providing poor value for money. I do not think, however, we need to be too anxious about this. The privatised PSA will doubtless be concerned above all else to retain as large a share as possible of the market which Government Departments provide and to avoid a reputation for overcharging.

Government Departments may well judge that they can rise to the challenge of early privatisation of PSA Services and will be able to obtain good value for money. I would, however, make two points on this.

X | First, I would support the proposal in Paul Gray's letter that departments in E(A) should be consulted about the accelerated timetable. I would however go further and urge that PSA's main customer departments should be consulted as well - the Ministry of Defence, the Home Office, the Lord Chancellor's Department, the Department of Health, the Department of Social Security and the FC0: it so happens that none of these Departments is represented on E(A).

Second, I would strongly support your proposal that PSA should give departments, including Property Holdings, all possible help with development of in-house intelligent customer capabilities. Property Holdings in particular will need a generous share of PSA's best management resources since it will soon be the central repository of property management expertise inside the Government. I suggest we invite officials to consider as soon as possible how this can best be followed up.

Public expenditure implications

From the public expenditure standpoint, neither the early nor the late option look appealing in themselves and I am far from clear that the comparison between the two is as straightforward as the report implies.

So far as the net proceeds from sale are concerned, the estimates in paragraph 76 of the report make no allowance for the premium which a buyer might require in return for taking over the existing pension scheme obligations. My understanding is that, to judge by experience with the water authorities and other privatisations, this premium could on a 'worst-case' scenario be up to £100 million for a 1992-93 privatisation and up to £75 million for a 1995-96 privatisation. Clearly we would hope to get away with much less than this. However, I am not sure that a zero premium can be regarded as a central assumption for the purposes of estimating likely net proceeds. Contrary to what the report suggests, it seems clear that the premium could, if we were unlucky, wipe out the expected net proceeds altogether. Such a premium, unlike the commutation of the pension scheme, would count as public expenditure.

The comparison of proceeds as between early and later privatisation turns critically on a number of insecure assumptions about the rate of loss of existing business, access to new markets and, not least, PSA's assumed ability to reduce unit costs faster with the prospect of early privatisation. If as is quite possible PSA's level of business with Government Departments declined more slowly than the report envisages, and PSA management took determined steps to win markets elsewhere in the public sector and reduce unit costs, the comparison might look very different.

That said, I share the report's view that the value of the PSA Services businesses must lie chiefly in their customer lists and order books, together with their resources of skilled manpower. With untying, there must be a risk that these sources of value will look distinctly less impressive to potential purchasers in 1996 than in 1992. If we allow for this, for staff losses and for continuing expenditure requirements so long as PSA Services remain in the Government, early privatisation, though financially unattractive and risky in itself, looks like a less financially unattractive and less risky option than later privatisation. On that basis, I would go along with your conclusions.

Other points

IT. The report is right to make the point that those parts of the existing IT programme not required for early production of management and commercial accounts will need to be reviewed. We should ask officials to follow this up.

USAF and BAOR. As the report notes, it will be necessary to consider how best to handle the property and works requirements of USAF and BAOR following privatisation of PSA Services. I suggest we ask officials to study these two problems with the MOD officials concerned and report back as soon as practicable. There may be some similar problems with the Diplomatic Service Estate.

Arrangements for privatisation. It will as you say be necessary to set up a privatisation unit in DOE, possibly developed from the TCS privatisation unit.

Legislation. I agree with you that the best way ahead on legislation will be to extend next Session's TCS Bill to include PSA as well. My impression, based on earlier privatisations, is that more than one or two extra clauses may be needed.

Announcement

Your letter does not make clear when you would plan to make the announcement. It will be necessary to discuss this in September.

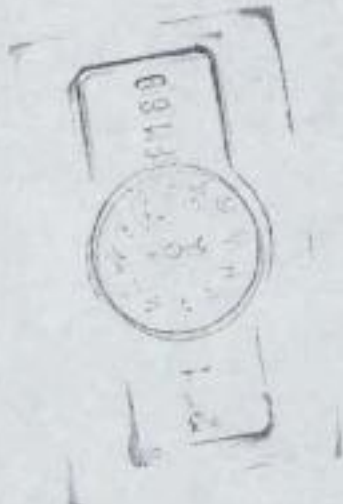
I am copying this letter to the Prime Minister, John Wakeham and Sir Robin Butler.

Yours sincerely,

P. Wainless

pp JOHN MAJOR

*[Approved by the Chief Secretary
and signed in his absence]*





COMMERCIAL IN CONFIDENCE

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

Paul Gray Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON
SW1A 2AA

NBM

B/E 4/9/89

PRUB

WJ

20 July 1989

Dear Paul

PSA CORPORATE STRATEGY

attached

Thank you for your letter of 17 July, recording that the Prime Minister is content with my Secretary of State's conclusion in favour of early privatisation for the service businesses of the Property Services Agency.

We will put in hand the arrangements to clear this with a wider group of colleagues, through a paper for E(A) to be circulated in early September.

I am copying this to Carys Evans (Chief Secretary's Office), Stephen Catling (Lord President's Office) and to Sir Robin Butler.

Yours

KES Bush

KATE BUSH
Private Secretary

File DS



10 DOWNING STREET

LONDON SW1A 2AA

17 July 1989

From the Private Secretary

Dear Kate,

PSA CORPORATE STRATEGY

The Prime Minister has seen your Secretary of State's letter of 11 July to the Chief Secretary and the attached report.

The Prime Minister is content with your Secretary of State's conclusion in favour of early privatisation, but she feels that his proposals should be cleared with a wider group of colleagues before a final decision is reached. She would be grateful if your Secretary of State could circulate his proposals to members of E(A) in early September for this purpose.

I am copying this letter to Carys Evans (Chief Secretary's Office), Stephen Catling (Lord President's Office) and to Sir Robin Butler

PAUL GRAY

Miss Kate Bush
Department of the Environment

File DS



10 DOWNING STREET

LONDON SW1A 2AA

17 July 1989

From the Private Secretary

Dear Kate,

PSA CORPORATE STRATEGY

The Prime Minister has seen your Secretary of State's letter of 11 July to the Chief Secretary and the attached report.

The Prime Minister is content with your Secretary of State's conclusion in favour of early privatisation, but she feels that his proposals should be cleared with a wider group of colleagues before a final decision is reached. She would be grateful if your Secretary of State could circulate his proposals to members of E(A) in early September for this purpose.

I am copying this letter to Carys Evans (Chief Secretary's Office), Stephen Catling (Lord President's Office) and to Sir Robin Butler

Yours,
Paul

PAUL GRAY

Miss Kate Bush
Department of the Environment

Handwritten initials

PRIME MINISTER

PSA CORPORATE STRATEGY

In May you agreed that Nicholas Ridley should commission further work on the timetable options for privatisation of PSA Services.

That work has now been done, and Nicholas Ridley's minute at Flag A attaches the report of the Working Group. I do not suggest you go through the full report, but you may like to glance at the Executive Summary on pages 1 - 4 as well as Nicholas Ridley's covering minute. He recommends:

- Going for privatisation as early as possible, in 1992-1993.
- Including provision for privatisation in the Bill already agreed for next Session on privatisation of the Crown Suppliers.
- Not consulting colleagues more widely at this stage on the principle of early privatisation, but consulting them in due course on the terms of an announcement.

The Lord President (Flag B) is content to include provision for PSA Services privatisation in next Session's Bill, subject to policy approval being given.

Richard Wilson (Flag C) sets out the pros and cons of early privatisation. He suggests that you may want to endorse early privatisation but also ask Nicholas Ridley to circulate his proposals for discussion with colleagues in E(A) in early September in advance of an announcement later during the Recess.

Content to endorse Nicholas Ridley's proposals in the terms recommended by Richard Wilson?

PG

14 July, 1989.

CONFIDENTIAL

Yes mb

f.h.c.

MR GRAY

P 03514

PSA CORPORATE STRATEGY

SUMMARY

The Secretary of State for the Environment's letter of 11 July to the Chief Secretary covers a report on the timing of the privatisation of PSA Services. He proposes to accept the report's conclusion that it would be best to proceed with privatisation in 1992-93. He seeks agreement to expand next Session's Bill for the privatisation of the Crown Suppliers to provide the necessary powers. This may be the right way to proceed. But early privatisation would have implications for all other Departments who are PSA's customers. The Prime Minister may therefore feel that there should be a discussion in early September, probably in E(A), before a final decision is reached.

BACKGROUND

2. The present understanding is that PSA services will be established as a Trading Fund by 1 April 1993 at the latest, moving towards privatisation in the mid-1990s. But in his letter of 13 April to the Chief Secretary, Mr Ridley proposed a much faster timetable, with privatisation in 1992. The Chief Secretary suggested that the two privatisation options (early and late) should be considered in a Working Party comprising representatives of the PSA, the Treasury and Price Waterhouse. Mr Gray's letter of 5 May to Mr Ridley's private secretary endorsed this proposal. The report attached to Mr Ridley's new letter is the outcome.

TIMING OF PRIVATISATION

3. The report concludes that it would be better to proceed with privatisation in 1992-93 (the earliest practicable date) rather than 1995-96 or later. The main reasons are:

i. PSA Services is expected to be a stronger business if it is privatised in 1992-93, with turnover stabilising at around £400m in the mid-1990s (compared with around £300m if privatisation is delayed). The difference results from the assumption that it would not be acceptable to let the business seek work in the private market prior to the final 2 years before privatisation;

ii. gross proceeds for the Exchequer are therefore likely to be higher, perhaps £100-150m in 1989-90 prices compared to £55-85m with later privatisation;

iii. the need for redundancies would be reduced (although major staff reductions would still be required) saving the Exchequer up to £20m in redundancy costs.

4. Early privatisation also raises a number of problems:

i. other Departments, who are PSA's present clients, will need to accelerate their plans to establish "intelligent customer units" to deal with private contractors, including PSA Services;

ii. it will put a substantially greater burden on PSA's top management. Paragraph 80 of the report notes "some doubt among senior management about whether this challenge can be achieved while still running the core business effectively and devoting effort to wider markets;"

iii. the net implications for the Exchequer are still unclear, because the cost of discharging pensions liabilities is not yet known. This point may concern the Chief Secretary.

5. Mr Ridley's judgement is in favour of early privatisation. He is clearly best placed to consider whether, given the

financial benefits, it is feasible in terms of the burden it will place on PSA's top management. I understand that the Lord President has agreed that next Session's Bill can be expanded to provide the necessary powers. Subject to the Chief Secretary's views the Prime Minister will probably want to endorse Mr Ridley's view that early privatisation is in the PSA's best interest.

COLLECTIVE CONSIDERATION

6. There is a strong case for a collective discussion before an announcement is made, in view of the implications for other Departments, particularly major PSA customers like MOD, the Home Office and the Lord Chancellor's Department. The report reflects some of the reservations which have been expressed by these Departments (paragraphs 36-45). Mr Ridley argues that they will also see earlier benefits and that they face a much less daunting task than PSA itself. But privatisation will be one of PSA management's main tasks whereas for other Departments it will be secondary to their main policy objectives. Ministers in these Departments will expect an opportunity to comment.

CONCLUSION

7. I understand that Mr Ridley wishes to announce a decision during the Recess, probably in September. That would still allow Ministerial discussion of the proposals at a meeting in the first half of that month. The Prime Minister may therefore wish to suggest that Mr Ridley should circulate his proposals for discussion, probably in E(A), in early September. We would make arrangements to ensure that the papers received a restricted circulation to avoid increasing the risk of the proposals getting back to PSA staff.

RJW
R T J WILSON
CABINET OFFICE
14 July 1989

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B
PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT



13 July 1989

Dear David

LEGISLATIVE PROGRAMME 1989/90 : CROWN SUPPLIERS BILL

Thank you for your letter of 26 June seeking agreement to the inclusion of paving provisions for the privatisation of the National Engineering Laboratory (NEL) in the Crown Suppliers Bill for the next Session.

As you know, Nick Ridley has also asked for the inclusion in the Crown Suppliers Bill of paving provisions for the privatisation of the service businesses of the Property Services Agency (PSA), subject to final policy approval of the privatisation option. QL considered the issues at its meeting on 28 June and, as foreshadowed in my letter to you of 4 May, concluded that the handling of the Crown Suppliers Bill would be seriously complicated if paving provisions for the privatisation of both NEL and PSA were to be added to it, since the scope would then be opened very wide. Notwithstanding the fact that relatively few additional clauses might be required for each of the privatisations, such an increase in the scope and difficulty of the Bill could not be sustained given that the Bill had been allocated a provisional place in the programme as a short, relatively simple and uncontentious measure, and that the Cabinet had agreed that there was no scope for adding to next Session's legislative programme without offsetting reductions. QL took the view that PSA was the stronger candidate for inclusion in the Bill in view of the closer affinity of the subject matter with Crown Suppliers, the larger potential gain to the Exchequer and the risk that privatisation of NEL might well complicate the handling of the Bill by arousing the opposition of the science and technology lobby, particularly in the House of Lords.

Inclusion of paving provisions for the privatisation of PSA is, of course, subject to final policy approval being given to early privatisation rather than to any of the other options for PSA's future.

I am copying this letter to the Prime Minister, Nicholas Ridley, John Major and Sir Robin Butler.

JOHN WAKEHAM

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
Victoria Street
LONDON
SW1H 0ET

Govt Mach : Sept 83

Cram Suppliers

14 JUL 1989



COMMERCIAL IN CONFIDENCE

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2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

11 July 1989

Dear Chief Secretary

PSA CORPORATE STRATEGY

Following our correspondence during May culminating with my letter of 18 May, we set up the Working Party to examine possible privatisation options for PSA Services. The report of the Working Party is attached.

As you will see they take the view that the future of PSA Services depends critically on two main factors: on their having freedom to enter new markets to offset the inevitable decline in Government work, and on management attacking the cost base. On the assumption that Government would be unwilling to see extensive trading in wider markets except as a step on a clear path to privatisation, the Working Party believe that privatisation is very desirable and early privatisation is to be preferred to a later date. I agree strongly with this view, and would not be prepared to allow general access to wider markets without a commitment to early privatisation. Later privatisation would damage the business; it would cause good staff to leave, provide a poor basis for recruitment and with falling workload, efficiency would drop. In consequence the quality of service to Government Departments would suffer.

The Working Party consulted PSA's major clients - covering over 75% of their business - about the consequences of privatisation. The Departments' general view was that it would present them with some practical problems, because they would need to gear up more rapidly to be in a position to deal with private firms for all their works services. My view, like that of the Working Party is that client Departments would benefit more quickly from early competition. A three year timetable should be perfectly adequate. And I would add that PSA have been given a tough remit to become fully commercial very quickly - and it would be quite wrong to worsen their commercial prospects merely to soften the impact of much smaller

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changes that other Departments are being required to undertake. But I accept that PSA would need to help them with staff and guidance to achieve a smooth and successful transition.

Because a firm decision for privatisation would lead client Departments to move more quickly towards full market testing, the earlier date would require even faster staff reductions from PSA Services in the first few years - offset by more stable prospects later. Many of the PSA's staff could be redeployed to other Departments but some redundancies (voluntary or compulsory) might be needed. However, the cost of these should be more than offset by an improved sale value for the business.

Thus the report has confirmed me in the opinion that we must aim for early privatisation, and to do that we need a carefully handled announcement and early legislation. As you know we already have a Bill allocated for the next session to deal with the privatisation of a part of the PSA - The Crown Suppliers (TCS). The scope of this Bill could be easily expanded, by the addition of only one or two clauses, to cover the whole of PSA's commercial services. This would also make a sensible legislation package dealing only with PSA issues - and would be easier to handle and defend than a Bill seeking to cover the more diverse activities of TCS and NEL as David Young would prefer. My strong preference, unless colleagues think otherwise, would be to confine next Session's Bill to PSA (and the Crown Suppliers).

For the reasons I have set out earlier, I see no case for consulting colleagues more widely at this stage on the principle of early privatisation, and so I am restricting circulation of this letter to the Prime Minister and John Wakeham, and Sir Robin Butler it is important that news of a decision does not get back to PSA staff until we have prepared the ground for an announcement. I would propose, in due course, to consult colleagues on the terms of the announcement, and then subsequently on the kind of practical help PSA can offer to prepare Departments for the change.

CEJ Bush

pp NICHOLAS RIDLEY

(Approved by the Secretary of State
and Signed in his Absence)

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**PSA SERVICES
REPORT ON OPTIONS**

7.7.89

COMMERCIAL IN CONFIDENCE

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EXECUTIVE SUMMARY

Introduction

1. This Report considers the comparative advantages of privatising PSA Services in 1992/93 (the earliest practical date) and 1995/96 or later. It has been prepared by a Working Party consisting of representatives of PSA, Treasury and Price Waterhouse.
2. Its conclusion is that it would be best to proceed with privatisation in 1992/93. The main arguments are summarised below.

The Options for Privatisation

3. No decision has been taken yet about how the PSA Services should be privatised. In theory a flotation, a Management-buy-out or a Trade Sale could be appropriate. Early privatisation in 1992/93 would allow a Trade Sale or an MBO. It would rule out a flotation; but that method of sale is unlikely to be desirable in any case.
4. The Report considers whether there could be a case for restructuring the business into smaller units before sale on a different basis from the one envisaged in the Corporate Strategy; and considers the options to see whether they might be affected by a decision on the timing of privatisation. It concludes that:
 - * There is no reason at this stage to alter the structure envisaged in the Corporate Strategy, principally because there should be commercial advantage in selling the business as one entity. If it seems desirable to market the business in smaller units, in order to increase interest in the sale, then the business units now being created - and their profit centres - should comprise suitable packages for sale.

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- * The aim, in descending order of preference should therefore be to find buyers for:-
 - The PSA Services business as a whole, or failing that
 - The PSA Projects and PSA Building Management operating divisions separately, or failing that
 - Individual sub-units of those two businesses based upon the proposed profit centres.
 - * If some further restructuring does ultimately appear to be desirable - either to assist in marketing the business - or to exclude certain overseas work from privatisation, it should be possible to carry it out before 1992/93.
5. A decision on the timing of privatisation can therefore be taken without restricting Ministers' choice between these options for selling the business in different ways.

The Choice between 1992/93 and 1995/96

6. There are a number of factors to consider in deciding on the timing of privatisation.
- * Government Departments who are clients of PSA Services will face additional problems if privatisation takes place at the earlier date. They will need to accelerate their plans to establish an in-house capability to deal with external suppliers. However, provided PSA Services is able to assist by transferring appropriate staff and issue guidance this should not be a major difficulty.
 - * PSA Services itself will be stronger as a business if it is privatised earlier rather than later. Although early privatisation may imply lower turnover in 1992/93 (because Client Departments will bring forward plans for market testing) the ability to compete for work in wider markets from an earlier date will more than offset this in the longer term. Early privatisation should also make it easier to retain and motivate the best staff. This will avoid the potential danger of the business entering an unmanageable spiral of decline.

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- * If access to major new markets is to be linked to privatisation, early privatisation is therefore vitally important to the business. It will give PSA Services the opportunity to go for new work while it still has available the skilled resources that it needs to compete effectively.
 - * The value of the business at the time of sale is impossible to predict other than within a very wide margin at this stage. It depends on how successful management is in improving profitability and winning new work. However, the prospective order book in 1992/93 will be larger, and clearly more attractive to purchasers than the lower turnover projected in 1995/96.
 - * Gross proceeds for the Exchequer are therefore likely to be higher if privatisation takes place at the earlier date. We estimate that they may be in the range £130m to £200m (ie. £100m to £150m in 1989/90 prices) in 1992/93, compared to £100m to £150m (ie. £55m to £85m in 1989/90 prices) if privatisation is delayed until 1995/96.
 - * Under either option there will be a need for major staff reductions and possibly some compulsory redundancies. Privatisation in 1992/93 should keep this to a minimum, saving the Exchequer up to £20m in redundancy costs over the period as a whole.
7. There are therefore benefits in proceeding with privatisation in 1992/93 or as soon as possible thereafter. However, early action needs to be taken to reduce staff numbers.

Other Points to Note

8. A major accrued pensions liability would crystallise at the date of privatisation, whether it is in 1992/93 or 1995/96. This is predominantly a cash flow issue since it brings to one point in time a series of payments which would otherwise have arisen over a longer period. However, private sector buyers may insist on a premium payment from Treasury to cover extra costs which they perceive to exist in setting up pensions provisions for staff with firm index linking. The Government Actuary has not been able to quantify this premium at this stage. The sum involved may be higher in the event of early privatisation (because of the larger number of staff transferring) but the difference is unlikely to be significant enough to cast doubt on the financial case for earlier privatisation.

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Feasibility

9. Privatisation in 1992/93 should be feasible.
 - * There is some doubt about whether the business can achieve the envisaged turnover in new markets and improve its margins to commercial levels. However, a sale should still be possible, albeit at lower proceeds even if it could not do so.
 - * It should be feasible to instal the necessary business systems and to audit Memorandum Accounts as a basis for sale. However if there is any difficulty in this, the date of sale might have to move back to 1993/94.

Implementation Issues

10. Section 5 comments on a number of implementation issues which need to be considered in more detail soon if early privatisation is agreed in principle. These are not relevant to the decision on timing. One point which should be noted, however, is that a policy unit will have to be set up - independently of PSA Services - to pursue privatisation questions and represent the interest of Government as vendor. The Report suggests that this might conveniently be provided by strengthening the TCS Privatisation Unit and locating it within DOE (C).

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SECTION 1 : INTRODUCTION

1. In May 1988 it was announced that PSA was to become a commercial organisation. From April 1990 Departments would no longer be tied to using PSA, and PSA's service businesses would compete for work with the private sector. As much of their operations as possible were to be established as a trading fund no later than April 1993.
2. In the light of those decisions a corporate strategy was developed for PSA, with assistance from consultants Price Waterhouse. This was considered by the PSA Board and DoE Ministers during March 1989.
3. The principal features of the strategy are a complete separation of PSA's service activities (to be called PSA Services) from its "Government" roles; and the organisation of the service activities into two business operating Divisions, PSA Projects and PSA Building Management, reporting to a Chief Executive supported by a small central organisation.
4. Other important elements of the strategy are the reduction of unit costs to ensure competitiveness; more flexibility in personnel policies and a major programme of training, to help in recruiting, retaining and motivating staff; and new systems and procedures for planning and management information, to assist control of the business.
5. The Secretary of State endorsed the thrust of the strategy. However, he felt that flexibility in pay and conditions of service, and freedom to trade in wider markets, could more easily be provided if PSA Services was on a clear path towards early privatisation. He therefore asked the Chief Secretary and the Prime Minister for their views on the early introduction of the necessary legislation to enable the privatisation of PSA Services.
6. As a result of this correspondence it was agreed that there should be a study, to report by early July, into the possibilities for privatisation and the implications of proceeding in say 1992/93 (being the earliest feasible date of sale) rather than 3 or 4 years later. The present Working party was set up to examine these issues, with Terms of Reference as at Appendix 1.

7. Bearing in mind the Secretary of State's view that greater flexibility in pay and freedom to trade in wider markets could more easily be pursued outside the public sector we have not considered alternatives to privatisation such as greater freedom for the business as a Trading Fund.

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SECTION 2 : THE OPTIONS FOR PRIVATISATION

8. No firm view has so far been taken about how PSA Services might be privatised. There are three forms of sale which could in theory be appropriate.

- Flotation
- A Management buy-out, probably including employee participation
- A Trade Sale

There are also a number of different ways in which restructuring of the business might assist a sale.

9. Before reviewing the comparative implications of privatisation in 1992/3 or 1995/6 we have examined whether a decision in principle to privatise at the earlier date might rule out any of these options. There are two questions:
- a. Do any of the forms of privatisation need a trading record beyond 1992/93?
 - b. Should the business be restructured before privatisation in a different way from that currently planned under the corporate strategy?

THE FORM OF SALE

10. A flotation generally requires a trading record of at least five years and full disclosure by the vendor of all material facts relating to the business. This is to a standard defined by legislation and in Stock Exchange Rules. The level of disclosure is far higher than commercial practice requires when inviting private bids through an information memorandum.
11. It would not be possible to comply with these requirements if PSA was privatised in 1992/93, so early privatisation would rule out a flotation. However, even in 1995/96 flotation is most unlikely to be an appropriate form of sale. It would carry relatively high costs; Government would forego the sale premium which is achievable in sale to a single purchaser; and wider share ownership is

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unlikely to be an objective in this sale. The fact that early privatisation would not allow this form of privatisation is not therefore a major consideration.

12. A management buy-out is not subject to Stock Exchange disclosure requirements but it is usually based on some record of the current financial position and performance as a benchmark for judging future prospects. It would therefore be essential for any management team bidding for PSA Services to have at least a year of audited figures which they could show to financiers. However, Management will have direct knowledge of the business; and the key issue for prospective lenders will be not historic performance but management's plans to secure strong cash flow in the future. One year's audited set of financial statements, would therefore be sufficient to allow an MBO to be considered.
13. In a Trade Sale greater importance might be attached to a longer trading record. Trade purchasers would have less inside knowledge of the business than management and could be more concerned to have reliable data on existing cost levels, staff utilisation and margins. However, they are also likely to be sophisticated in their approach to an acquisition. It would be quite normal for them to ask for access to internal financial information on the business. Their own staff or professional advisers could then reach judgements about the value of the acquisition based on their knowledge of the industry. In our view, trading accounts for a minimum of one financial year, which should be available before 1992/93, should be sufficient for a trade sale. Any additional information would be an extra help.
14. Provided a flotation is thought to be inappropriate a decision in principle to privatise in 1992-93 would not therefore limit the choice of sale method. A Trade Sale or MBO could be conducted on the basis of one year's audited Memorandum Accounts.

POSSIBLE DIFFERENT RESTRUCTURING FOR SALE

15. The corporate strategy reflects the conclusion that PSA Services will gain competitive advantage from remaining as one business with two operating Divisions. One of its objectives is to exploit the potential synergy between PSA Projects and PSA Building Management. While key functions such as finance, marketing and personnel will be decentralised to the two main operating Divisions, the structure envisaged in the strategy therefore retains a small corporate head office with responsibility for exploiting cross-selling, co-ordinating common technical and design skills through DGDS, and allocating scarce resources between the businesses.

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16. This part of the Report considers whether privatisation provides a case for a different form of restructuring for sale, and if so whether it could be carried out before an early privatisation in 1992/93. There are three sets of arguments to consider:
- a Policy arguments for restructuring
 - b Arguments for restructuring to market the business
 - c Arguments for restructuring because of special considerations in certain areas such as overseas work

If there is a case for further restructuring then particular thought needs to be given to planned investments in Information Technology.

a Policy arguments for Restructuring

17. A common argument for restructuring at the time of privatisation is that smaller units are necessary in order to prevent the abuse of monopoly power. This argument does not apply here. PSA Projects will face strong competition from 1990. Competitors for some of the PSA Building Management work may be slower to emerge, but even here there is a real opportunity for contractors and consultant firms to compete for business throughout the country. Moreover the prices offered in competitive tenders will provide a benchmark for judging the competitiveness of building management work that is not subject to tendering. We do not therefore see any need for restructuring to prevent monopoly.
18. There are also good reasons from the point of view of the business for keeping PSA Services in one unit rather than selling it in parts. A privatised PSA Services would still gain competitive advantage from synergy between the different parts of the business as envisaged in the Strategy.
19. Finally, the Government as vendor stands to gain from selling the business as a whole:
- (i) The competitive advantage inherent in the structure put forward in the Strategy ought to be reflected in the proceeds received from privatisation providing there are prospective purchasers who are able to exploit the opportunities in a business of this size.
 - (ii) Restructuring the business into smaller units with the aim of selling parts separately to different buyers would be more difficult and costly, particularly if some units proved less attractive than others.

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Subject to potential buyers being available, it would therefore be preferable to sell PSA Services as a whole. Privatisation does not present reasons for a different form of restructuring.

b Restructuring to Market the Business

20. Despite these arguments it is important to recognise that the structure put forward in the Strategy might limit interest in the sale among prospective purchasers because of the size of the business relative to potential purchasers. This could make it difficult to market the business and depress proceeds. There might therefore be a case for restructuring the business into smaller units purely on marketing grounds.

21. If this is the case, two options might be considered:

(1) Selling PSA Projects & PSA Building Management as separate businesses. This has an obvious rationale on marketing grounds because different private firms could be interested in the main parts of the business. Large practices of design consultants or contractors engaged in design and build work might be interested in PSA Projects. PSA Building Management might interest contractors (including those who offer total facilities management), design firms, and quantity surveyors. However, even PSA Projects and PSA Building Management as separate businesses would still be very large by the standards of firms operating in their respective sectors. Professional partnerships in particular might be unwilling to accept the risks involved in an acquisition of this size. If that proved a problem, one might want to consider the second option of subdividing the businesses further.

(2) Subdividing PSA Projects and PSA Building Management further into a number of units. This approach would involve selling both PSA Projects and PSA Building Management in smaller units, perhaps based on the offices in particular geographical locations. This would make it more feasible for smaller consultants or contractors to consider bidding for parts of the business. It might also stimulate offers from PSA's local management teams. But it would be more difficult and costly to implement than (1), and while it could well be a better way of marketing the attractive parts of the business it would raise the prospect of having greater difficulty in selling other parts, as mentioned in para 19.(ii).

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22. It is too early to say whether it will be necessary to consider these options. A judgement will have to be made based on information about the range of potential buyers - and this cannot be obtained until the proposed timing of privatisation has been announced. Creating smaller units in order to attract a larger number of potential purchasers would not necessarily mean increased proceeds, because of the potential value of one co-ordinated business. Moreover, it is possible that large organisations will come forward and express an interest in the whole of PSA Services. If they did, that would probably be the preferred course.
23. At this stage, therefore, we could not advise Ministers to take a firm decision on whether further restructuring should be carried out for marketing reasons. However, the order of preference for achieving an effective sale appears to be:
1. To sell PSA Services as a whole - or if that fails to attract sufficient interest;
 2. To sell PSA Projects and PSA Building Management as separate businesses - or, failing that;
 3. To sell various sub-units within the two businesses.
24. If a decision is taken to create smaller units for the purposes of sale there must be some risk that it will not be possible to implement restructuring and the sale of all the individual businesses by 1992/93. This could imply slippage of early privatisation by up to a year. However, we do not regard this as inevitable. The Corporate Strategy proposes structuring PSA Projects around a series of about 8 design offices. A study is about to start to consider rationalisation of the PSA Building Management Structure. These studies should be complete this year, and the structures can be put in place in time for financial results to be collated on the basis of these units for 1991/92 and possibly 1990/91. Provided a decision on the options for marketing is taken in the first half of 1990, following an announcement about privatisation in 1989, it will therefore be possible to begin preparation for sale next year, giving up to 2 years lead-in to early privatisation.
- c Special Considerations, Overseas Work and USAF
25. PSA Services currently has Regions in Germany, Gibraltar and Cyprus, together with a number of smaller overseas outstations, all of which deal predominantly with work for the MoD. (MoD are about to take in-house the work that PSA currently undertakes in Hong Kong.)

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26. The principal problem is in Germany where arrangements are governed by an inter-Governmental agreement, the NATO Status of Forces Agreement (SOFA). In essence, this shares the MoD works in Germany between the German Construction Agencies and the PSA, acting as advisors to MoD but also as an arm of the UK Government. There are various tax and other advantages provided to UK Government employees as part of the SOFA agreement. The cost of professional advice given to MoD by a private consultant which did not benefit from these advantages would be greater. There are also doubts about whether the German Construction Agencies would be willing to deal with private sector consultants. MoD are therefore inclined to the view that if PSA Services were privatised, the PSA operation in Germany - amounting to some £65m income for PSA Services - would have to be retained within Government, being taken in-house within the MoD.
27. The same special circumstances do not occur at other locations overseas, because the work is passed directly from PSA Services to private sector contractors or carried out by a directly employed labour force. There seems no reason why the treatment of this work, which accounts for income to PSA Services of £17m, should be handled any differently in privatisation terms from similar work undertaken for the MoD within the UK. The MoD would no doubt wish to strengthen their in-house capacity to some extent. But this will not prevent a privatised PSA Services maintaining units to compete for the work.
28. The US Forces tell us that their aim will be to maintain the nature, continuity and quality of service presently provided for them in the UK by PSA with no increase in cost to the US and no increase in US Forces manpower. They want to maintain the substance of the 1973 US/UK Cost Sharing Agreement. For them, the benefits of competition will be balanced against their need for a works services organisation capable of providing support for their operational role both in peace and in transition to war. If, following detailed discussion with MoD and PSA, the US Forces can be satisfied that a privatised Agency could continue to provide this service, possibly through long-term contracts with appropriate break-clauses, they are likely to accept privatisation. If not, they would probably press for the UK to set up some form of organisation within Government to meet their works requirements.

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29. The arrangements for Germany and USAF will have to be considered soon if privatisation is to proceed in 1992/93. However, it should be possible to make any alternative arrangements that may be necessary before 1992/93 without any adverse impact - particularly as there are likely to be sufficient staff within the PSA who are interested in serving abroad to meet requirements in Germany. Early privatisation should not therefore make it any more difficult to resolve these issues.

d Investment in IT

30. The Corporate Strategy envisaged major capital investment in IT to provide systems for planning and controlling the business and producing commercial accounts. This investment is now proceeding. Given the possibility that PSA Services might be sold in parts for marketing reasons it becomes important to consider the implications of this for the IT investment programme.
31. There are three main areas to consider; system applications and hardware and telecommunications and support functions.
- (i) Applications. By April 1991 some 80% of all business applications are likely to be unique to PSA Projects or PSA Building Management. Commercial accounts which are common to both business divisions are being developed on the basis of profit centres within the business. These should be capable of development in a way which will facilitate separation. Providing the needs of privatisation are kept in mind it should therefore be feasible to develop systems so that the applications and data can be split between the two business operating divisions, or even sub-units within those business divisions, at little additional expense.
- (ii) Hardware and Telecommunications. The IT infrastructure is flexible and should enable a range of restructuring options to be considered at no significant cost. To the extent that the telecommunications network is being designed as an integrated network, there would be costs in separating this for the two businesses. It would be feasible to incur expenditure of no more than a few million pounds now so that the network can be redesigned to minimise costs in the event of a split after implementation. The amount involved would not be significant in the context of privatisation.

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- (iii) Support Functions. Support for applications, hardware and telecommunications is concentrated at one location because of economies of scale. If the businesses were restructured into smaller units, each would need to make its own arrangements, which could mean more staff and additional costs.

From the perspective of possible restructuring there is therefore no major difficulty in proceeding with the IT investments currently planned, subject to slight modifications to provide for separability should it be needed. IT Support functions could be an area of difficulty if the business is restructured into much smaller units. However, this would apply whatever the date of privatisation, and is a further argument for preferring to sell the business as a whole.

32. Once a decision has been taken on the timing of privatisation there is a separate issue to consider. This is whether proposed IT investments scheduled for after April 1990 will provide value for money for the Exchequer before privatisation, or whether if possible they should be deferred until after sale. This is an important decision, but it is not critical in determining the best timing for privatisation. We consider it in Section 5, along with other implementation issues.

Conclusion

33. Privatisation in 1992/93 would allow Ministers to consider a Trade Sale or an MBO. If it proves necessary, it should also allow the business to be restructured to assist in marketing and to exclude certain work from privatisation. A decision on the timing of privatisation can therefore be taken without restricting Ministers' choice between options (although it has to be recognised that any significant restructuring could lead to slippage of early privatisation into 1993/94 unless a decision on its form is taken very soon).
34. If privatisation is to take place in 1992/93, PSA Services should proceed on the following basis:
- i. Plans should be made for auditing the Memorandum Accounts for 1991/92 - and if feasible for 1990/91.
 - ii. The existing plans for restructuring the businesses along the lines recommended by the Corporate Strategy should be implemented.

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- iii. The order of preference for the sale should be to sell as one business; failing that, as two operating Divisions; or, failing that, as sub-units of the two operating Divisions.
- iv. IT investments planned to April 1990, including those necessary for commercial accounting should proceed subject to any small amendments that may be necessary to keep open future options to sell the business in part (Paragraph 31 (ii)). The case for investments after April 1990 needs to be reconsidered in the light of the decision on the timing of privatisation.

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SECTION 3 : THE CHOICE BETWEEN 1992/93 AND 1995/96

35. This section of the paper discusses the comparative implications of early and later privatisation for:
- a) The Major Client Departments which account for over 75% of PSA Services' business
 - b) The PSA Services Business itself
 - c) Proceeds to the Exchequer

VIEWS OF CLIENT DEPARTMENTS

36. MOD say that they do not want to stand in the way of early privatisation, but it would present them with real practical difficulties. It would accelerate their expected rate of progress towards full market testing, so they would need more staff in the short to medium-term. They would expect PSA to provide such staff - from those parts of PSA that "straddle the customer/supplier boundary". The change of expected timescale would present them with more difficulties for maintenance than for new works. For maintenance, MoD had intended to gain experience by relying in the first instance on PSA for professional advice, and market testing only the management function. They had expected the pace of change to be constrained by the need to guarantee continuity of service, particularly at operational stations. They would therefore need to build up their UK organisation more quickly to the point where they were entirely independent of PSA.
37. The Home Office say that in the event of early privatisation they would probably take the project management of the new prison programme in-house, and look to PSA to transfer staff to allow that to happen. Because they have an existing in-house works organisation they believe this would be the logical way forward for them. PSA could still compete for design work, but by 1992 the design workload on the new prison programme would be running down rapidly.

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38. **The Lord Chancellor's Department** say that they have serious concern about the likely effect on the court building programme which could result from early privatisation of PSA Services. This is particularly because of the significant extra specialised resources which they would need to cope with so radical a change and the difficulty of being able to obtain them. For these reasons, they would prefer a smooth and orderly progression through a Trading Fund as previously envisaged.
39. **Property Holdings** say that the prospect of early privatisation would not alter their planning. They aim to set up an in-house capability from the outset that will allow them progressively to commission works services from the market. They will also handle any existing PSA activities that are essentially "Governmental" and in-house. They would therefore expect to deal similarly with PSA Services whether it was in the public or private sector.
40. We have not canvassed the views of more minor customer Departments. However, like the Lord Chancellor's Department, they might be expected to prefer a slower rate of progress towards the dependence on private sector suppliers of professional services.

Conclusion on views of client departments

41. The major clients, other than the Lord Chancellor's Department do not therefore see any objection in principle to early privatisation. But it would lead them to increase their in-house capability earlier than they would otherwise do. This would probably require transfers of specific staff from PSA - many in professional grades, although staff with administrative experience in works and contract matters would also be a requirement.
42. We assume Ministers will wish to ensure that customer Departments will increase their in-house capabilities only to the extent needed to deal competently with external suppliers of works services. The rationale for the benefits of commercialising PSA Services would be jeopardised if departments responded by building up their own organisation beyond this, creating mini-PSAs of their own.
43. The Working Party notes that Departments will have to accelerate the rate at which they establish their necessary in-house organisations. Our judgement is that in total, across all Departments, this would not require more than, say, 500 staff at most (excluding Germany and Property Holdings). However, we recognise that establishing these units quickly may lead to some extra costs, because the change will be less well planned than it might be if it took place over a longer timescale.

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44. Against this, the shorter timescale for setting up in-house units will accelerate the implementation of a policy which is expected to benefit both Customer Departments and the Exchequer. It will achieve the advantages of competition more quickly. It is undesirable in principle for these benefits to be deferred longer than necessary.
45. Provided PSA Services is able to assist Customer Departments to set up their in-house intelligent customer units the Working Party does not therefore feel that the views expressed by the main Client Departments should be a major factor in determining the date for privatisation.

IMPLICATIONS FOR THE BUSINESS

46. The Working Party has considered the prospects on the basis of management projections for the next three years. It has not been possible to verify these figures. However, the existing projections of workload for PSA Services show a continuing decline in business throughout the 1990's. This reflects the fact that untying implies the erosion of the traditional work for Government Departments without substantial replacement from new markets. Turnover from Government Clients (excluding overseas work) is expected to reduce from £512m per annum in 1990/91 to £303m per annum in 1995/96. This is illustrated in detail in Appendix 2.1 (The projections extend the assumptions in the Three Year Resource Management Plan, which has been approved by PSA Services senior management and the Secretary of State, but which is subject to review and refinement during 1989 as part of the business planning process).
47. The main assumptions behind the projections are as follows:
 - a) Even if the business is successful in competition it is bound to lose some of its existing business after untying. It is assumed that market share in work for existing clients will gradually decline to 30% for Projects and 50-60% for Building Management by 1995/96.
 - b) Without a commitment to early privatisation, PSA Services will be allowed only limited scope to compete for private sector work, and then only on a case by case basis. The base figures therefore assume that, if privatisation does not take place until 1995/96, then the contribution from wider markets would be very small, with general access only taking place in 1994/95 once an announcement of privatisation had been made.
48. On these assumptions the business will have shrunk to about £280m in resource costs by 1995/96 and it will be difficult to regain turnover by entering wider markets because of a lack of skilled resources.

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49. This picture could change substantially if Ministers were to agree that PSA Services should be free to compete with the private sector in new markets without a commitment to early privatisation. However, as we said in the introduction to our Report, we have assumed that general access to wider markets would only be acceptable if it was specifically linked to a decision on the timing of privatisation.
50. A decision to proceed with privatisation in 1992/93, instead of moving to Trading Fund status first, should imply the following improvement in turnover.

	1990/91 £m	1991/92 £m	1992/93 £m	1993/94 £m	1994/95 £m	1995/96 £m
<u>Later Privatisation</u>						
Existing work	512	496	454	386	312	303
New Markets	-	-	-	-	5	10
	—	—	—	—	—	—
	512	496	454	386	317	313
<u>Early Privatisation</u>						
Existing work	507	459	399	342	305	303
New Markets	5	10	25	50	90	100
	—	—	—	—	—	—
	512	469	424	392	395	403
(Disbenefit)/Benefit	-	(27)	(30)	6	78	90

51. This revised projection reflects the following factors:

- a) With early privatisation, the business would by definition be free to compete for private sector work from 1992/93. We have assumed that Ministers would allow it to do so immediately once it has been decided that privatisation should take place in that year. PSA Services senior management have agreed that the business should be able to achieve new work equal to about a quarter of total turnover. We have assumed that it will be possible to build up to this level over a period of six years - involving a progressive diversification away from the

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Government field in order to restore lost turnover. This will allow the business to maintain its resource base at a higher level.

- b) However, the additional turnover generated in these new markets is likely to be more than offset in the period to 1992/93 by client departments responding to early privatisation by accelerating the rate at which they test the market and invite competitive bids. We believe that a reasonable interpretation of the views of Client Departments is that this would mean bringing forward by about a year the decline in turnover in existing markets shown in Appendix 2.1. However, this is merely a timing effect: by 1995/96 PSA Services income from existing markets is likely to be the same.
52. The net effect of early privatisation would therefore be to reduce turnover below the level currently projected in the 3 year resource cost management plan in 1992/93, but to increase it significantly in 1995/96 and later years. At the cost of an accelerated transition to competition, the business would stabilise at a higher level of turnover in the longer run. This is illustrated in more detail by the projections in 2.2, which indicate the likely breakdown of turnover between business sectors.
53. There are also other, intangible factors to consider:
- a) Early privatisation could have a significant effect on the ability of the business to retain and motivate key staff. It would allow the business to pay the market rate for the quality staff that it needs and to match its resources more flexibly to its business requirements.
 - b) We have been unable to gauge the view of staff accurately, but it appears that a large body - perhaps the most able - would welcome early privatisation as the best means of giving the business better prospects in competitive markets. Some others are probably apprehensive about the scale of change that is required within the organisation. If they feel that the business could not adapt quickly enough to competition these staff might prefer to leave PSA for another employer soon rather than face uncertain prospects after privatisation. On balance we believe that the effect of early privatisation should be beneficial. Morale would generally improve, if only because an announcement about early privatisation would remove existing uncertainty. Staff who would prefer to see out the balance of their career in the Civil Service should have some opportunities to transfer to the "intelligent customer" organisations needed in client departments.

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Conclusion on business prospects

54. Privatisation at an early date should strengthen the business in the longer term by giving it an earlier opportunity to compete for private sector work. This should allow turnover to stabilise at a higher level in the longer run. Early privatisation should also make it easier to retain key staff. However, it is likely to mean lower turnover at about the time of privatisation as client department's accelerate market testing.

IMPLICATIONS FOR THE EXCHEQUER

55. In deciding between 1992/93 and 1995/96, there are two major factors for the Government to consider as a vendor. The first is the gross proceeds from the sale of the business. The second is the transitional costs which are likely to be incurred - principally in redundancy compensation and pension payments. The objective should be to maximise net proceeds in Net Present Value Terms.

Gross Proceeds from the sale of the Business

56. PSA Services' main assets are its staff and its order book. It does not have any significant net assets apart possibly from property.
57. Properties have not been allocated between Property Holdings and the different elements of PSA Services. It has not therefore been possible to estimate any likely proceeds from this source. There might be individual properties within the Departmental Estate which have potential sale values that are significant compared to the cash flow generated by the business. These need to be identified at an early stage so that the Government can consider the best way of ensuring that it shares in any realisation. However, property values should be realisable whenever privatisation takes place, so this is not a factor in the decision on timing.
58. Apart from property realisation, the level of proceeds will depend on the contracts that are in place, profitability over the next few years, the amount of market interest in the sale, and the opportunities purchasers see to increase earnings from the business.

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59. Assuming that privatisation takes place in 1995/96 we set out the current projections of profitability below:

Projected Profitability - later privatisation

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
	£m	£m	£m	£m	£m	£m
Income	512	496	454	386	317	313
Expenditure	512	491	443	[No existing plans]		
	—	—	—			
Gross margin	-	5	11			
	—	—	—			
Interest and Depreciation	(15)	(15)	(14)			
	—	—	—			
Net margin after Interest and Depn.	(15)	(10)	(3)			
	—	—	—			
Net margin as % Turnover	(3%)	(2%)	(1%)			

These are based on the 3 Year Resource Management Plan (adjusted for estimated interest on working capital and depreciation) and the extrapolation of income through to 1995/96.

They assume there would be no substantial access to new markets before privatisation had been announced.

60. On this basis the business would have very limited value in 1992/93. It would be hovering about the break-even level at a time of rapidly declining turnover with no clear prospect of improved profitability. There would be a real risk that the business was entering a spiral of decline, with staff leaving. This would probably be unattractive to any purchaser.

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61. Even if it is assumed that management would succeed in improving margins to a commercial level by 1995/96 (say a net margin of 10% on turnover as illustrated in appendix 2.3), the lower level of turnover in 1995/96 means that the business would still only have a value in the range £100m to £150m (in 1995/96 cash) based on the Net Present Value of its cash flows. (The mid point of this range would be consistent with with a P/E of 6 and a dividend yield to 8% in the year of sale).
62. Revised projections, on the assumption that the business is privatised in 1992/93 rather than 1995/96, might be as follows:

Projected Profitability (based on assumption of early privatisation)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
	£m	£m	£m	£m	£m	£m
<u>Income</u>						
Existing	507	459	399	342	305	303
New	5	10	25	50	90	100
	—	—	—	—	—	—
Total income	512	469	424	392	395	403
	—	—	—	—	—	—
Expenditure (incl. interest and Depn.)	512	446	390	353	356	363
	—	—	—	—	—	—
Net margin	-	23	34	39	39	40
	—	—	—	—	—	—
Net margin as of turnover	0	5%	8%	10%	10%	10%

63. There are two main differences between these projections and those based on later privatisation shown in appendix 2.3.
- a) If privatisation takes place in 1992/93 turnover is assumed to be some £424m with only a slight further decline to £403m by 1995/96 (compared to £313m if privatisation takes place at the later date). This is a key consideration for a purchaser. The larger orderbook based on earlier access to wider markets, would provide a better base from which to improve performance in later years.

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- b) Early privatisation will also imply an earlier improvement in margins, because the performance projected in paragraph 59 would not be attractive to a new owner. We have assumed this would mean improving the net margin to at least 8% of income at the time of early privatisation and increasing to 10% thereafter.
64. If management can achieve this performance - the most significant and difficult element of which will be reducing costs and manpower in the early years while entering new markets - then the prospective value of the business at the time of privatisation in 1992/93 would be significantly higher. The value should be in the range £130m to £200m (in 1992/93 cash) based upon the Net Present Value of its cash flows. (The mid-point of this range would be consistent with a P/E ratio of 6 and a dividend yield of 8% in the year of sale.)
65. The value that is actually achieved within the ranges quoted for early or later privatisation depends on the success of management in the period before privatisation and the buyer's perception of the opportunities at the point of sale. The more progress that can be made in improving margins before privatisation the greater the proceeds are likely to be.

Manpower Reductions and Transitional Costs

66. The existing corporate strategy makes clear that PSA Services needs to achieve significant reductions in staff before 1992, both to adjust to reduced levels of business after untying and to reduce unit costs. The projections in Annex 2.1, without general access to new markets in the early years, imply reductions of non-industrial staff from some 12,000 on 1.4.89 to 7,900 on 1.4.93 and 6,400 on 1.4.95. (All these figures exclude staff within Property Holdings and overseas). Industrial staff have been reduced in proportion to the reduction in turnover.
67. On present trends for natural wastage (5% pa for P & T, 1% for AEG and 2% for industrials), and on reasonable assumptions about the incidence of staff reductions, this profile implies large surpluses of AEG staff and industrials from 1990. Allowing for essential recruitment there will be no significant surpluses among P&T staff to 1992 but the possibility of large surpluses in AEG staff grades and industrial and some surplus P & T staff after 1992.

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Present Plans leading to privatisation in 1995/96: Required Staff Reductions

	1990	1991	1992	1993	1994	1995
<u>P&T and AEG</u>						
Gross Reduction	700	600	800	2000	1300	200
Reduction net of wastage and essential recruitment	200	400	500	1700	1100	100
Cumulative surplus net of wastage and recruitment	200	600	1100	2800	3900	4000

(The detailed figures in Appendix 3.1 give a breakdown between P & T and AEG.)

Irrespective of privatisation, there will therefore be a need to consider a large programme of transfers to other Government Departments. If surpluses still remain, a redundancy programme will be necessary.

68. In addition to the P & T and AEG surpluses it will be necessary to reduce industrial staff. The numbers shown in the appendix assume reductions in proportion to the decline in turnover. A separate study is progressing to establish a strategy for direct labour activity which may change these figures.
69. We have considered how early privatisation is likely to change the required profile of staff reductions based on the financial projections considered in paragraphs 59 and 62. The implications are likely to be as follows:

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- i. In order to improve margins to more commercial levels in preparation for privatisation it would be necessary to accelerate staff reductions in 1991 and 1992, (indeed, a purchaser might want any redundancy projected for 1993 and afterwards to be brought forward into earlier years - something which staff themselves might welcome because it would ensure them compensation on Civil Service terms).
- ii. On the other hand, the ability to enter new markets immediately will lead to more work and higher turnover throughout the period. This will stabilise the level of employment in the years after 1993.

70. This can be summarised as follows:

Early Privatisation: Required Staff Reductions

	1990	1991	1992	1993	1994	1995
<u>P&T and AEG</u>						
Gross	700	1200	1000	400	200	-
Reduction net of natural wastage and essential recruitment	200	800	600	300	200	-
Cumulative surplus net wastage and recruitment	200	1000	1600	1900	2100	2100

(More detailed figures are given in Appendix 3.2)

The key difference is that with earlier privatisation, non-industrial staff reductions over the period, net of natural wastage, will be only 2,100 rather than 4,000. From 1993 both P & T and staff levels will be stable and at a higher level than with later privatisation. By 1995 early privatisation should allow the business to employ a total of 8,700 non-industrial staff (5,700 P & T and 3,000 AEG) compared to 6,400 non-industrial staff (4,200 P & T and 2,200 AEG) if privatisation were to be later.

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71. These projections make no allowance for relocation into other government departments. The Treasury tells us that the required profile of reductions in PSA may not match expected staff requirements in OGD's. Based upon preliminary indications, some 50-60% of the AEG surplus may be capable of relocation into other Departments but few industrials and only 10% of P & T. On the other hand some PSA client departments have referred to the fact that they currently have vacancies in all these grades, and their needs for such staff including P & T staff will increase as they develop their customer capability and surpluses would assist departments in setting up their ICC capability.
72. The position is far from clear. Following our discussions with Treasury however, we do not believe there is any reason to suppose that early privatisation will make it significantly more difficult to absorb surplus staff in other Departments. This is not, therefore, a factor in the decision on timing.
73. Given the uncertainty about the scope for transfers to other Departments we have considered the potential cost of redundancy compensation on the pessimistic assumption that the whole of the cumulative staff surplus, net of wastage and recruitment, had to be tackled by means of a redundancy programme. Treasury have advised us that compensation could vary significantly depending upon the age profile and length of service of surplus staff. For illustrative purpose a figure of £10,000 per employee on average in 89/90 prices has been used which is likely to be at the top of the cost range. On this basis the total cost of redundancy compensation in today's terms would be up to £20 million in the event of early privatisation (for some 2,100 AEG and P&T staff) and £40 million in the event of later privatisation (for some 4,000 AEG and P&T staff). In addition to this there will be costs involved in reducing industrial staff. These might be as much as £25 million. A more precise estimate cannot be made at this stage, but the cost is likely to be the same or higher if privatisation takes place later rather than in 1992/93.

Other Considerations

74. There is a large accrued pensions liability which will crystallise at the point when PSA Service employees leave the PCSPS. The Government Actuary estimates the total pensions liability to be some £590 million based upon the existing staff numbers (excluding Property Holdings) of 19,000. The actual transfer cost would depend upon the number of staff transferred to the private sector and the number of staff who chose to transfer their pension. It could reduce to about £440m in the event of an early sale in 1992/93 and would reduce to about £320m with a later sale. This is a timing point which would affect the PSBR. However, it is not relevant to the financial evaluation of the options for privatisation because it represents the discharge of accrued liabilities.

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75. However, the buyer may insist on a further premium payment into a new scheme - to cover of future uncertainties in earnings growth and the risks perceived to exist in firm "index linking". The level of transfer payments is always a matter for a discussion. Although this issue has been a significant feature in other privatisations the Government Actuary has not felt able to assess the possible figure.

Conclusions

76. The net proceeds in Net Present Value Terms, based upon the above, can be summarised thus. Figures are restated into 1989/90 prices for consistency of comparison between the two options.

	<u>Early Privatisation</u> £m	<u>Later Privatisation</u> £m
Gross proceeds [cash]	130 - 200	100 - 150
Gross proceeds [89/90 prices]	100 - 150	550 - 85
Potential Redundancy costs	(20)	(40)
Property Proceeds }	unquantifiable	unquantifiable
Pensions Top Up }	unquantifiable	unquantifiable
Net Proceeds	80 - 130	15 - 45

So far as the unquantifiable elements are concerned, proceeds from property realisation would not be affected by the timing of privatisation. While pensions top up payments would reduce the net proceeds in both cases set out above they could be somewhat higher for an early privatisation (because of the larger number of staff involved), and any additional cost involved would be unlikely to be significant in the context of overall proceeds of this size. There is therefore a clear financial benefit in earlier privatisation.

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SECTION 4 : THE FEASIBILITY OF PRIVATISATION IN 1992/93

77. The Terms of Reference require us to consider the feasibility of privatisation in 1992/93 as well as the balance of advantage between that and a later date. There are two areas which could raise doubt about the feasibility of early privatisation. These are:
- a. The viability of the business (particularly its ability to enter wider markets and improve margins).
 - b. The feasibility of installing business systems and auditing accounts before an early sale.

The Viability of the Business

78. The financial projections based on the 3 year Resource Cost Management Plan show a declining workload to 1992/93 and beyond because of the inability to attack wider markets as Government workload reduces. (Paragraph 50 and Appendix 2.1). On existing plans this decline in turnover will be accompanied by margins after depreciation and interest on working capital which, while projected to improve over the period, would still be unacceptably low for a private firm. (Paragraph 59)
79. Our comments on the prospective value of the business if privatisation takes place in 1992/93 assume that it will be possible for PSA Services to arrest this decline in turnover, by winning work in new markets, and to improve profitability. The Corporate Strategy that has been drawn up for achieving commercial performance as a Trading Fund provides the framework for this. But a great deal of detailed work is still needed in order to identify specific actions and implement them.
80. While early privatisation would make the task easier in one respect, by bringing forward the opportunity to deploy resources in new markets, it would also increase the scale of the challenge. It would accelerate the pace of market testing by Client Departments, reducing turnover in 1991/92 and 1992/93, and it would increase pressure to improve margins. The combined effect would be higher profitability but a need for greater reductions in staffing during 1991/92 and 1992/93. There is some doubt among senior management about whether

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this challenge can be achieved while still running the core business effectively and devoting effort to wider markets.

81. The Working Party recognises that early privatisation would pose additional challenges for management. Until more detailed business plans have been completed it would be wrong to be confident that the improved performance projected in Paragraph 62 can be achieved. However, we do not feel that this casts doubt on the feasibility of privatisation in 1992/93, for three reasons:
- i The business has skilled resources at its disposal and we have no reason to doubt that it can improve performance if it has a clear target to aim for, greater flexibility and sufficient will to take a commercial approach. The incentive to do so will be clearer once privatisation has been announced and the business has a clear timetable to work to.
 - ii Even if improved profitability is not achieved, the business could still trade on tighter margins and be attractive to prospective purchasers who believed that they would improve performance. Lower levels of profitability would imply lower proceeds, but would not make privatisation infeasible.
 - iii Given the prospect of a continued decline in turnover after 1992/93 if the business is not privatised and is therefore denied general access to wider markets, we see no prospect of privatisation becoming more viable at a later date. The existence in 1992/93 of a significant order book and prospects of stabilising workload is likely to be more important than the level of profitability at the time of sale.

While there must be doubt about the position which will be reached by 1992/93, and about proceeds, we therefore believe that the business will be more attractive to a potential purchaser in 1992/93 than in 1995/96. Earlier privatisation is more feasible than later privatisation.

b. The feasibility of Installing Systems and Auditing Accounts

82. We noted that a Trade Sale or an MBO could be completed in 1992/93 on the basis of one year's audited Memorandum Accounts for 1991/92, with the addition of some audited data for 1990/91 if possible. It needs to be considered whether this is feasible.

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83. As part of the Corporate Strategy, new systems are planned to be introduced by April 1991 to produce reliable management information and establish appropriate systems for planning, budgeting and control. The present intention is that auditable memorandum accounts should be prepared on the basis of these systems for 1991/92 and if possible from existing systems for 1990/91. These accounts will be memorandum accounts for 1991/92 as they will not be the prime financial accounts which will still be vote accounts during that period. The Strategy makes clear that this timetable will be tight. It may not be feasible to implement auditable commercial accounting and management controls by April 1991 in time to test them in parallel with Vote Accounting in the year to 1992. The difficulty could be intensified if any additional restructuring was thought to be necessary to package the businesses for sale.
84. However there is no reason why the prospect of early privatisation should make the introduction of commercial accounts more difficult. Nor are full commercial accounts essential for privatisation. An audit of Memorandum Accounts could be undertaken by a firm of Chartered Accountants, in parallel with the NAO audit of Appropriation Accounts. This would provide significant comfort to prospective purchasers both on the trading record and the systems that support them - even if fully audited accounts are not available for 1990/91.
85. If problems do arise with preparing relevant information which make the audit of Memorandum Accounts impracticable in 1991/92 then some slippage in the timetable would have to be accommodated by setting the date of sale back by up to a year.

Conclusion

86. Privatisation should be feasible in 1992/93. There would be some possibility of slippage into 1993/94 if it proved difficult to prepare relevant information for audit in 1991/92.

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SECTION 5 : IMPLEMENTATION ISSUES

87. This section comments on some of the issues which will need to be considered before privatisation. They are not relevant to a decision on timing, but they will need to be progressed more quickly if a decision is taken to proceed in 1992/93.

Marketing the Sale

88. We have noted that the decision on whether or not to package PSA Services on a different basis before privatisation is likely to depend on whether it appears desirable from the point of view of marketing to offer smaller units to potential purchasers [para 23]. This suggests that an announcement about the proposed date for privatisation should be made soon if it is decided to proceed with early privatisation, followed by soundings to try to identify potential purchasers for the whole business. In the light of the response, consideration will then have to be given to whether to think in terms of offers for parts of the business. This seems to be the only way to assess interest in smaller units.

Pensions

89. The liability for pension payments will crystallise on privatisation when staff gain the option either to freeze their accrued pension rights under the PCSPS or to take transfer payments into a new scheme.
90. Payments made on privatisation will discharge existing pension entitlements. They will represent the same cost in NPV terms as paying pensions at a later date, and should not therefore be regarded as cost of privatisation in either 1992/93 or 1995/96. However Treasury will need to consider the assessed liability so that financial planning can be based on reasonable assumptions about the number of staff who are likely to opt for transfer payments and commutation and their lengths of service.
91. Pensions arrangements inevitably attract intense staff interest, and handling pensions issues would be a major workload at the time of privatisation. Work also needs to begin on the attitude that the Government should take to the form of new schemes that would be provided by the buyer(s) in respect of

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future service. The new schemes for Royal Ordnance and the Royal Dockyards were designed to reflect the PCSPS as closely as possible.

Property

92. Further work is needed to identify the amount and type of space occupied by PSA Projects and PSA Building Management as distinct from Property Holdings.
93. Properties which are part of the Departmental Estate are in the main in single occupation and often of a specialised character which are unlikely to have a use elsewhere within the Government. It seems likely that these properties could be part of the assets of the privatised entity; though provision may be needed in legislation to allow the assignment of leases to a company formed for the purposes of privatisation, in cases where assignment would normally need the landlord's consent.
94. Properties on the Common User Estate require closer consideration. Where they are in single occupation by PSA Services, it may be possible to transfer them to the privatised entity. But where there is joint occupancy, Property Holdings could be unwilling to sacrifice the flexibility that arises from being able to relocate occupancy within the estate. PSA Services itself might also prefer premises which are separate from Government and more in keeping with their new commercial image.

Residential Training Centre

95. The requirement for residential training for the businesses presents special issues. The existing training centre at Cardington is in a very poor physical condition and runs a serious risk of being closed down on Health & Safety grounds. That would have two serious consequences if it happens before alternative facilities can be provided. It would leave PSA Services short of trained manpower, particularly in the PSA Building Management field, where the existing Centre provides essential training facilities. It would also be very damaging to PSA Services marketing image if its own facilities had to be closed on such grounds.
96. PSA Services believe that the only practicable course is to press ahead with planning for replacement of the Training Centre as quickly as possible - which should be before 1992-93. But final decisions on the size and cost of the facility to be provided should wait for the outcome of a study currently in hand on the likely total residential training requirements of PSA Services in the mid-1990s - bearing in mind the projection of workload and staffing emerging in the

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business planning process. The aim would be to keep the facility to the minimum essential size, and rely on external top-up to cope with peak loads. And the design should be flexible enough to allow for the sale of parts of the centre if business requirements in the future are for less residential training than is initially foreseen.

IT Investments

97. We noted in paragraph 32 that once a decision had been taken on the timing of privatisation it would be necessary to review the investments in IT proposed for the period after 1990 to consider whether the programme now under consideration would still represent value for money or whether parts of it could and should be deferred.
98. The proposed IT capital investment up to 1991 is essential for the business to become a commercial organisation. Without this it would not be possible to implement the invoicing of customers following untying, to provide managers with basic information to manage the business, or to produce commercial accounts. It is clear that these elements of the investment, must proceed or else privatisation will not be feasible at any date.
99. However, the later systems development, needs to be considered more closely. It is possible that some of this investment would not be recovered in additional proceeds and that it should be deferred until after privatisation. The investment appraisal for this expenditure should therefore be reviewed, particularly if a decision is taken to proceed with privatisation in 1992/93.

Client Contracts

100. The principal assets and liabilities of the PSA Services business will be contained in its agreements with client departments and in its ongoing works contracts and consultant commissions. These need to be transferred from the Crown to the purchaser of PSA Services and a legislative provision may be helpful, as in the case of TCS, to avoid the need to strike individual agreements. The terms of the contracts will be a key issue in determining the value of the business.

Professional Indemnity Insurance

101. The Government will have to indemnify the business against any claims arising from work before a certain date. However, for future work insurance should be put on a commercial footing as soon as possible. If discussions with insurance companies begin soon about establishing a track record in the next two years,

COMMERCIAL IN CONFIDENCE

it should be possible to achieve this by the time of privatisation, even if it takes place in 1992/93.

Top management

102. Whenever privatisation occurs it will be essential that the top management of PSA Services has the right balance of leadership experience and skills to manage the difficult transition from a Government department to a private sector company. If the sale is to an MBO team, the top management will need to secure the confidence both of City Institutions and also of the staff who it wants to take a share of the business. The earlier the date for privatisation the more necessary it will be to bring in people with relevant commercial experience into PSA Services rather than trying progressively to develop such experience in-house.

Managing the privatisation

103. It will be also important to identify officials with separate responsibility for taking forward privatisation, to avoid any conflict of interest which would arise between the interests of the Exchequer and the interests of any management buy-out team. A separate privatisation unit should be set up, responsible to the Accounting Officer in DoE, to take forward work on legislation and the structure of privatisation, and to shadow decisions taken about PSA Services between now and privatisation from the point of view of the vendor. Extension of responsibility of the TCS privatisation unit, with specific staff dealing with PSA Services privatisation, and transferring it to DoE (C) might be a convenient way to fulfil this role, particularly if the TCS Bill were to be used as the vehicle for legislation.

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Appendix 1

TERMS OF REFERENCE

To evaluate the feasibility and comparative implications of privatising PSA Services in 1992/93 as against 1995/96, or some other date, the study should cover:

- (1) The practical implications, not least in terms of trading and accounts, of getting the business ready for privatisation by 1992 on the one hand or a later date on the other.
- (2) What methods of privatisation might be feasible including a sale of the whole or in part; and which might be appropriate under the two timescales, including terms of transfer of staff.
- (3) The possible sale proceeds and wider public expenditure implications under the two suggested timetables; the expenditure requirements ahead of privatisation; the treatment of assets, working capital requirements, possible redundancies and pension liabilities.
- (4) The implications for PSA's government clients, not least the Ministry of Defence, and in particular Government purchasing of building and maintenance services and value for money; and
- (5) The implications for PSA over the period to 1992. This would need to cover any necessary changes in investment policy, for example on IT; the likely effect on staff morale; the implications for the TCS privatisation; and the arrangements and Accounting officer responsibilities for advice on privatisation, which would presumably need to be separated from the responsibilities of the Chief Executive of PSA Services.

WORKING PARTY MEMBERSHIP

R Gomme	PSA (Chairman)
R Munday	PSA
I Urquhart	PSA
W Inglis	HM Treasury
H Hyman	Price Waterhouse
P Wright	Price Waterhouse
M Dennett	Price Waterhouse
A Poulter	Price Waterhouse

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Appendix 2.1

PROJECTIONS OF INCOME - LATER PRIVATISATION

Income	1990/91 £m	1991/92 £m	1992/93 £m	1993/94 £m	1994/95 £m	1995/96 £m
Projects	195	190	170	140	110	110
Building	231	225	207	181	148	141
Management						
DEL	83	78	74	62	51	49
DGDS	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>
	512	496	454	386	312	303
New markets	-	-	-	-	5	10
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>317</u>	<u>313</u>

Broad assumptions on market share of new starts.

- PSA Projects
 - market share from existing clients declining to 30%
 - marginal activity on an individual project basis with new clients.
 - 100% of MoD schemes are market tested.
 - Tender success rate approximately 1 in 4 to 1 in 5.

PSA Building Management

- Part III, Maintenance Management Contracting Processes, Estate Surveying decline to 60% from existing clients.
- Part II activity decline to 50%.
- Advisory services decline to 45%.

DEL

- Pending finalisation of the DEL strategy DEL has been assumed to decline proportate to Building Management Activity.

No major move into new markets has been assumed in the period 1990/91 - 1993/94, but access has been assumed once a later privatisation announcement has been made.

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APPENDIX 2.2

PROJECTIONS OF INCOME - EARLIER PRIVATISATION

	1990/91 £m	1991/92 £m	1992/93 £m	1993/94 £m	1994/95 £m	1995/96 £m
Projects	190	175	150	120	110	110
Building Management	231	207	181	161	141	141
DEL	83	74	65	58	51	49
DGDS	3	3	3	3	3	3
	—	—	—	—	—	—
	507	459	399	342	305	303
	—	—	—	—	—	—
<u>New Markets</u>	5	10	25	50	90	1100
	—	—	—	—	—	—
TOTAL	512	469	424	392	395	403

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Appendix 2.3

PROJECTIONS OF MARGINS - LATER PRIVATISATION

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
	£m	£m	£m	£m	£m	£m
Income	512	496	454	386	317	313
Expenditure	<u>512</u>	<u>491</u>	<u>443</u>	<u>354</u>	<u>281</u>	<u>271</u>
Margin	-	<u>5</u>	<u>11</u>	<u>32</u>	<u>36</u>	<u>42</u>
Interest & Depreciation	(15) —	(15) —	(14) —	(13) —	(11) —	(11) —
Net margin after interest and depreciation	(15)	(10)	(3)	19	25	31
Net margin as % of Turnover	(3%)	(2%)	(1%)	5%	8%	10%

Note: Expenditure figures exclude provision for cost of change for which a case has been made to Treasury for separate funding amounting to some £20m.

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Appendix 3.1

MANPOWER PROJECTIONS - LATER PRIVATISATION

Projections with gradual market decline and later new markets.

	1990	1991	1992	1993	1994	1995
P & T	6600	6500	6100	5000	4300	4200
AEG	<u>4700</u>	<u>4200</u>	<u>3800</u>	<u>2900</u>	<u>2300</u>	<u>2200</u>
	11300	10700	9900	7900	6600	6400
Industrials (in proportion to Turnover)	6400	6200	5900	4800	4100	4000

Gross Reductions by year

P & T	400	100	400	1100	700	100
AEG	300	500	400	900	600	100
Industrials	<u>400</u>	<u>500</u>	<u>300</u>	<u>1100</u>	<u>700</u>	<u>100</u>
Total	1100	1100	1100	3100	2000	300

Reductions by year net of natural wastage

P & T	-	(200)	100	800	500	(100)
AEG	200	400	400	900	600	100
Industrial	<u>300</u>	<u>400</u>	<u>200</u>	<u>1000</u>	<u>600</u>	<u>-</u>
Total	500	600	700	2700	1700	-

Cumulative Reductions net of natural wastage

P & T	-	(200)	(100)	700	1200	1100
AEG	200	600	1000	1900	2500	2600
Industrial	<u>300</u>	<u>700</u>	<u>900</u>	<u>1900</u>	<u>2500</u>	<u>2500</u>
Total	500	1100	1800	4500	6200	6200

ALL MANPOWER NUMBERS ROUNDED TO NEAREST HUNDRED

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Appendix 3.2

MANPOWER PROJECTIONS - EARLY PRIVATISATION

Projections with accelerated market testing and early new markets.

	1990	1991	1992	1993	1994	1995
P & T	6600	6000	5600	5500	5600	5700
AEG	<u>4700</u>	<u>4100</u>	<u>3500</u>	<u>3200</u>	<u>3000</u>	<u>3000</u>
	11300	10100	9100	8700	8600	8700
Industrials (In proportion to Turnover)	6400	5700	5400	5300	5300	5400

Gross Reductions by year

P & T	400	600	400	100	(100)	(100)
AEG	300	600	600	300	200	-
Industrials	<u>400</u>	<u>700</u>	<u>300</u>	<u>100</u>	-	<u>(100)</u>
Total	1100	1900	1300	500	(100)	(200)

Reductions net of natural wastage

P & T	-	300	100	(200)	(300)	(300)
AEG	200	500	500	300	200	-
Industrial	<u>300</u>	<u>600</u>	<u>200</u>	-	-	-
Total	500	1400	800	100	(100)	(300)

Cumulative reductions net of natural wastage

P & T	-	300	400	200	(100)	(400)
AEG	200	700	1200	1500	1700	1700
Industrial	<u>300</u>	<u>900</u>	<u>1100</u>	<u>1100</u>	<u>1100</u>	<u>1100</u>
Total	500	1900	2700	2800	2700	2400

ALL MANPOWER NUMBERS ROUNDED TO NEAREST HUNDRED

CIVIL SERVICE: PSA
6861 701 14 Restructuring
R7





file

DAS

bcBG.

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

SIR ROBIN BUTLER

PSA CORPORATE STRATEGY

Thank you for your minute of 8 June which the Prime Minister has seen. She has noted that you will be holding a meeting with the Department of the Environment, the PSA and the Treasury concerning the two points you raise and looks forward to receiving your further advice in the light of that meeting.

PLG.

PAUL GRAY
9 June 1989

COMMERCIAL IN CONFIDENCE

PRIME MINISTER

PSA CORPORATE STRATEGY

You saw some papers about a month ago on the PSA Corporate Strategy. You authorised me to minute out (see Flag A):

- agreeing that there should be a quick study of the alternative paths to privatisation for the PSA "Service" businesses;
- raising the possibility of an interim stage for these businesses as Next Steps Agencies;
- stressing the need to consider now the possibility of establishing the residual PSA landlord/ownership activity as an Agency.

Nick Ridley responded to the earlier exchanges on 18 May (Flag B). Robin Butler advises (Flag C) that his response raises two points which merit further consideration:

- (i) he wants to defer even considering an Agency solution for the residual business until April 1990 or later;
- (ii) the need to consider in any event the future location (in Machinery of Government terms) for the residual functions.

Robin proposes to consider these issues further with Departments then to submit further advice.

Content to proceed on that basis?

Paul G.

PAUL GRAY
8 June 1989

Yes

Ref. AO89/1519

MR GRAYPSA Corporate Strategy *at front*

The Secretary of State for the Environment's letter of 18 May to the Chief Secretary accepts the proposal made in the previous round of correspondence for a ^{guide} study of the main options, in terms of timing, for privatising PSA's Service businesses. It does however raise two other points which merit further comment, if the Prime Minister agrees.

2. First, Mr Ridley's letter defers until April 1990 or later consideration of even the possibility of making the residual PSA functions (i.e. those which will need to remain in Government long term) into a Next Steps Agency, in contrast with the wish expressed in your letter of 5 May that positive consideration should be given now to this question.

3. Second, if the Service businesses are put firmly on the privatisation track, the residual in-Government functions will be an order of magnitude smaller in manpower terms than the PSA is now: this raises the question, acknowledged in Mr Ridley's letter, of their future location. He appears to be thinking in terms of an interim location at least in or with the rest of the Department of the Environment. Since Machinery of Government matters are at stake, it would be as well for these to be registered explicitly at this stage, so that they can be looked at properly between now and April next, and the Prime Minister's agreement sought.



4. I propose to hold a meeting with DOE, PSA and Treasury about these points and will submit further advice in the light of that.

R.B.

ROBIN BUTLER

8 June 1989

CIVIL SERVICE: PSA



Restrooming

PT 3

500

1180

COMMUNICATIONS



2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

MBM

Rec 6

19/5

18 May 1989

Dear Chief Secretary

PSA CORPORATE STRATEGY

Thank you for your letter of 3 ^{*Ap*}May, replying to mine of ~~13~~ April.

I agree that a quick study of the privatisation options for the Service businesses is desirable, and I am putting this in hand along the lines you suggested. I welcome your offer of a Treasury member in the team.

I propose to use Price Waterhouse as advisors for the work - since they already have all the background. Their team will be led by Mr P D Wright and Mr H J Hyman, both of whom have wide experience of privatisation. Within PSA the lead will be taken by the PFO, Robert Gomme. Both he and the Price Waterhouse members will be ready to forswear any future involvement in the privatised PSA business.

As far as the separation of Property Holdings is concerned, on which the Prime Minister has also commented in her minute of 5 May, an internal DOE(C)/PSA Working Party is sitting now to look at the practical implications of brigading Property Holdings with DOE(C) from 1 April 1990, pending decisions on its final location. But it will take all our available resources to carry through effectively and on time by 1 April 1990 the establishment of PSA Services and the separation of Property Holdings. This must be our first priority, before we move on to consider the possibility of establishing the management of the Common User Estate as an Agency.

I am copying this to the Prime Minister, John Wakeham, and to Sir Robin Butler.

CES Bush

PP NICHOLAS RIDLEY
(Approved by the Secretary of State
and signed in his absence)

CIVIL SERVICES: PSA PT3





bc 89

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

5 May 1989

PSA CORPORATE STRATEGY

The Prime Minister has seen your Secretary of State's letter of 13 April to the Chief Secretary, together with his reply of 3 May.

The Prime Minister would be content for your Secretary of State to explore with the Lord President the prospects for getting the necessary enabling legislation in 1989/90 for privatisation of parts of the PSA. But she agrees with the Chief Secretary that the first priority is to undertake a quick appraisal of the alternatives of 1992 privatisation or a period of trading within the public sector with privatisation following later.

The Prime Minister notes that there is no mention of the Next Steps initiative in your Secretary of State's letter. She accepts that, if it is concluded that early legislation leading to privatisation of the two service activities not later than 1992 is desirable and can be achieved, there is little point in establishing them as Next Steps Agencies inside Government meanwhile. But if the Chief Secretary's alternative option was to be adopted, she feels that consideration should be given to this taking the form of establishing the two service activities as Agencies in the interim, as a help to eventual privatisation. So far as the landlord/ownership activity is concerned, she thinks that positive consideration should be given now to the form in which that could be established as a Next Steps Agency inside Government.

I am copying this letter to Carys Evans (Chief Secretary's Office), Steve Catling (Lord President's Office) and Trevor Woolley (Cabinet Office).

PAUL GRAY

Roger Bright, Esq.,
Department of the Environment.

6

PRIME MINISTER

PSA CORPORATE STRATEGY

Last year you agreed in principle that parts of the PSA should be privatised in the longer term.

Mr Ridley's letter of 13 April (Flag A) now reports that further work by Price Waterhouse has now been completed. The resulting strategy recommends that the Agency's Service businesses - projects and building management - should be privatised as soon as possible; with late 1992 suggested as the target. But to facilitate that, a privatisation Bill is necessary to avoid the costs of technical redundancy.

Mr Ridley seeks your agreement to discuss with the Lord President the possibility of incorporating the necessary provisions in the 1989/90 Crown Suppliers' Privatisation Bill.

Robin Butler (Flag B) makes three recommendations:

- you should agree to Mr Ridley consulting the Lord President on the legislative possibilities in 1989/90;
- in due course the detailed proposals should be cleared through E(A);
- if a privatisation by late 1992 proves not to be possible, the two Service businesses should in the interim be established as Next Steps Agencies.

Robin recommends that, subject to any further comments from John Major, we should minute these points out on your behalf: his draft minute is at Flag C.

John Major has now commented (Flag D). He agrees that there should be discussions on the possibility of legislation in 1989/90. But he does not want at this stage to reach a firm view that 1992 privatisation is the right course; he wants a quick appraisal to be done of the comparative merits of 1992

privatisation or deferring privatisation for three to four years while the PSA Businesses develop a proven track record.

I have amended Robin's draft minute to take account of John Major's comments. Content for me now to minute out in the amended terms at Flag C?

In view of John Major's
minute which I agree with
the whole balance of the minute
at Flag C is wrong.

We should first complete
the assessment of 1992 value
and pursue the Market Share
possibility. I think we

should delete as I have indicated etc.

AGG.

PAUL GRAY
3 May 1989

DASAVG

COMMERCIAL IN CONFIDENCE



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London
SW1P 3EB

3 May 1989

Dear Secretary of State,

PSA CORPORATE STRATEGY

Thank you for your letter of 13 April, *at Kap*

I agree that the PSA Services business should be separated as soon as practicable from Property Holdings and the other functions which should be long-term functions of Government. This is in line with the policy agreed collectively last year. It will be most important to establish the independence of Property Holdings, which requires it to have substantial capacity to act as an intelligent client for building and maintenance work, as well as to manage the civil estate portfolio. I look forward to receiving your proposals on these matters.

I note what you say about the flexibilities you believe PSA Services would need. My officials are in touch on these matters and have put a number of questions to yours.

Your main point was to suggest bringing privatisation forward to 1992. I agree that this should be considered now. Subject to John Wakeham's views, the Crown Suppliers Bill may as you suggest provide a legislative opportunity. In addition, I believe we ought anyway to take firm decisions soon for or against early privatisation, since otherwise uncertainties will multiply in ways which will damage both PSA's business and the service to Departments.

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COMMERCIAL-IN-CONFIDENCE

That said, however, I do not think we are in a position to reach a judgment here and now as between a 1992 privatisation option (if that proves feasible), hard on the heels of the introduction of full commercial accounts in 1991-92, and the existing option of setting up PSA as a Trading Fund in 1992 with a view to privatisation from a proven track record perhaps three or four years later. The comparative implications and feasibility of these two broad options have not as yet been directly addressed.

I would like therefore to suggest that you should commission a quick appraisal of the two broad options, to be delivered by the beginning of July at the latest. This appraisal should, in my view, cover:

- i. the practical implications, not least in terms of trading and accounts, of getting the business ready for privatisation by 1992 on the one hand or a date in the mid-1990s on the other;
- ii. what methods of privatisation might be feasible under the two timescales, including terms of transfer of staff;
- iii. the possible sale proceeds and wider public expenditure implications, under the two suggested timetables, bearing in mind the difficult questions of public expenditure requirements ahead of privatisation, treatment of assets, working capital requirements, possible redundancies and pension liabilities;
- iv. implications for PSA's Government clients, not least the Ministry of Defence, and in particular Government purchasing of building and maintenance services and value for money; and
- v. implications for PSA over the period to 1992. This would need to cover any necessary changes in investment policy, for example on IT; the likely effect on staff morale; the implications for the TCS privatisation; and the arrangements and Accounting Officer responsibilities for advice on privatisation, which would I presume need to be separated from the responsibilities of the Chief Executive of PSA services.

I agree with what I know to be your view on the importance of confidentiality. It will however be necessary, I believe, for the appraisal team discreetly to consult a limited number of PSA customer departments, notably the Ministry of Defence.

There remains the question of who should conduct the appraisal. It seems clear that privatisation in 1992, if this proves feasible, may have to take the form of a trade sale or management buy-out as against a flotation. That being so, I am sure you will feel, as I do, that, to avoid possible conflicts of interest, the officials and consultants who conduct the appraisal should forswear any future involvement with a privatised PSA services business. The appraisal team would presumably need to include a senior official

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COMMERCIAL-IN-CONFIDENCE

with knowledge of the subject and one of your existing consultants. I would be glad to nominate one of the Treasury's accountants to serve on the team as well, if you would think that helpful.

I am copying this letter to the Prime Minister, John Wakeham (to whom I understand your letter has been copied) and Sir Robin Butler.

Yours sincerely,

P. Walker

PP JOHN MAJOR

*[Approved by the Chief Secretary
and signed in his absence.]*

COMMERCIAL-IN-CONFIDENCE

CIVIL SERVICE P 8A Review Pt 3



B
CPJ

Ref. A089/1052

MR TURNBULL

PSA Corporate Strategy

at top

The Secretary of State for the Environment's note to the Chief Secretary of 13 April about the future of PSA was copied to the Prime Minister and myself.

2. PSA and its future are clearly a matter of interest to a wide range of Ministers, and in due course a wider discussion of what is proposed would be appropriate, particularly since the rapid route to privatisation in 1992 now proposed is a change in course from the strategy announced by Mr Ridley a year ago. But the proposals for privatisation of PSA Projects and PSA Building Management in late 1992 depend critically on getting the necessary legislation in 1989-90 and I suggest that the first step, after the Prime Minister has seen the Treasury's comments, is for Mr Ridley to consult Mr Wakeham on this aspect as he suggests.

3. A further aspect is the application to PSA of our Next Steps policies. The Prime Minister's statement of 18 February 1988 accepted the Ibbs recommendation that "... to the greatest extent practicable the executive functions of Government, as distinct from policy advice, should be carried out by units clearly designated within Departments, referred to in the report as "Agencies"...". The constituent parts of PSA are par excellence examples of such units.

4. The Secretary of State does not mention Next Steps in his minute. If there is a realistic possibility of early legislation to enable privatisation of the two Service businesses - PSA Projects and PSA Building Management - by late 1992 it is

probably right that it is not worth troubling to set up Next Steps Agencies in the meantime. On the other hand, if there is no possibility, then their establishment as Agencies would not only be in accordance with policy, but could enhance the ultimate marketability of the units by providing them with a framework and "packaging" which might increase their attractiveness to a purchaser or purchasers.

5. So far as concerns the part of PSA which Mr Ridley does not propose to privatise - the landlord function for Government buildings - this should become a Next Steps agency and there is no reason why consideration of the form of this should not start as soon as the main strategy is agreed.

6. So, subject to first seeing the Chief Secretary's comments, I suggest that the Prime Minister invites Mr Ridley to discuss the legislative aspects with Mr ^{Widdowson} Ridley and, subject to these being satisfactorily resolved, agrees that the proposals should be worked up in detail with user Departments before being circulated for Ministerial clearance, probably in E(A).

7. A draft minute which, if the Prime Minister agrees, you might send to Mr Ridley's office is below.

R.B.

ROBIN BUTLER

25 April 1989

CONFIDENTIAL

DRAFT MINUTE FROM MR TURNBULL TO

SECRETARY OF STATE FOR THE ENVIRONMENT

The Prime Minister has seen your Secretary of State's letter to the Chief Secretary of 13 April and the Chief Secretary's letter of 3 May.

She has also noted and agrees with the Chief Secretary's proposal for a quick appraisal of the alternatives of 1992 privatisation or a period as a Trading Fund with privatisation following later.

delete

2. ~~{Subject to the points made by the Chief Secretary}~~ The Prime Minister would be content for your Secretary of State to explore with the Lord President the prospects for getting the necessary enabling legislation in 1989-90 for privatisation of parts of PSA. If ^{these} ~~this~~ issues can be satisfactorily resolved, the Prime Minister would like details of the proposals to be discussed with at least the main departmental users of PSA services prior to circulation for clearance by Ministers generally, probably through E(A).

3. The Prime Minister notes that there is no mention of the Next Steps initiative in your Secretary of State's letter. She accepts that if early legislation leading to privatisation of the two service activities not later than 1992 can be achieved, then there is little point in seeking to set them up as Agencies inside Government

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The Chief Secretary's
alternative option
was to be
adopted

meanwhile. But if ~~legislation is to be delayed,~~
then consideration should be given to
~~establishing these~~ as Next Steps Agencies in the
meanwhile, as a help to eventual privatisation.
So far as the landlord/ownership activity goes,
she thinks that positive consideration should be
given now to the form in which that could be
established as a Next Steps Agency inside
Government.

4. I am copying this to the Private Secretaries
to the Chief Secretary and Sir Robin Butler.

This being the form of
establishing the two service
corporations

CONFIDENTIAL

CIVIL SERVICE. PSA

Restricting

Pi

6-0-1111-93
7/5/54

RESTRICTED



A A
CONFIDENTIAL

copy
(letter over)
2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

NB for at this stage. 13 April 1989

B/F 1 needs pt. FERR coach
present to 21/4

PLCC

13/4

Dear John

PSA CORPORATE STRATEGY

Since I announced last May that the Property Services Agency's operations would be put on to a commercial footing, officials supported by a team from Price Waterhouse have been working up a corporate strategy for the Agency. A copy is attached: copies have already gone to your officials. Its main recommendations (annexed to the Management Summary) have been endorsed by the Chief Executive and the PSA Board. Christopher Chope and I fully support what is proposed.

You will recall that the Prime Minister agreed in principle prior to my Statement in May 1988 that parts of PSA should be privatised in the longer term. To facilitate this, the Strategy recommends that the Agency's Service businesses - PSA Projects and PSA Building Management should by April 1990 be separated completely from those PSA activities which are likely to remain long term functions of Government, most notably the landlord function for the civil estate. I want to consider further the most appropriate location of these functions, and I will make further proposals to you as soon as possible.

From 1990 PSA Services will be fully exposed to competition from the private sector and to survive and prosper will need to operate very much in commercial terms. The Strategy concentrates on how the more commercial approach can be achieved. PSA Projects will be subject to strong competition from the outset. Market testing by civil clients (who are already untied) has been limited so far but will increase and I am told that MOD's aim is to market test all their new projects from the end of 1989. Competition is not yet so well established for PSA Building Management's services (principally maintenance), but there is no doubt that it will grow fairly quickly. The Businesses' performance in the early years will be critical in securing work thereafter.

To enable PSA Services to compete successfully I believe it will need some significant additional flexibilities particularly -

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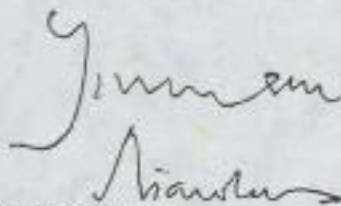
- a. on pay and conditions of service (for example, to pay more where performance and business profitability justify it and less where it does not);
- b. to trade selectively in wider markets outside Government;
- c. to move to net control of running costs;
- d. for an interim period to treat as extraordinary items the costs of change and parallel running of Vote and commercial accounting systems.

My officials have written to yours setting out a more detailed case for most of these changes.

I believe these flexibilities are essential if PSA Services is to trade profitably, particularly as a Government body during a transitional period prior to privatisation. I asked the Chief Executive of PSA what he saw as the fastest practicable timetable for privatising PSA Services, were Ministers to decide on early privatisation. His view is that if PSA Services can be put on to full commercial accounts in April 1991 (which is the target set in the Strategy) privatisation should then be feasible in late 1992. But he emphasised that this was a very demanding target.

One of the main difficulties with such a timetable is securing time for a privatisation bill to avoid the costs of technical redundancy. I am very aware how other legislative demands ruled out a Crown Suppliers bill this year and forced us to delay that privatisation until 1990. A possible way round this problem for PSA Services, if you and colleagues were to agree the principle of early privatisation, would be to expand the scope of the 1989/90 Crown Suppliers' privatisation bill to cover PSA Services as well. While it would make the bill somewhat more controversial it should not be unmanageable and the prize of putting us in a position to privatise PSA Services in 1992 would be substantial. I fear that if we delay legislation until 1991 or 1992 it would risk being squeezed out by higher political priorities immediately prior to or after the next General Election.

If you agree that we should proceed with early privatisation, I will have a word with John Wakeham about the legislative implications. A copy of this letter together with the summary of the Corporate Strategy goes to the Prime Minister and to Sir Robin Butler.



NICHOLAS RIDLEY

Co [redacted] 206
Mr Chope

PROPOSED
CORPORATE STRATEGY
FOR
THE PROPERTY SERVICES AGENCY
MANAGEMENT SUMMARY

15 February 1989

COMMERCIAL IN CONFIDENCE

MANAGEMENT SUMMARY

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MANAGEMENT SUMMARY

CORPORATE STRATEGY

Introduction

- 1 This report is about implementing the decision announced by the Secretary of State on 25 May 1988 that PSA's operations should be put onto a more commercial footing. The report is long because it brings together all the main activities which have a bearing on PSA's commercial future to ensure that they fit within a consistent and properly directed framework. The fact that much of the analysis and many of the recommendations will be familiar and accepted, reflects how much work is already in progress and the extent to which thinking has developed since the Top Management Conference on 15 November. With so much to be done before April 1990 it would be disturbing if many of the messages were novel.

General

- 2 Essential to the business strategy is the early separation of those PSA activities which will remain tied (Civil Ownership and other functions like security and Parliamentary works), from the Property Service functions which from 1990 will be exposed to competition. This report focuses on how to ensure the speedy transition of these service functions into successful competitive businesses, in the medium term within Government and possibly, in the longer term, within the private sector. The strategy for Civil Ownership, to get the best value for money from the Government's civil accommodation assets, will be different in nature from the strategy for the service businesses. It will therefore need to be developed separately and interdepartmentally with Treasury and occupying departments. For that reason it is dealt with only briefly in this report.

The Service Businesses

- 3 For convenience in these reports the two service businesses and supporting functions when taken together are titled the Property Services Business (PSB). It will in the main consist of two distinctly different types of service - new works and maintenance (the core of Project Services and Estates Services). The two areas of work are different in nature in many of the skills they require and in the way those skills are organised. However, the two service businesses will need to be closely co-ordinated, certainly in the short term, and possibly in the longer term. Many of their clients will be shared and will need to be covered by joint marketing operations, and aspects of each service will be strengthened by drawing on the other. Tough decisions will be needed about the best

allocation of the Agency's scarce professional and technical resources between the businesses; both initially and in the light of how they prosper under competition. This suggests that Project and Estates Services should operate as distinct business divisions with which their staff can identify and that they should have their own accounts and commercial targets. But they should operate under the overall control of a small, central management unit which will monitor relative performance and decide on the allocation of scarce personnel and financial resources between the two businesses. This management unit should also contain business support functions such as finance, marketing and the bulk of the present DGDS. The present PSA "Head Office" functions should be devolved as far as possible and in phases to the central management of the PSB and to the line.

- 4 A clear dividing line must be drawn quickly between these two business divisions even though it will need to be reviewed and adjusted over time. That said, there is no single self evident division. The nature of the work and the most efficient management structure should determine where and how work is handled. Having reviewed the options, our view is that Project Services will be best placed to compete if it concentrates on larger projects over about £1m (but with significant variations up and down depending on the nature of the project). Project Services would then have a Professional and Technical staff of about 1200 and be organised in some 8 large design offices on broadly the same lines as the leading multi-disciplinary design consultants.
- 5 On the other side of the division we believe that Estates Services would benefit from a continued responsibility for simpler, smaller new works projects, particularly those related to maintenance. This would constitute a valuable expansion of the market range of their core maintenance services (e.g. refurbishments and extensions) and the presence of a design capability would enhance the quality of their works services across the board. But to be competitive for smaller projects, Estates Services will need to reduce their design costs and organise themselves more on the lines of the small, local design practices with which they will be competing.
- 6 DGDS will add valuable research and development and specialist support to the two businesses not least in the quality assurance field. Apart from some early limited transfers of functions (most notably the Design Standards Office) we have concluded that it would not be economical or practical to divide up DGDS's remaining activities between the service businesses. We have therefore concluded that DGDS should be kept together with the demand for its services and its resource levels determined in the medium term through an internal market. In the short term, in view of the lack of specialist staff, we believe that PSA would make best use of its scarce resources by reducing the levels of some DGDS activities and transferring those staff to direct fee earning work in the service businesses. The extent and nature of such transfers should be determined by the heads of Project and Estates Services and DGDS during the business planning process for 1990.

Business Prospects : Project Services

- 7 Project Services will face considerable and early competitive pressure particularly following MoD's market testing of major new works from December 1989. At present PSA controls the whole market: in the longer term it would be optimistic to assume that PSA will win more than one project out of three in competition. So it is bound to lose market share probably reducing to 40-50% of new projects in the medium term, and to one in three at most in the long term.
- 8 Project management should be a business strength particularly in the defence field and on large, complex programmes. The strengthening of PSA's project management following the Efficiency Scrutiny is very timely. The competitive strength of the Agency's in-house design is more difficult to assess not least because so much of the current work is done by consultants. Over time the right approach will probably be to concentrate in-house resources on profitable, specialist areas and reduce the use of consultants.

Business Prospects : Estates Services

- 9 The bulk of the Estates Services business will be maintenance. Here PSA is likely to face low levels of early competition. MoD, for example, will probably exercise only limited market testing from 1990. And where PSA does face competition there are presently few firms offering the Agency's full range of services. The term maintenance agreements which are intended to be in place from April 1990 for civil and defence customers also reflect the limits which customers are likely to set for early competition.
- 10 This gradual growth of competition will give PSA a few years breathing space to improve its service to customers and get its pricing right. But this is no cause for complacency. Competition will inevitably increase significantly during the medium term and PSA's success at the end of that time will be critically dependent on its performance on the non-market tested work in the intervening period.
- 11 PSA's business strategy in the maintenance area should probably be to play to its strength of planned maintenance with careful marketing to convince its customers that this approach will offer them best value for money. PSA's network of local offices and forms of contract (particularly MTCs) will provide a business advantage, especially for customers looking for service across a large estate.

- 12 The prospects for Estates Surveying Services are more difficult to gauge. Some services will complement and enhance the services offered by the mainstream businesses in the maintenance and projects areas. Others will be marketed on a free standing basis. The whole of the Estates Surveying function will be organised as a separate profit centre.
- 13 The majority of Estates Surveying Services will be provided to Civil Ownership though about 20% of present Estates activities will in future relate to the Departmental Estate. In the medium term it is likely that market testing by Civil Ownership will be limited, but competition will be fierce for work on the Departmental Estate. Perhaps the best business opportunities on the Departmental Estate will be estate rationalisation.

Overseas

- 14 The overseas market is currently worth about £46m (resource costs). If we retained a 50% market share, this would add £20m to turnover. We will need to consider further whether overseas work should be organised as part of one or other business or as a separate unit within PSB.

Action On Costs

- 15 The competitive position of both service businesses will depend to a large extent on reducing costs and this needs to be done quickly.
- 16 There are three requirements:
- (1) A major exercise during 1989 to reduce central and local overheads and through the business planning process to reduce direct costs
 - (2) Treasury agreement in setting prices and a rate of return for the PSB to treat as extraordinary items the costs of change and parallel running so that these do not have to be passed on to customers
 - (3) Wherever possible charging for services which up to now have been provided as a free service (e.g. British Standards).

People

- 17 People are the largest and most important resource in the businesses. Whatever improvements are secured in pay and conditions (see below), the Agency will, for the foreseeable future, continue to be short of staff in key disciplines and areas. It is therefore essential that PSA has clear plans to get the most out of the staff it has through better management, motivation, training and career

development. Allied to that, it will need to make a number of key appointments from the private sector in areas where internal skills are lacking (e.g. marketing and commercial finance). And to provide flexibility to cope with changing levels of business, without automatically putting work out to consultants, it should make more use of period contract appointment.

- 18 AEG numbers will need to be slimmed principally through the overheads reduction exercise. This may be possible to achieve without significant redundancies though there may be problems in particular locations. But it will still leave AEG staff with good career opportunities operating as specialists in the finance, marketing and management information fields as well as in general management and support roles.
- 19 It will be essential over the next year or so for PSA to secure a transfer of control from Treasury/OMCS over the pay, conditions of service and recruitment of its staff. Responsibility for personnel management must be progressively transferred from the PSA centre to the service businesses bringing responsibility for and control of staff resources more into line with the business they generate.
- 20 Communications within PSA are poor, but the cascade conferences, related management effort, and the BDD newsletters are starting to secure an improvement. Good regular two way communication with clear and consistent messages will be essential if the whole process of change, including changes in culture, is to be achieved. It will also be important to maintain the present good, constructive relationship with the Trade Unions.

Business Planning

- 21 Business planning by Project and Estates Services and the central support functions will in future be the main mechanism for analysing markets, allocating resources and setting financial targets. However, the initial business plans for 1989/90 will be different in nature and will concentrate on ways of improving services to customers and on action to get PSA into good shape to face the competition in 1990.
- 22 The business plans for 1990/91 and beyond will, within the framework of this corporate strategy, flesh out the likely levels of business over the medium term and relate this to forecast resource levels.
- 23 These business assumptions are bound to be tentative until customer intentions become clearer, levels of profitability can be properly assessed and PSA builds up a track record of achievement under competition. In the early years the business strategy will need to be reviewed and probably changed significantly through the annual business planning cycles.

Systems And Finance

- 24 The PSB and its divisions will need financial and management systems and procedures to support their commercial operations. The major gaps at present are the lack of an adequate invoicing system, the lack of a timely and locally useful resource costing system, the lack of any financial or management reporting systems geared to commercial needs, and the poor financial reconciliation and control systems.
- 25 Radical improvements in all these systems are necessary to provide the commercial accounting routines needed for the viable operation of the service businesses. The whole organisation needs to become more educated in commercial finance: this is the area within the service businesses where there is the largest skills gap at present. The lack of experience of business management makes developing user requirements for information systems in this area difficult.

Information Technology

- 26 Major improvements are needed in the Information Technology (IT) area. The Agency has no shortage of information but much is of doubtful value, is produced too slowly and fails to focus on the key indicators that management needs to manage the business. If in future more responsibility and accountability is to be devolved to the line, it will be essential for senior management to have much better information to monitor the way those responsibilities are being discharged.
- 27 The priority IT applications to be in place for April 1990 have been identified, the most important having to do with the introduction of improved resource costing and invoicing feeding into the new operating accounts - the so called coarse commercial accounts. Work is proceeding in parallel and should be completed by June 1989 to determine the priority systems required for full commercial accounts and other essential business operational needs from 1991. The new Steering Groups for Project, Estates Services, Finance and Personnel will play a major part in determining these information requirements.
- 28 It is clear that the approved IT infrastructure call-off contract is essential to meet the 1990 and 1991 systems and information requirements and that it should be sufficiently flexible to cope with both the current uncertainties about longer term information requirements and the sort of organisational and accommodation changes likely over the next few years. When the Agency's IT strategy is in place it will give it a significant competitive advantage.

Ownership

- 29 Whilst not ideal, the present proposals by Treasury and PSA for managing the Common User and Departmental estates are workable and an improvement on the current PRS system. But it is essential that they are agreed by departments quickly if the changes are to be made in 1990 in a reasonably ordered manner.
- 30 The detailed objectives for Civil Ownership will not be easy to settle. At one level it will be a tied service function responding to the accommodation requirements of departments and meeting them most economically. At another level, Ownership will have a hugely valuable asset portfolio to manage and it will be essential to do that in a positive, financially informed way, pushing ahead worthwhile estate rationalisations and maximising disposal receipts. If experience over the next few years suggests that the mechanisms for ensuring this positive management are insufficient, there will be a need to persuade Treasury to strengthen the arrangements for central control of the estate when the system is reviewed prior to the move to a Trading Fund.

Making It Happen

- 31 Making all this happen is a huge task. It will be helped by the broad agreement throughout the PSA that the direction set by Ministers is the right one. And judging by the response at the cascade conferences, most staff find the prospect of competing for their work a challenging one, and are confident of their ability to match the private sector, provided they are freed from unnecessary impediments and given some better tools for the job. There is a feeling, however, that progress since 25 May 1988 has been long on talk and decisions on high level changes and short on practical action. If credibility and momentum are to be maintained, it will be vital to secure and announce additional flexibilities, which staff will accept as helping the Agency to compete. Early decisions, for example to enable in-house and out-house resources to be allocated in a more commercial way, on selective trading in wider markets and a move to net control of running costs, will be very important in their own right and psychologically. And in the slightly longer term a more commercial approach to pay and conditions will be vital to help tackle the loss of staff, particularly the good ones. It will also be important to secure early action on the essential organisational changes that need to be made before 1990 - the separation of Ownership and the establishment of the Project and Estates Services businesses. More difficult but essential will be some progress in simplifying and rationalising the operation of procedures and controls.
- 32 In management terms one of the keys to a successful move to payment and untying will be to rigorously distinguish between those actions which must be completed over the next fourteen months and those which can be phased in gradually over a longer period. The list of actions required which follows

attempts to draw such a distinction. PSA's limited resources, particularly of key people, must be directed to these essential priority areas and they must be given the necessary support. The whole action programme will need to be carefully monitored and managed by SMM(D) and the Service Business, Finance and Personnel Boards to ensure that it stays on course. The activities resulting from the programme of change will be in addition to the ongoing work of delivering and improving services to customers. At the same time, action will be underway to reduce costs. This combination makes it essential to review activities and the way they are carried out, in order to release staff resources from lower priority tasks to those that are really essential.

RA Munday
Business Development Directorate

PD Wright
Price Waterhouse
15 February 1989

ACTIONS REQUIRED

- 33 We summarise below the actions required to implement the corporate strategy over the short, medium and long terms. Appropriate references are made to the Chapters and paragraphs of the annexed report (Proposed Corporate Strategy for the Property Services Agency) where they are discussed in more detail. As the individual chapters of the report will also be issued separately, the proposed actions are also repeated within the relevant chapters.
- 34 We define each term as follows :
- (1) Short term : 1989/90
 - (2) Medium term : 1990/93
 - (3) Long term : 1993 and beyond

- CHAPTER 2. BUSINESS STRATEGY

Current Business

Short Term

- 35 Paragraph 11 The top priority must be to reduce costs to competitive levels.
- 36 Paragraph 14 There should be flexibility in priorities and targets between regions and HQ directorates, with meaningful indicators.
- 37 Paragraph 15 There must be better and more consistent time sheet recording by individuals throughout the organisation, as a basis for improved management information.

Business Segmentation

Short Term

- 38 Paragraph 41-42 The Project Services and Estates Services businesses of PSA should be separated to achieve clarity of management and objectives. The businesses should, however, be closely coordinated.

- 39 Paragraphs 44-45 The businesses should be segregated organisationally in such a way as to match their predominant workload as economically as possible. Although the nature of the work will be the major deciding factor, it is necessary to have a size criterion as an indicator. A suitable rule of thumb might be to use a capital cost of £1m, above which works should be undertaken by Project Services, unless the nature of the work dictates otherwise.
- 40 Paragraph 50 PSB must avoid jeopardising the Project Services business; Estates Services should not therefore compete for new works above £1m. If these can be profitably and efficiently handled by Project Services, they should be allocated to this business. In a case which cannot be resolved between the business heads, this should be referred up through one of the Account Executives (see page 19, paragraph 80).

Overseas

Short Term

- 41 Paragraph 56 Both maintenance and new projects overseas should be organised as a whole either as part of one or other business or as a separate unit. At this stage we do not have the full information to suggest firm action.

Objectives

Short And Medium Term

- 42 Paragraph 57 PSB's overall objective should be to provide Property Services on a competitive basis to Government departments and where appropriate, to others.
- 43 Paragraph 58 In the short and medium term, business planning will centre around retaining as high a market share as possible of existing markets. In the medium and longer term, PSB should also look for a limited extension into some new markets where there is a niche that matches particular strengths.
- 44 Paragraph 60-64 Objectives should be agreed covering marketing and client relations and a more commercial management approach (including the key support functions).

Estates Services Phased Strategy

Short Term

- 45 Paragraph 71-82 Markets:
- (1) Although very little work will be untied in 1989/90, prepare for market testing expected for work from 1 April 1990
 - (2) Bid for all work put out to competition by priority clients and bid for other work if resources allow
 - (3) Become selective as the profitability of services for different clients is known
 - (4) Influence clients' market testing intentions
 - (5) Make sure clients are aware of what PSB can offer, and the differential advantages it provides
 - (6) Develop a detailed marketing strategy for the business with advice from the central marketing adviser
 - (7) Begin to develop selling processes, skills and structures
 - (8) Together with the Project Services business, submit a case for selective new markets for appropriate work.
- 46 Paragraph 83-90 Services:
- (1) Maintain the full range of existing services. Market and sell from 1 April 1990, where possible, complete standard packages of services under term contracts of varying lengths
 - (2) Develop plans for service improvements, to be implemented in 1989 and 1990
 - (3) Continue to use consultants where necessary (e.g. because of resource constraints) but try to use them in areas where it will minimise their exposure to clients and specialist knowledge

- (4) Review the role of DEL in different locations in the business in the light of client requirements.

47 Paragraph 91-102 Pricing:

- (1) Develop a pricing strategy for 1990 onwards and provide for clear central control. Price as low as possible, but so that total revenue equals total costs, excluding the costs of change (that is the extraordinary and exceptional costs associated with PSB's transition to a commercial organisation including the costs of running commercial and vote accounts in parallel - refer also to Chapter 4 paragraph 21)
- (2) Develop a breakdown of costs by service, excluding costs of change, so that prices can reflect costs in the absence, generally, of clear market prices
- (3) Standardise prices for similar services to different clients, except for those clearly justified on grounds of regional location or "bulk discount"
- (4) Include provision for re-negotiating prices in contracts.

48 Chapter 2 Internal developments:

- (1) Develop payment systems and ensure staff understand the changes payment will bring
- (2) Start to reduce costs to private sector levels by action on both overheads and direct costs
- (3) Ensure staffing matches prospective workload as far as possible
- (4) Develop marketing arrangements for the business.

Medium Term

- 49 Paragraph 71-82 Markets:
- (1) Segment the market in more detail, identifying those areas where PSB has a competitive advantage
 - (2) Focus on the most important and profitable markets as the extent of market testing increases
 - (3) Bid selectively for work put out to competition
 - (4) Selectively explore the scope for new markets.
- 50 Paragraph 83-90 Services:
- (1) Review and prioritise the range of services provided, focusing on planned preventative maintenance, and make changes as appropriate, including DEL
 - (2) If the market demands it, provide a bespoke service
 - (3) Use consultants only if the required margin can be earned
 - (4) Continue to improve services.
- 51 Paragraph 91-102 Pricing:
- (1) Price so that, service by service, revenue at least covers costs, and the business overall earns any return required by Treasury, after taking account of costs of change. The initial requirement should be for break-even; subsequent rates of return should be agreed in the light of the performance of the business
 - (2) Charge at marginal cost only if, exceptionally, there are resources for which there is no profitable use
 - (3) Charge below cost only with senior management agreement and where there is a clear direct benefit in terms of additional profitable work
 - (4) Allow more flexibility in pricing, within centrally set guidelines, reflecting the development of market prices.

- 52 Chapter 2 Internal developments:
- (1) Refine payment systems and develop staff understanding of their implications
 - (2) Reduce costs to private sector levels
 - (3) Continue to match staff to workload as far as possible
 - (4) Continue to develop marketing arrangements for the business.

Long Term

- 53 Paragraph 71-82 Markets:
- (1) Concentrate on the important and profitable markets
 - (2) Develop new markets in order to reduce dependence on MoD.
- 54 Paragraph 83-90 Services:
- (1) Continue to monitor resource requirements, and aim to use out-house resources only to meet peaks in workload.
- 55 Paragraph 91-102 Pricing:
- (1) Seek to raise prices so as to increase margins.

Project Services Phased Strategy

Short Term

- 56 Paragraph 116-136 Markets:
- (1) Consider bidding for all new work offered, giving emphasis to key clients and larger projects. Balance workload by level of in/and out-house design
 - (2) Keep all existing clients and work where possible
 - (3) Develop a marketing strategy. Subject to advice from the central marketing adviser, recruit a market

manager with private sector experience, and make use of client-orientated project managers

- (4) Submit a case to Ministers to compete for selective new market segments.
- (5) Become selective as the profitability of services for different clients is known
- (6) Influence clients' market testing intentions
- (7) Make sure clients are aware of what PSB can offer, and the differential advantages it provides
- (8) Begin to develop selling processes, skills and structures.

57 Paragraph 137-140 Services:

- (1) Continue to provide the full range of existing services and gain further experience from civil market testing
- (2) Develop packages to emphasise separate services, e.g. briefing/conceptual design, project management, detailed design
- (3) Improve service quality, particularly in information for clients, but also in overall speed and accuracy of costing
- (4) Use consultants where necessary in the light of current in-house resources, but aim to minimise the loss of in-house skills and to avoid competitors gaining experience in key areas such as complex military installations.

58 Paragraph 141 Pricing:

- (1) Bid for work at the cheapest price to cover costs, excluding costs of change as defined for Estates Services
- (2) Charge at marginal cost or below only with senior management agreement and on an exceptional basis
- (3) Develop cost breakdown for services to allow pricing to reflect costs and help market segmentation.

59 Chapter 2

Internal developments:

- (1) Separate more clearly project management and design
- (2) Continue to develop payment systems and ensure staff understand their implications
- (3) Start to reduce costs to private sector levels by rationalisation of the London design offices and other action on both direct and overhead costs.

Medium Term

60 Paragraph 116-136 Markets:

- (1) Develop stronger links with major civil clients (HO, LCD), if market experience confirms viability
- (2) Reduce MoD dependence, if possible, partly by selective expansion into new markets and seeking opportunities to do more work for civil clients
- (3) Identify/nurture most profitable customers/services. Conversely, withdraw from areas of low profitability unless there are exceptional reasons to the contrary.

61 Paragraph 137-140 Services:

- (1) Refine service packages to emphasise separate services
- (2) If resources are constrained, focus on conceptual design, other 'up front' stages of projects and on the higher value design elements. Be ready to subcontract less complex detailed design
- (3) Give lower priority to relatively uncompetitive areas such as standard office accommodation unless profitable.

62 Paragraph 141 Pricing:

- (1) Price so that, service by service, revenue at least covers costs, and the business overall earns any return required by Treasury, after taking account of costs of change. The initial requirement should be for break-even; subsequent rates of return should be agreed in the light of the performance of the business
- (2) Charge at marginal cost only if, exceptionally, there are resources for which there is no profitable use
- (3) Charge below cost only with senior management agreement and where there is a clear direct benefit in terms of additional profitable work
- (4) Allow more flexibility in pricing, within centrally set guidelines, reflecting the development of market prices.

63 Chapter 2 Internal developments:

- (1) Ensure staffing matches prospective work-load as far as possible, in the light of the use of consultants. Continue to develop the policy of using consultants to supplement key skills which should be retained in-house.

Long Term

64 Paragraph 116-140 Markets and Services:

- (1) Concentrate on the important and profitable markets
- (2) Develop new markets in order to reduce dependence on MoD
- (3) Develop joint ventures with private sector consultancies/contractors.

Corporate Image

Short Term

- 65 Paragraphs 152-155 PSB needs to develop and communicate a corporate image. Images should be developed for the PSB itself and the two service businesses based on understanding of clients, flexibility and value for money.

Overall Organisation Structure

Short And Medium Term

- 66 Paragraph 156-157 PSA in the future should be organised so that there is a clear separation of the two service businesses from Ownership and the other governmental activities not subject to competition.
- 67 Paragraph 157 The two service businesses, Project Services and Estates Services, will, in the medium term, have decentralised responsibility for key functions such as Finance and Accounting, Marketing, Personnel and parts of Information Technology.
- 68 Paragraph 158 There will be a need for central support functions for the service businesses to develop overall policy in specific areas, to support the businesses and to decide on the allocation of financial and service personnel resources.
- 69 Paragraph 161 The finance and personnel functions for Ownership and other tied governmental activities should continue to be provided by the PEO and PFO whose remaining functions may be merged in the medium term.
- 70 Paragraph 166, 170 Private sector appointments should be made in finance and marketing for the PSB, the former executive, the latter, initially at least, advisory.
- 71 Paragraph 169 PSA should urgently decide the most effective top structure for the overall control and co-ordination of the service businesses and the major programme of change ahead.
- 72 Paragraph 170-173 Appoint a marketing advisor to bring marketing expertise to the PSB and a marketing manager within each business, who will be responsible for marketing and selling.

Organisation Of Project Services

- 73 Paragraph 174-175 Project Services should be organised around a limited number of design offices, say around eight, each with a staff of 150.
- 74 Paragraph 175 Four design offices might be located in London, one in Scotland, and one in the Midlands/Cambridge, one in the north of England and one in Wales/the South West. Early rationalisation of the existing facilities in the London area will be necessary.
- 75 Paragraph 176 The local office directors for Project Services should report directly to the Managing Director of Project Services.

Organisation Of Estates Services

- 76 Paragraph 178 In the short-term, the present regional structure should be retained until there is a sharper picture of market segments, and of client and competitor intentions.
- 77 Paragraph 179 The size of Estates Services design offices will be much smaller than Project Services offices. It may be desirable to devolve more Estates Services design capacity from Regional HQ to a more local level.
- 78 Paragraph 180 Estates Surveying should be organised as part of Estates Services, but measured as a separate profit centre.
- 79 Paragraph 182-83 No short term changes should be made to group and district organisations until further experience has been gained from market experience, but there will probably be a need to enhance the role of groups, and review the number and functions of Regions.

Client Liaison

- 80 Paragraph 172 PSB should appoint managers designated to co-ordinate services to particular clients, reporting to both business heads. In addition, there should be a few Account Executives at HQ (about 6) to cover genuine cross business issues. The reporting line of these Account Executives should be through the Marketing Advisor.

DGDS

- 81 Paragraph 185 DGDS should remain as a smaller central professional service organisation, managed as a profit centre, selling its services to both Project Services and Estates Services in specialist areas where it is not economic to duplicate resources and PSB needs to concentrate its skills. The size and structure of DGDS should be reviewed in the 1989 Business Planning process with the aim of the early transfer of a significant number of staff to the service businesses.

Overhead Cost Management

- 82 Paragraphs 186, 188 To achieve cost competitiveness, PSB has to reduce its unit costs by 20-30%. The implementation of a cost reduction programme will be a major task and priority during 1989.

- CHAPTER 3. A STRATEGY FOR PERSONNEL

Priorities

- 83 Many of the actions need to start now but will continue over the medium and longer term. In summary the priorities are:
- Paragraphs 59 & 65 (1) Develop a manpower plan, based on better information and related to business needs, closely linked to the business planning process and overhead cost management initiative
- Paragraphs 74,82-85 (2) Define and secure the flexibilities required in personnel systems over pay and recruitment
- Paragraphs 100-102 (3) Undertake a thorough analysis of training needs, coupled with an immediate response to urgent priorities
- Paragraphs 107-108 (4) Develop a fresh and managed approach to communications

- Paragraphs 111-114 (5) Decentralise personnel work as fully as possible to the service businesses and progressively to line managers, with appropriate specialist support.

Detailed Actions

General

- 84 Paragraphs 46-47 In the medium to longer term "people management" should rest more firmly with line management.
- 85 Paragraph 48 PSA requires a coordinated implementation plan which pulls together all of the elements of personnel strategy, sets priorities and phases initiatives.

Reducing Costs

- 86 Paragraph 58 PSA should estimate the staff numbers and mix required for future business needs. An overhead cost reduction exercise should be started immediately.
- 87 Paragraph 58 A skills audit should be undertaken to identify the skills and experience that currently exist and what is required in future. The exercise would be most effective if undertaken by line managers according to a consistent and positive plan.
- 88 Paragraph 58 There should be a review of current transfer arrangements including those with other government departments as well as retirement and redundancy agreements which may well be unsuited to PSA's needs.
- 89 Paragraph 58 A flexible policy on retirement age should be established, allowing late and early retirement.

Information Requirements

- 90 Paragraphs 63-65 PSA should set up its own manpower information system which is simple, interactive, locally based and maintained, and capable of providing some information for central purposes.

Relocation

- 91 Paragraphs 66-68 Staff are already widely dispersed and major early moves would be very disruptive at a critical time. But the case for dispersing several hundred staff from the South East in the medium term should be examined in the business planning process and the review of the London and design offices.

Recruitment

- 92 Paragraphs 72-73 PSA should seek the agreement of the Treasury and the Civil Service Commission for full delegated authority to handle the advertising and recruitment for all grades up to and including Grade 7, and graduate recruitment.
- 93 Paragraphs 72-74 In preparation for this change a number of initiatives are needed:
- (1) Develop a manpower plan, short and long term (as recommended earlier). This should include succession plans for senior grades
 - (2) Ensure that PSA develops the necessary skills and resources internally to handle recruitment activities. This could well represent an additional cost
 - (3) Develop better manpower information systems (as recommended earlier)
 - (4) If possible, ensure that action on this front is integrated with action on pay, etc. Otherwise recruitment costs might be incurred to little effect
 - (5) Examine current procedures to establish what flexibilities exist within current arrangements. For example, whether the scope and scale of present security clearance procedures is always necessary.

Pay And Grading

- 94 Paragraphs 81-85 PSA should press for speedy resolution of outstanding applicants for Special and Local Pay Additions and pay migrations.

- 95 Paragraphs 81-85 PSA should begin revising grading and salary structures.
- 96 Paragraphs 81, 85-88 Action should be taken to link pay to performance of organisational units.
- 97 Paragraphs 88-89 Incentives for key staff should be considered further. In the medium term PSA should tailor the performance appraisal system to its specific requirements.
- 98 Paragraph 90 In the medium term, PSA should tailor the performance appraisal system to its specific requirements.

Promotion And Career Development

- 99 Paragraph 92(4) A fast track promotion and career development system should be established for professional staff to enable them to move into senior management or specialist professional roles.
- 100 Paragraph 92(4) PSA should identify administrators at HEO and SEO level who have the potential to develop commercial skills and who are likely to progress beyond Grade 7.
- 101 Paragraph 92(4) Areas of specialism and advancement for AEG staff should be defined which are relevant to business needs, e.g. finance, marketing, personnel.
- 102 Paragraph 92 Where appropriate, use of special boards for promotion to particular jobs or groups of jobs, and simplified procedures for trawling should be established.
- 103 Paragraph 63-64 92-93(6) External recruitments should be used on a small scale to bring new blood into the organisation.
- 104 Paragraphs 63-64, 92 There should be more use of period contracts to meet urgent short term needs and balance resources.

Training

- 105 Paragraphs 97-99 In addition to all the work being done on technical training a fresh training needs analysis and training strategy is required to ensure management training is targeted more effectively. The recently formed training development project team has this in hand for March 1989. The key priorities are business planning, customer care, commercial

skills, and business management. Training should, as far as possible, be held at the work place.

- 106 Paragraph 97-99, 102 PSA's training policy should be communicated clearly to staff.

Communications

- 107 Paragraphs 105-107 A communication policy statement should be made widely known so that all managers and staff are fully aware of their responsibilities.
- 108 Paragraphs 105-107 It will be important to stay in close touch with the trade unions in implementing the programme of change.
- 109 Paragraphs 105-107 Improved communications will require a substantial management effort.
- 110 Paragraphs 105-107 Top management should define the core messages to be conveyed.

Organisation

- 111 Paragraphs 110-114 If the focus of decision-taking is to shift to the main business units then responsibilities for personnel work should move accordingly. Further devolution down the line within the businesses should be considered for the longer term.
- 112 Paragraphs 110-114 Decisions on decentralisation of personnel should not be finalised until the Managing Directors of the service businesses have focused on them.
- 113 Paragraphs 111-114 We believe that more personnel administrators should be professionally qualified.
- 114 Paragraphs 111-114 The business personnel heads should be among the first people appointed within the new business structures so that they can help to build them.
- 115 Paragraphs 111-114 The Estates Services and Project Services businesses should each have their own personnel function, probably headed at Grade 5 level and reporting in line to the business Managing Directors.

- 116 Paragraphs 111-114 The heads of business personnel functions should retain a strong functional link to the PEO and be involved closely in the formation of general personnel policies for PSA.
- 117 Paragraphs 111-116 At PSB level there may be a case for a small central personnel unit straddling the two businesses as well as DGDS and other central services. But a Group Director of Personnel is unlikely to be necessary.
- 118 Paragraphs 111-114 The PEO would retain a policy unit which should be kept as small as possible.
- 119 Paragraphs 123-124 Strategy on industrial staff needs examination. It should be based on a selective business view of potentially profitable activities, taking account of client views.

CHAPTER 4. FINANCIAL MANAGEMENT STRATEGY

Objectives

Short Term

- 120 Paragraphs 4-14 Implement the following short term objectives:
- (1) Develop and implement for operation from 1 April 1989 some basic commercial management tools to help managers prepare for payment and untying
 - (2) By 1 April 1989 develop and apply, as far as possible, appropriate commercial accounting policies, in accordance with best accounting practice and then agree them with Treasury during 1989
 - (3) Develop interim measures of income for use in operating accounts from 1 April 1989
 - (4) Implement for operation from 1 April 1989 control arrangements to support the application of flexible gross running cost limits
 - (5) By 1 April 1989 agree with the Treasury a revised vote structure for PSA's Civil Ownership and professional services businesses for 1990/91

- (6) By 30 June 1989 develop and obtain Treasury agreement to the control arrangements to support the introduction of net running cost control for PSB with effect from 1 April 1990
- (7) During 1989 ensure cost savings are identified and taken into account in resource cost budgets and financial objectives for 1990/91
- (8) During 1989/90 ascertain the financial position of the businesses in commercial terms based on operating accounts in 1989/90 and set the financial objectives for 1990/91 in the light of performance and market comparisons
- (9) Develop during 1989/90 and implement with effect from 1 April 1990, coarse commercial accounts including relevant pricing policies to support the businesses under a full payment and untying regime
- (10) Start to develop the core strategic commercial accounting systems for implementation by 1 April 1991, to the extent that requirements cannot be met by 1 April 1990.

Medium Term

121 Paragraphs 4-14

Aim to achieve the following objectives:

- (1) Implement all agreed commercial accounting policies by 1 April 1991 if possible, or 1 April 1992 at latest
- (2) Determine, propose and agree with the Treasury appropriate capital structure, financing arrangements and financial objectives for each of the businesses by 1 April 1991 for final implementation on Trading Fund vesting day
- (3) Refine pricing policies with and for each business
- (4) To the extent that requirements cannot be met by 1 April 1990, design, develop and implement in parallel by 1 April 1991 a set of core strategic systems, controls and revised manual procedures to produce auditable accounts and support the successful

operation of the businesses as Trading Funds from 1 April 1992 (possibly from April 1993).

Costs Of Restructuring

- 122 Paragraphs 20-21 All exceptional restructuring costs, and the costs of running parallel commercial and vote accounting systems, should be identified separately and a surplus or deficit on the Agency's operating accounts struck before these costs are taken into account, and before setting prices to customers.

Organisation

- 123 Paragraph 22-23 In the medium term the reporting line for the existing internal audit should be to the PFO, but consideration should be given to the appropriate form of internal audit for the commercial businesses.
- 124 Paragraph 24 There should be an external appointment of a Group Financial Controller. In the medium term, once a commercial organisation is established, a Director of Finance should be appointed to be an executive member of the PSB board.
- 125 Paragraph 24 The finance responsibilities at the centre of the service businesses should be devolved over time to the respective businesses, but the PSB board will have a continuing role in formulating financial policy, setting financial goals and giving overall financial direction.
- 126 Paragraph 26 Each of the commercial businesses should make an external appointment of a Business Financial Controller (a senior appointment) with line responsibility to the head of the business, and functional responsibility to the Group Financial Controller.
- 127 Paragraph 26-27 Each of the Business Financial Controllers will require accountancy support within the distributed/regional structure and initially this will be at profit centre level.
- 128 Paragraph 28 Over the next three years the number of accountants in PSA will probably need to be doubled.

Profit Centres

- 129 Paragraph 31-32 The Project and Estates Services businesses should be set up as separate profit centres. Lower level profit centres during 1989/90 should be as follows:
- Project Services - Directorates and divisions
- Estates Services - Regions and Groups
- Below these levels e.g. DWO's in Estates Services will be cost centres in the short term with reconsideration in the medium term.
- 130 Paragraph 33 Other income generating functions including DGDS should also be established as profit centres.
- 131 Paragraph 33 Central services will be established initially as cost centres and the cost of their activities will either be subject to the disciplines of an internal market and charged on the basis of usage or apportioned. Consideration should be given to establishing internal profit centres in the medium term.

Financial Control Framework

- 132 Paragraph 36 During the course of 1989/90 performance will be monitored monthly at all management levels through workload and resource cost budgeting, operating statements and quarterly business operating accounts.

Business Plans

- 133 Paragraph 37 A start should be made on business planning during 1989/90, with a limited plan, emphasising key actions to get PSA in shape to face competition.
- 134 Paragraph 39 For 1990/91 a comprehensive business planning process will be adopted commencing in March 1989. This will be based upon bottom-up estimates (from profit centres) of expected workload assessed income and associated resources related to the new business organisation effective from 1 April 1990.

Workload Performance Indicators

- 135 Paragraph 40-44 From 1 April 1989 a series of performance indicators will be used as a means of linking resource costs to agreed workload factors. Target ratios will be set and monitored by line managers and central finance through operating statements designed for the purpose.

Operating Accounts

- 136 Paragraph 45-49,
53-54 The operating accounts being introduced for the bulk of PSA's service retrospectively for 1987/88 (as a whole) and for each quarter of 1988/89 and 1989/90 should be used to:
- (1) Enable line managers to begin looking at their operations in a more commercial way as a means of generating income or measuring notional income which must at least cover their costs and make an appropriate contribution towards central overheads
 - (2) Assist in assessing the viability of the component parts of the businesses, developing pricing policies, identifying areas of excessive cost, and considering the need for management action
 - (3) Identify gaps or inconsistencies in the data available for calculating income and expenditure so that they can be filled and improve the methodology for processing the data.
- 137 Paragraphs 50-51 Changes will need to be made to the costing systems and the diary recording on which they are based with a target date of 1 April 1989. The changes will include cost recording individual projects down to a value of £25,000 instead of £100,000, recording costs of work below £25,000 on the PSA managed civil estate against customer department instead of one block PRS code, the separate costing of client and government services, and recording costs of Estates services work against each type of work package. The extension of diary recording will need to be discussed with the Trade Unions.

Corporate Reporting

- 138 Paragraph 52 A corporate reporting package on the PSB's commercial performance should be developed for staged implementation during 1989/90 and the medium term.

Coarse Commercial Accounts

Medium And Long Term

- 139 Paragraph 55 The key areas of financial management change needed to support payment and untying from 1 April 1990 are:
- (1) Income and expenditure accounts for the Agency as a whole and for each profit centre which will be the basis of reporting on financial performance
 - (2) Pricing arrangements to provide a basis of charging for services
 - (3) Modified invoicing and bill paying procedures
 - (4) Identification of assets and liabilities with initial emphasis on debtors and creditors
 - (5) Project and task accounts to enable control over individual project or service areas
 - (6) Improved resource costing at local level and more detailed diary recording.

Financial Systems

Medium Term

- 140 Paragraph 57-60 The user requirements for core strategic financial systems for full commercial accounting are required quickly so that system development can start in May 1989, for implementation by 1 April 1991 for a Trading Fund vesting day of April 1992 (if possible), to the extent that requirements cannot be met by 1 April 1990.

- 141 Paragraph 57-60 To enable the core financial systems to be in place by 1 April 1991 the following actions will be necessary:
- (1) Establish a project team and terms of reference
 - (2) Review the systems needs in the light of the emerging business strategy
 - (3) Confirm the priority systems to support a fully auditable set of accounts
 - (4) Identify priority operating needs of the businesses
 - (5) Prepare the first user requirements by 1 May 1989 to enable DITMOS to progress the key financial strategic systems.

Resources

- 142 Paragraph 65 On current estimates a minimum central core of 9 staff and 4 consultants in BDD (FM) will be needed to develop the requirements for interim and strategic systems and commercial accounting policies, to oversee their IT implementation, to deal with Trading Fund and other financial policy issues, to define financial training needs and specify changes in financial controls and manual procedures.

Trading Fund

- 143 Paragraph 66 The objective of achieving Trading Fund vesting day on 1 April 1992 be confirmed, subject to final validation by September 1991.

CHAPTER 5 - IT STRATEGY

Detailed Actions

Short Term

- 144 Paragraph 68 In the short term, leading up to 1 April 1990, the following action is required:
- (1) The high priority business requirement is for costing systems to analyse resource usage (for all businesses)
 - (2) This could be achieved for Estates Services by the development of a simple PC based diary sheet recording system and the installation of the system at DWO, Estates offices and Group offices. The feasibility of implementing a similar system for Project Services should also be examined.
 - (3) The high priority business requirement for overall project planning is to decide whether by 1 April 1990 the use of the PERTMASTER planning package can and should be extended to all locations where projects are managed
 - (4) The high priority business requirement to monitor and control work is addressed by 1 April 1990. Potentially this could be achieved by implementing the Phase 1 applications developed as part of the THESIS project on the IT Infrastructure linked to Group offices
 - (5) The requirements for coarse accounting systems are refined and prioritised for IT development
 - (6) Any additional requirements for core strategic commercial accounting systems, beyond those that can be implemented by 1 April 1990, and other key areas are specified by May 1989 with a view to development by April 1991.

Medium And Long Term

- 145 Paragraph 37 Replacement of WIS should be completed by 1991.

- 146 Paragraph 52 In order to ensure close links between DITMOS and the priority development of commercial accounting systems, DITMOS should report to the PFO. In the medium term, once Ownership and the PSB are split DITMOS should be divided on a similar basis.
- 147 Paragraph 73 We recommend that a set of service level agreements be negotiated between DITMOS and the businesses as a basis for DITMOS charging the business for IT services.
- 148 Paragraph 74 In the medium term, the feasibility and practicality of devolving DITMOS to the service businesses should be examined for possible implementation in the longer term.

Implementation Plan

- 149 Paragraph 75 We recommend that the following actions are taken:
- (1) The work on overall business priorities is completed
 - (2) The required application systems for the short term IT strategy are compared with those systems already being developed for Project Services and Estates Services Phase 1 and any additional essential needs are identified
 - (3) The user requirements for short term strategy systems are defined, or reviewed as appropriate, and the effort required to fully implement each system estimated
 - (4) A detailed implementation plan is developed giving priority to short term strategic systems and identifying short falls in technical specialists and user representatives required.



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My ref:
Your ref:

Dominic Morris Esq
Private Secretary to the
Prime Minister
10 Downing Street
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30 November 1988

Handwritten notes:
AAS
RAB
20 see x + y
Jm

Dear Dominic

SPEECH BY MR CHOPE ON THE FUTURE OF PSA: 1 DECEMBER

Tomorrow (1 December) lunchtime Mr Chope will be speaking at an RIBA Seminar. His subject will be the 'Future of the Property Services Agency' (PSA). I attach a copy of his speech. It amplifies a Statement made in the House by Mr Ridley on 25 May (copy also attached) but does not say anything which was not implicit in that Statement or the subsequent questioning. However, in view of the amount of public interest in the Agency's future, and in particular in the possibility of ultimate privatisation of 2 of its 3 business segments, it is possible that this matter could be raised at Prime Minister's Questions tomorrow afternoon or subsequently. The Prime Minister will recall that PSA is to be split into 3 businesses: Project Services and Estate Services (accounting for the bulk of PSA staff engaged on the design and management of major projects or maintenance) with Common Ownership (the landlord function for the Government Estate) as the 3rd business. The first 2 businesses may well prove to be suitable candidates for privatisation, although it is extremely hard to envisage how the Common Ownership business could be successfully privatised.

The section in Mr Chope's speech dealing with the possibility of privatisation of the project services and estate services businesses has been agreed by the Financial Secretary to the Treasury. If this matter is raised, the line to take should be:

As far as the 2 service businesses - Project Services and Estate Services - are concerned, privatisation is an obvious option which the Government will wish to consider very carefully. It cannot, though, be an immediate option because the Agency has to be restructured into commercial businesses and start operating as such.

If pressed on the future of the 3rd PSA business, Common Ownership, the Prime Minister can say that she cannot envisage this business being a suitable candidate for privatisation.

/ A copy of this letter goes to Susan Frost in Norman Lamont's office.

Yours

David

DAVID MOTTERSHEAD
Private Secretary

"BUILDING"/RIBA SEMINAR: 1 DECEMBER 1988

1. Thank you for inviting me to speak this morning to your seminar. I recognise that the essential topic being debated is the future workload of the construction industry. Many of you will be aware that the Government is itself the largest single client of the industry: a recent analysis showed that some 6% of the industry's output was dedicated to Government projects. Hitherto PSA has been the focus of that client/industry relationship. So I make no apology for taking a good deal of my time today so as to describe our plans and hopes for the PSA of the future.

2. But first let me speak briefly on more general matters. I should like to draw out the overall philosophy which underlies both the Government's relationship to your industry and our management of Government generally - and, as part of that management, our proposals for the Property Services Agency. I should then like to set out how we see the PSA developing and to leave with you some suggestions about aspects of that development which may be of particular interest to you.

3. Let me start by touching on important areas of common interest to the Government and the construction industry. I do not lay claim to a detailed grasp of all the facts and figures about your performance. But the key achievements are impressive and are a measure of the major contribution which the construction industry makes to the economy. Output in 1987 was up nearly 8% in real terms, almost double the rate of increase in national output as a whole. The forecasts for this year and the next predict a further growth, with a real growth in output for the first part of

1988 already running above 10%. Private commercial new orders are at an all time record. And within these, there are major infrastructure projects coming on stream which would traditionally have been paid for from the public purse, but which are now wholly financed from the private sector: the Channel Tunnel where £6 billion has been raised without any Government subsidy or guarantee; the new Dartford Bridge where we chose private finance because it offered the best overall benefits to the community; and our proposals for the private sector to be given the opportunity to participate in the design, construction, financing and operation of the second Severn Bridge. And we foresee that the continuing growth in investment in water and sewerage, £1200M this year with next year's provision 20 per cent higher, will be financed readily and efficiently by the private sector once our proposals for privatising the water authorities have been put into effect a year from now.

4. These achievements do not mean that life is easy for the construction industry. You will face testing challenges over the next few years. You have to manage the problems of growth which your prospects entail. Without an increase in productivity it is estimated that an extra one million workers will be needed by the end of the century. They do not exist. For every 10 school leavers today there will be only 7 by the year 2001. So you need to start taking steps now to enhance productivity even further.

5. In the medium term, you have to gear up for the single European market at the end of 1992 and to ensure that the construction industry's voice is heard where common European standards are under discussion. But the single market is likely to offer you opportunities which outweigh the difficulties.

6. More immediately, there have been suggestions that overheating could occur if there is a lack of capacity to meet demand. The result could be a bidding up of the prices of building labour and materials. In some areas there have been some such bidding up this year, most notably where Docklands development has its impact. But the latest indications are not of general overheating. Our view is that there is still some significant spare capacity in the industry as you begin to draw more on previously unemployed and under-utilised resources. And your management record to date affords confidence that you can achieve increased output from a given quantum of supply.

7. Prices in construction have been rising nationally, and rising more than general inflation. I fully understand that part of this has been a long-postponed rebuilding of profit margins. But remember, you will need the additional profits to invest for the increased productivity. Nor can you count on a continued flow of rising real profits. This Government stands very firm indeed against tolerating inflation, and I know that many of you will be feeling the impact of higher interest rates in both higher costs and a tailing off of new orders. Tempted as some of you are in the most pressed parts of the industry, the last thing the construction industry can afford to do is to bid up the general price of labour against itself.

8. I recognise there are local problems, for example shortages of bricklayers and other skilled labour in the South East and South. But these are essentially short-term. Trends in material prices suggest that the overall pressure of demand has not reached acute levels. The spectre of sustained overheating is not threatening.

8. From that outline of issues where Government and the construction industry interact, I hope that our respective roles emerge. It is for Government to set the right economic climate, and keep a close eye on changes to it. But the Government should go no further and should actively seek to disengage from areas where the private sector can operate as well or better. This policy is based around the belief that the customer is king, and in order to be king has to have choice. The producer should be a servant of the consumer, not the other way round. And when that is the case the producer is under the maximum incentive to release entrepreneurial skills, initiative and energy.

9. Over the past 9½ years, the same thinking has informed the major policy steps which we have taken as a Government - for example, in selling council houses to tenants, or in returning nationalised industries to private ownership. It has also been the basis of our drive to streamline the actual operation of Government. Thus we have pursued contractorisation of Government services wherever this is justifiable on value for money grounds. And we have set in motion the Financial Management Initiative. This aims to give individual Government Departments control, as far as practicable, over their business operations. It reflects our commitment to the belief that better decisions are taken when the person making them also has the financial responsibility which flows from that decision.

10. I should like to turn from Government in general to the PSA in particular. Over the past few years, under Sir Gordon Manzie's leadership, the PSA has already become more commercial in outlook. But we have all been aware of just how much further we have to go before we become a business competing for work from our customers, reaping the rewards for our success but also the consequences for our failures. So most people were probably not surprised when

Nicholas Ridley last summer, on 25 May, made to the House of Commons a statement about the future of PSA which was a logical extension of policies already applied elsewhere in Government. The main features of his announcement were as follows.

11. From 1 April 1990 all Government Departments will pay PSA for services provided, and will have the freedom to shop elsewhere - that is, they will be untied. From 1 April 1990 as well, the PSA will be restructured into three main business areas. One of these will be primarily concerned with managing the Government's central property portfolio. The others will be service businesses responsible for design and management of new construction on the one hand and maintenance and estate surveying on the other. No later than 1 April 1993, PSA will be put onto a Trading Fund basis, and will thus no longer rely on monies voted annually by Parliament to sustain the majority of its activities. If possible, we should like to shorten this timetable. But if we are realistic, we must recognise that creation of commercial accounts to underpin the Trading Fund, depending as it does on considerable new investment in Information Technology systems, is not an overnight job.

12. There are three particular aspects of Nicholas Ridley's statement which are worth commenting on further. The first concerns management of the central property portfolio. In line with the Financial Management Initiative, we see individual Departments taking over substantial responsibility for much of the property which they occupy. But as the all-part Select Committee on the Environment recognised in a report on PSA in 1987, PSA should be allowed to manage the central portfolio. The object here is for

Departments to get the accommodation they need - but for PSA at the same time to provide positive estate management of a major property resource so as to keep to costs across Government as whole to a minimum. This will require a degree of commercial freedom for PSA. But the task will by definition remain an activity of Government alongside other accommodation functions which Government must keep (for example, for security reasons).

13. Secondly, management of the central property portfolio will call for supply of services which the other PSA businesses can provide. But they will not be sole suppliers. The property management business will therefore be untied from the service business like any other Government Department.

14. Thirdly, the move to a Trading Fund and the freedom from Vote Accounting is something that I have often heard people in PSA say that they would like. Now we are going to have that freedom. That is likely to mean pressure for further freedoms - on pay and conditions, investment decisions and so on. As far as the two service businesses are concerned, privatisation is an obvious option which the Government will wish to consider very carefully.

15. Privatisation cannot be an immediate option because we have to be restructured into commercial businesses and start operating as such. ^{Although we cannot take a /-ct.} ~~But~~ ~~from~~ decision ~~on whether or not to privatise cannot be taken until then.~~ But, one major advantage of privatisation for PSA is that it would give the Agency unfettered scope to sell its expertise and services to the private sector both at home and abroad. That would be a great opportunity for the Agency to demonstrate its quality and its capacity to compete with the private sector across the board.

16. As we all know, PSA has had its problems. The dishonesty some years ago of a handful of employees damaged the PSA's reputation, and to some extent the confidence and morale of staff. Because the wheels of justice take so long to turn, these same malpractices have been repeatedly brought into the news over a period of years. Our task during this period has been to put in place the management

systems to deal with the problem. Although all our procedures will have to be reviewed with a critical eye, it is only right to recognise that taxpayer's money must be safeguarded. The requirements of public accountability in this field must therefore remain over-riding.

18. That said, my own belief in PSA's future is not based solely on the efficiency of the framework we are creating, strong though that is. In the first place, as other Departments face the prospect of fuller responsibilities, there is a growing appreciation of what PSA has provided and can continue to provide. This should stand PSA in good stead as it moves into a competitive era.

19. Secondly, PSA has acquired among its staff an unsurpassed expertise that in certain fields seems irreplaceable and a dedication in the best tradition of service to the community. I think, for example, of the spontaneous and largely unheralded extra effort given a year ago to cope with the effects of storm damage.

20. And thirdly, we can point to solid achievements demonstrating PSA's reputation as a centre of excellence. Our new build and refurbishment programme are admired by many. The Prince of Wales was not only very pleased with the work at Fort George, he has also expressed pleasure at Richmond House. And we hope that in due course he will express positive views about a number of other projects. We have, for example, every reason to be proud of the recently completed restoration of the Palm House at Kew and of the refurbishment of the Foreign and Commonwealth Office building in the heart of London. I myself saw only last week the award winning new court house in Truro. These are,

in a sense, on the glamour side. But on the less glamorous side of our work; for example, energy efficiency, we are getting plaudits too. I was at a presentation the other day when Roger Freeman, the Minister at Defence who deals with Energy Efficiency, went out of his way to pay tribute to a number of individual PSA employees who have found ways of making massive energy savings for individual parts of the MOD. Again on routine maintenance, a number of people are coming forward and saying what a fine job our organisation does.

20. In highlighting what I see as PSA's trump cards, I ought also to make clear that I do not subscribe to the pessimistic theory about PSA's short-term prospects in the run-up to a Trading Fund. Although commercial discipline will be bracing, the fact that other Government Departments will also be learning how to act in market place will afford a breathing space to PSA so long as they do not assume that it will last for more than a few years. But as we go down the commercial road, we have to ensure that we are competing on fair and equal terms and that during the process of adjusting from where we are now, to where we want to get to, PSA is not treated unfairly. It will be one of my Ministerial tasks during this period.

21. In my view untying must not be a mere one-way process. I pose the question why shouldn't we be able to compete for the work of other Government Departments (and perhaps wider markets too?) which they currently do in-house? I hope from what I have said it is clear that there is a strong

commitment by the Government and by Ministers to the future of the PSA. And I am confident it will be a successful commercial future.

23. I have no doubt that the construction industry will want to keep abreast of the commercial development of one of its major clients. But it seems to me that your natural interest in your future workload should guide you towards a detailed rather than a distinct interest. The PSA has to resolve over the next 18 months and beyond a number of key questions which could directly affect you.

24. Let me put to you just some of the key questions which we have to tackle in the near future. The RIBA sponsors of today's seminar will be especially interested in the future design role of the PSA. How far should PSA concentrate on project management rather than on design? Can the two realistically be separated. Is it necessary to have a pool of design staff in order to groom project managers?

25. Will the shift of responsibilities to individual Departments have any marked impact on the total amount of construction work commissioned by Government. Within the overall envelope of public expenditure, will accommodation assume a greater or lesser significance as much of the funding passes from PSA to Departments?

26. What standards on accommodation, or what guidance on standards, should be imposed or offered respectively across

Government? In the light of this, what adaptations will the construction industry have to make in their dealings with the Government as client?

27. The list is far from exhaustive. Even so, at this stage, I have no answers to suggest. But the questions seem not only for you as representatives of the construction

industry as a whole but in some cases immediately relevant to the individual firm that make up your membership.

28. We in PSA pride ourselves on being the largest design and construction organisation in the country, with our £3bn turn-over, and I hope that soon we will be able to prove that we are the best in delivering to price and quality. We will not merely say that we are the largest, we will say with confidence, and with evidence, that we are the best. It will, of course, be for the construction industry to establish the pattern of its dealings with Government on future workload. I should like to believe, however, that I have shown this morning why the PSA should feature prominently as this pattern develops.



PA

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J G Ashcroft Esq
Ministry of Defence
Main Building
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28 June 1988

Dear Mr Ashcroft,

MAJOR CAPITAL PROJECTS: UNTYING FROM PSA

As you will be aware with effect from 1 April this year Departments have the opportunity to test the market and use agents other than PSA on Part I major works projects. The Secretary of State for the Environment also announced on 25 May plans for extending payment and untying to other PSA services by April 1990.

The attached paper however gives guidance only on the arrangements for untying on Part I Major New Works. The paper has been discussed and agreed by the Inter-Departmental Committee (IDC). A copy is also being sent to the Council for the Civil Service Unions.

We are currently discussing with PSA the application of building standards and we hope to issue a further paper, probably through the IDC, in the near future.

Enquiries on this paper should be directed to either D A Partridge: LG2 Division, Treasury (270-4756) or F Boonham: PSA (760-4131).

Alternatively Departments may of course discuss this issue with their normal Expenditure Division contact in the Treasury. Should however you wish to bring forward proposals for untying both PSA and LG2 Divisions must be informed.

I am copying this to Richard Munday and Gordon Johnston in PSA plus all Principal Finance Officers in Main and Small Departments.

Yours sincerely,
Steven Wood.

S N WOOD

MAJOR CAPITAL PROJECTS

IMPLEMENTATION OF UNTYING FROM PSA

NOTE BY THE TREASURY

INTRODUCTION

From 1 April 1988 departments have the opportunity to test the market and to use agents other than PSA for design and project management of civil projects where it appears cost effective and in the interests of good management to do so.

SCOPE OF THIS PAPER

2. This paper sets out how these new arrangements for these activities will be brought into effect and managed. It will be essential for them to be considered in the context of PSA's responsibility for the management and maintenance of the estate (paragraph 10 below) and the responsibilities which PSA carries as the owner of freehold buildings in the civil estate and as the legal tenant of buildings leased from private sector landlords. (See paragraph 11 below).

BACKGROUND

3. The Treasury working group on major capital projects recommended that departments should be untied from PSA for major civil capital projects costing more than £150,000, known as Part 1 major projects. The working group considered in outline the form that untying should take. It concluded that untying would need to be carefully controlled and managed to ensure maximum value for money and to avoid a risk of conflict between individual departments' requirements and wider interests. The group considered therefore that there should be discussions each year between the Agency and departments about the programme of work over the next three years or so. Each department's programme would be broken down into three broad elements:

- a. work which the Department intended should be carried out by PSA without any testing of the market.
- b. work which the Department intended to be the subject of "market testing";

c. work which the Department intended to put out to outside agencies sometimes after some initial market testing on a "pilot basis".

4. The working group expected that in the early years category (a) could be expected to form the great bulk of Departments' programmes. Departments' capacity to test markets and place work more widely would develop over time. The group noted that departments would be likely to move work to category c only after work of a similar nature had been the subject of market testing under category b.

5. The group also envisaged that during the early years the annual discussions between PSA and client departments would involve the Treasury, though there would be a general presumption that the Treasury would not stand in the way of departments wishing to use outside agencies, except where there were good reasons to the contrary. The results, lessons and experience acquired through market testing would be monitored centrally by PSA and the Treasury: the lessons learned during this process would be disseminated among other Departments.

6. The written answer (23 July 1987) announcing the introduction of untying to Parliament made it clear that under untying Departments would not necessarily be expected to test the market from the outset nor to use agents other than the PSA. The process was expected to be evolutionary for three reasons:

a. first - it would take time for departments to acquire the necessary resources and skills; for some departments, especially small departments or those with few building projects, it might not be economical for them to do so;

b. second - departments would need to satisfy the Treasury of their capacity to use alternative agencies;

c. third - it would be necessary to take into account the effects of changes in workload on PSA. Departments would therefore need to agree an advance programme of work with PSA.

7. PSA will initially operate on a cost recovery basis but work is in hand to allow 'advance quotations', which will allow the Agency to quote firm prices.

8. It is against this background that the detailed arrangements for untying

must be considered. It should be emphasised that this paper deals only with untying arrangements for Part 1 Civil projects.

Detailed Arrangements for Market Testing

9. The formal position from 1 April 1988 is that all departments have been untied from PSA for Part 1 projects for which they are financially responsible; ie those projects whose costs are met from their public expenditure programmes. The allocation of financial responsibility for part 1 projects to departments and PSA respectively, is currently being considered separately, in the light of the recommendation in the Deloittes report on commercial accounts that the estate should be divided into separate "departmental" and "common user" sectors. Under untying departments are free to test the market and to use agents other than PSA for design and project management, where it appears cost effective and in the interests of good management to do so subject to the conditions set out in paragraphs 9 to 21 below. The issue is therefore not whether departments should be untied, but how departments should exercise the freedom to test the market and how this process will be managed and controlled.

To which services or groups of services does untying apply?

10. The introduction of untying under the arrangements summarised in paragraph 3 above applies only to services provided by PSA in connection with major Part 1 projects. PSA will remain responsible until further notice for deciding how best to meet a department's requirement in terms of its overall responsibility for the civil estate. On identifying a requirement for new accommodation departments should, therefore, consult PSA via Regional Directors or the Client Liaison Branch in DCA about how best to meet those requirements, for example by using existing property, by leasing or new construction. Untying as covered in this paper applies only to the range of services which PSA provides in connection with Part 1 Civil projects once it has been agreed that such a project is the most cost effective solution.

11. In the case of buildings which are leased by PSA from private sector landlord's, there may be restrictions on the range and extent of any works which may be carried out. Departments should therefore always approach the local Estate Surveyor at the earliest possible stage to obtain PSA's consent, in its capacity as the lessee, for any works which they wish to carry out in leased buildings. Departments should similarly seek the consent of PSA as the landlord of freehold buildings. These requirements are distinct from the question of who should carry

out the works services, and are related only to the landlord's consent. This procedure may, of course change in the light of future decisions on the division between the "common user" and "departmental estate" as mentioned in paragraph 9 above.

Under untying where does the initiative for testing the market rest?

12. The initiative for testing the market will rest with departments. During the first two years of untying - ie between its introduction and the two year review - it will be assumed that departments have decided to commission all their Part 1 requirements from PSA on a payment basis unless they have approached PSA under the arrangements described in paragraph 19 below.

What criteria will departments need to satisfy if they wish to test the market?

13. There are two broad considerations:

- a. departments' ability to be able to deal with outside agencies;
- b. the effects on PSA's workload.

Departments' ability to test the market and to deal with outside agencies

14. The task of market testing by departments should be managed by the "project sponsor". In satisfying the Treasury of their capacity to use alternative agencies (see paragraph 6(b) above) departments will need to demonstrate that they have project sponsors capable of handling market testing. In the early days individual cases may have to be handled on an ad hoc basis.

15. Departments should of course have project sponsors in any case for all major projects in order to discharge their project ownership responsibilities. All departments likely to have Part 1 Project should be working towards this end even if they have decided that for the time being they should not test the market.

16. The Civil Service College is mounting a series of courses which sets out the details of, and seeks to give, guidance on the tasks facing project sponsors. A job description for a project sponsor is at Annex A. Project sponsors trained in these activities should be in a position to carry out successfully the tasks which Departments will face under market testing. Details of the work involved and the proprieties which Department's will have to observe will be covered in the course. A handbook for project sponsors is being prepared.

17. It will be for Expenditure Divisions in the Treasury, initially LG Division in consultation with colleagues, to determine whether a Department is competent to untie and which projects would be suitable. Considerations to be taken into account will include the organisational structure within the Department for sponsoring, the level of expertise of sponsors and the capability to define and implement a project execution strategy.

Measuring the effects of market testing on PSA's workload

18. The Treasury working group recognised that if departments exercised unlimited freedom to go outside a rapid, unplanned reduction in PSA workload would give rise to severe managerial problems. But the group envisaged that in the early years of untying category (a) (work which departments intended should be carried out by PSA without any testing of the market) would form the great bulk of departments' programmes. So in practice it seems unlikely that there will be any need to ration the extent to which departments' freedoms should be limited on account of the effects on PSA's workload. But this is something that PSA will wish to keep under review and to discuss with the Treasury if the Agency considers any formal rationing is necessary.

19. As a preliminary to testing the market departments will need to give PSA adequate notice to enable the consequences of a possible loss of work to be properly identified and considered by the Agency, the department and where necessary the Treasury. This process will be on the lines envisaged by the Treasury Working Group for annual discussion. In January of each year departments should discuss with the relevant Business Managers in PSA their programme of work for the four year period starting in the April of that year. During the course of these discussions the Agency and the Department will decide into which of the broad categories set out in paragraph 3 above each project should be placed.

20. The aim should be to complete these discussions by the end of March so that PSA will have a firm basis on which to draw up its plans for the Public Expenditure Survey. At the start of each new round of annual discussions the programme will be rolled forward by one year. Once a project has been placed into the first of the categories set out in paragraph 3 above it may be moved to another category only with the agreement of PSA, but that should not be unreasonably withheld.

21. Prior to introducing this scheme in April 1988 it was not generally practicable to follow the procedure in paragraphs 19 and 20 above. Should any

scheme come up before the 1989 round Departments should discuss this with the DCA Central Policy Unit before market testing. This approach should be adopted in future years for schemes that come up in between the annual round.

What part will PSA play in the process of market testing?

22. The issue here is the extent to which PSA should become involved in cases where a department has decided to test the market. PSA should be invited to compete for the business and, resources permitting, plans to do so in all cases. Where PSA is not able or decides not to put in a bid this will leave a clear field for outside agencies. It is not yet clear how much freedom PSA will have in pricing bids before the introduction of commercial accounts. This will be discussed with the Treasury with the intention of introducing firm price quotations as soon as possible. PSA must therefore operate initially on a full cost recovery basis for individual projects. Initial bids will however be constructed to be directly comparable with those made by consultants.

To what should market testing be applied - ie complete projects or phases of projects?

23. PSA will be prepared to offer a partial service covering, for example, only design and project management to those Departments who wish to act as contracting party and pay bills themselves. In such cases Departments would of course take on PSA's responsibilities for letting and managing the contract and paying contractors' bills. It will be for negotiation between Departments and PSA how far Payment procedures should apply to market tested projects which are awarded to PSA.

How will the costs and benefits of market testing be monitored?

24. As a separate exercise, a sub-group of the IDC was set up to consider how to undertake a full evaluation of the policies of payment, untying and project sponsorship. (Included in the sub-group's remit was the need to monitor the costs and benefit of market testing.) The sub-group is considering a draft evaluation plan produced by the Treasury, when this has been agreed it will be submitted to the IDC for approval.

25. The main purpose of the evaluation is to try and measure the extent to which the policies improve value for money in the management of large capital projects. There are a number of difficulties involved in this, most notably in trying to attribute any changes in project management performance to the particular policies.

In addition, progress on the implementation of payment and untying/market testing will be monitored. It is hoped to produce an interim report after the first year of operation of the new arrangements.

26. The sub-group has considered in some detail the problems involved in the evaluation and the information needed, both from client departments and the PSA. The evaluation plan will make it clear exactly what information in what format is needed from departments.

27. Market testing will be covered in the evaluation by the following measures:

i. transitional and continuing administrative costs involved in setting up and then operating the arrangements for market testing and untying;

ii. use of market testing: extent to which departments actually use their freedom to untie;

iii. project performance in terms of time and cost overruns of market tested projects. (In addition, the same information will be needed for project which are not market tested for comparisons);

iv. VFM cost yardsticks: comparison of total project costs (at both approval and completion stages); with suitably adjusted cost yardsticks from other similar projects;

v. project management and design costs of market : ratio of these to total project costs for market tested and other projects;

vi. project quality : client views on the quality of completed projects; and

vii. independent assessment of project management and design services (using value engineering methods).

28. These measures will be used as a package in the evaluation; no one measure will be used on its own, so this could be misleading (for instance costs (iii)-(v) above should not be considered in isolation from quality ((vi)-(vii)). The evaluation will need to take account of these complexities. It should also be noted that some information, particularly in measures (vi) and (vii) and possibly (iv) and (v), will only be needed on a sample basis, so as not to overburden departments. However, initially at least, all market tested projects should be covered if possible.

JOB DESCRIPTION
PROJECT SPONSORS

MAJOR CAPITAL PROJECTS
(Part 1 New Works)

GENERAL

The 'Ibbs' Report of June 1985 specified that, in future, all Government departments will 'own' their capital projects, ie will be held fully responsible for successfully managing them from inception through to completion. The 'Spackman' Report of May 1986 describes the means by which this 'OWNERSHIP' responsibility will be discharged, particularly by transferring "vote" responsibility from the PSA to the owning department. It also introduces the concept of Project Sponsors, full, personal responsibility for the successful execution of capital project(s) will be vested, by Senior Department Management, in the nominated "PROJECT SPONSOR". A Project Sponsor may be responsible for more than one project simultaneously depending on size, complexity, timing, etc.

Just as the Project Sponsor is the "Owning Department's" responsible person the execution of the project itself is the responsibility of the Project Manager. This person will usually be appointed by the company or department (Property Services Agency, Directorate of Works, etc) who is "contracted" to carry out the physical execution of this project for the owning department.

Following detailed development of this concept in an Interdepartmental Committee (IDC) chaired by M V Hawtin of Treasury, the Chief Secretary to the Treasury announced in the House on 23 July 1987 (W 433) that "... as of 1 April 1988 departments will be required to meet, directly from their votes the cost of major civil building projects which are funded from their public expenditure programmes. From the

same date departments will be able to test the market, and to use agents other than the PSA for design and project management of new construction where it appears cost effective and in the interests of good management to do so. These arrangements will apply to projects estimated to cost £150,000 or more. The property repayment services (PRS) arrangements will continue to govern the provision of leased accommodation, minor works and maintenance ...".

This move has become known as "Payment and Untying", more properly it should be recognised as two separate states, each having distinct requirements.

PAYMENT

Will be effective as of 1 April 1988, and will be subject to an agreement between PSA and its client departments under which all works will be carried out, and is called the "STANDARD AGREEMENT". This formalises and records the basis of the responsibilities and duties of the client department and PSA.

In order to establish "payment" in the rapid timescale required by Ministers, all Permanent Secretaries have agreed to the conditions of the Standard Agreement prepared by PSA and approved by the Inter-Departmental Committee on PRS. These conditions reflect the major change in financial accountability while continuing the existing contractual relationship between PSA (the Secretary of State for Environment) and contractors or consultants. Arrangements adding to the agreement can (and in some case already have) been made between officials within PSA and departments. It should be noted that the Standard Agreement comes into effect on 1 April 1988 and will be reviewed along with all the arrangements within two years".

UNTYING

This regime is a fully "untied" one with the client department free of any project management direction from PSA. This will apply only when departments have satisfied the Treasury that they may test the market and seek services other than from the Agency. The departments will be free to determine their own conditions of engagement for such services. PSA may wish to compete on the basis of those conditions or offer services on any other basis as they see fit. It will be only under exceptional circumstances that PSA should not be given the opportunity to compete on this basis.

The financial responsibility of the Project Sponsor is identical in both circumstances and as such his absolute responsibilities will be the same, however practically there will be a very real difference and these have been indicated where appropriate under specific responsibilities referring to notes at the end of the paper.

SPECIFIC RESPONSIBILITIES

The nominated PROJECT SPONSOR will:

- (1) Co-ordinate/rationalise the requirements of all the end-users in developing the project definition, design brief, owner objectives and success criteria for the project. He will act as their sole contact on the project.
- (2) Initiate and appraise the necessary studies to ensure that best value for money is obtained in finalising the definition of the optimum project to meet the departments' needs.
- (3) Develop the project in terms of design and estimate accuracy with all necessary financial and other justification to that stage where it can be confidently submitted for approval. In a timely manner co-ordinate the necessary documentation and present for approval.

(4) Seek and commission the necessary professional advice and assistance to progress the project through its principal execution stages of Development, Definition, Approval, Detailed Design, Procurement, Construction, Commissioning and Post-Project Appraisal. (See Note 1)

(5) Commission those professional services required to implement the project. Particularly for the management of the detailed design, procurement and construction phases of the project, obtain the services of a suitable Project Manager (and staff as necessary). In conjunction with the Project Manager ensure that these various groups are welded into a team motivated to meeting the success criteria of the project. (See Note 1)

(6) With the assistance of the Project Manager prepare, obtain Client approval for and finally publish a detailed, on-going Project Execution Plan for the project. Ensure that it includes a clear definition of the roles, responsibilities and delegated financial (and other) authorities for each key member of the project team. (See Note 2)

(7) Ensure that reporting/communications/control systems and methods to be utilised during the execution of the project to permit rapid, informed decision making are in place, appropriate and working. Ensure stringent cost and schedule control techniques are utilised during project execution (particularly by the Project Manager). Maintain records for Audit purposes, Quality Control, etc. (See Note 3)

(8) Carefully monitor and pro-actively review project progress with the Project Manager, intervening as necessary through him or as requested whenever the project is perceived to deviate from the established plans (usually covering cost, schedule and quality).

(9) Promptly make or obtain those decisions necessary to ensure project success criteria attained. In particular, exert stringent, formal control over all decisions involving major variations and changes in scope to the currently approved project. Where such decisions affect project costs and/or schedule, ensure adequate justification is developed, approval obtained from suitably authorised senior departmental personnel. In the event changes are approved then ensure project budgets/schedules are adjusted accordingly.

(10) Ensure satisfactory arrangements established for financing the project such that money is always available to meet the demands of project with minimum payment of interest charges or disruption of the optimum planned progress. Ensure systems are in place such that all monies are paid on due dates according to contract. (See Note 4)

(11) Monitor the execution of the contracting and construction phases and ensure procedures are operated such that minimum scope is offered for contractors, etc to claim extra monies. Where claims occur ensure settlements are achieved according to the contract. Where this proves impossible recommend to Client management means of achieving settlement including possible Arbitration/Litigation. (See Note 4)

(12) Ensure that the Project Manager has (or is seeking) the necessary support from those Authorities ancillary to the project (eg Local Authorities, Public Utilities, etc) and that all the necessary approvals/resources (eg Planning Approval, Electricity, etc) according to schedule both for the construction and operating phases of the project as applicable, are being obtained by the Project Manager. (See Note 5)

(13) Ensure that any Technical and Financial Audits of the project are implemented at the pre-planned strategic stages of project execution. Take any necessary corrective action resultant upon the findings of such Audits. (See Note 6)

(14) Plan the organisation and resources needed to execute both the pre-start up testing and the commissioning of the completed project. This will include the selection and training of permanent operating staff, and close liaison with the Project Manager concerning commissioning and equipment or facilities provided within his area of control.

(15) Review the spares policy of the department, ensure that provision is made in the project costings for spares meeting that policy to be purchased and maintained.

(16) Review the handover documentation and operating instructions requirements of the department and ensure these are prepared by the Project Manager and passed over on schedule.

(17) Ensure the production of a post completion report analysing the success (or otherwise) of the project, highlighting any lessons to be learnt and any recommendations for efficiency improvement on future projects of a similar nature.

(18) Critically examine current Civil Service and departmental policies, procedures and methods in respect of Capital Projects. Define where they need modification to better permit utilisation of efficient project execution techniques, justify these modifications to departmental management and, on approval, implement changes necessary.

PROJECT SPONSOR: TYPICAL REQUIREMENTS OF POSITION

SUPERVISION

(i) BY - SENIOR DEPARTMENTAL OFFICIAL GRADED AT LEVEL 5
(or above)

NATURE - Such supervision will probably be by regular monthly briefings augmented with irregular discussion of project current or anticipated problems involving cost - time -scope or public concern issues.

(ii) OF - Any Project Co-ordinators plus the whole of the project team including the contracted bodies.

NATURE - Project Sponsor supervision will range from close contact with, say design/estimating professionals during the planning and pre-approval stages of the project (ie with specialists forming part of the Sponsors team developing the project) to less intensive supervision involving regular progress meetings with his Project Manager (once appointed) following approval and during the implementation phases of the project.

Number of Reportees (Direct and Indirect)

This will vary depending on the size and complexity of the project. Normally would include any direct assistants, (eg Project Co-ordinators) plus any professional advisers employed (eg Architect, QS, etc). The Project Manager and, in the final stage, the Commissioning Manager would usually be indirect reportees, being held directly responsible by the Project Sponsor for the success of their delegated element and the project.

Delegated Authority

(i) Financial (Requisition Authority)

- Unlimited within the approved budget and schedule for the project as initially approved (plus/minus any officially approved increments/decrements reflecting the cost/schedule effects of changes).
- Limited to approval of the expenses within standard Civil Service rates for Civil Service personnel.
(See Note 7)

(ii) Personnel

- Limited to making recommendations covering Project Sponsor's department personnel assigned/dismissed from the project.
- Unlimited in respect of the appointment/dismissal of all other contracted project personnel.
(See Note 8)

(iii) Publicity

- Limited to making recommendations in respect of the political aspects and/or publicity statements about the project.

(iv) Delegation by Project Sponsor

Authority unlimited to delegate financial and other authority to members of the project team consistent with limiting it to that required to ensure smooth project implementation to schedule. Where commitment of delegated financial authority involves the authorisation of contract awards to other than the lowest bidders particular care will be exercised to ensure Audit criticism is avoided. (See Note 9)

Education

Preferably a University Graduate or of equivalent educational attainment preferably with technical or commercial background.

Experience

Should be an experienced official of 7/10 years standing in the Civil Service familiar with general Civil Service policies, procedures plus having an intimate understanding of those pertaining in his own department. Should be thoroughly familiar with the key people and their roles in his own department and, ideally, those in other departments upon which the project impinges. If possible should have functioned as an assistant (ie a Project Co-ordinator) to an experienced Project Sponsor on previous projects.

Personality Profile

Should possess the ability to select, weld into a motivated team and lead a group of construction industry professionals.

Must be numerate, able to concisely and accurately express himself both verbally and in writing. Capable of developing and making public presentations.

Must be able to deal with officials and people at all levels both within and without the Civil Service, eg Ministers, Members of a PAC, Local Authority Officials, Directors of Construction Companies, and Professional advisers such as Architects, Structural Engineers, etc.

Must be of such stature as to secure the co-operation to schedule of the various project and user management personnel.

Must be well used to taking major decisions rapidly and justifying them when necessary.

Grading

Project Sponsors ideally should be senior to Project Managers and have sufficient authority to command the respect and attention necessary from Civil Service colleagues affected by the project.

Hence, Salary Group will vary according to the size, complexity and political importance of the project but generally will fall into Groups 3 to 7.

UNDER PAYMENT ARRANGEMENTS AND THE STANDARD AGREEMENT TERMS:

- Note 1: PSA would provide such professional advice but will take note of Sponsors' views. PSA do not usually prepare a "Post Project Appraisal" but will support the Project Sponsors' preparation of such a report.
- Note 2: PSA do not currently produce Project Execution Plans, but all the components thereof should form part of every project development. PSA are reviewing their procedures in this area.
- Note 3: When the Project Manager is appointed these duties devolve upon PSA.
- Note 4: (i) PSA are obliged to operate under an "actual cost" recovery system. Nevertheless, Sponsors will receive formal pre-estimates of PSA costs and monitor expenditure against those estimates.
- (ii) PSA (the Secretary of State for the Environment) will be in a contractual relationship with contractors and consultants and hence responsible for the proper disbursement of monies to them.
- (iii) Similarly, it will be for PSA to see that proper settlements are made with contractors and consultants and the PSA Accounting Officer will be accountable. However, the Project Sponsor will need to be consulted and satisfied with arrangements made to review, consider options, etc.

- Note 5: PSA will be responsible for the timely advice on all necessary statutory approval and will seek that approval at appropriate stages.
- Note 6: Financial Audit specifically of PSA is subject to NAO and internal audit hence no separate audit on PSA services is necessary.
- Note 7: PSA staff travel and expenses are not separately identified but form part of their general overhead.
- Note 8: PSA will be responsible for the deployment of their staff and resources to best effect and for appointment/dismissal of their contracted personnel. Project Sponsors will monitor performance of the PSA project services and if dissatisfied will take the issue up with the Project Manager and his line management. Where the services are deemed inadequate to meet the needs of the project, the Project Sponsor will seek the assistance of senior management (in both departments) as necessary.
- Note 9: Contract award procedures will be the responsibility of PSA.

Property Services Agency

4.8 pm

The Secretary of State for the Environment (Mr. Nicholas Ridley): With permission, Mr. Speaker, I should like to make a statement on the future of the Property Services Agency.

The Government have decided that the PSA should become a commercial organisation. In reaching this decision, we have taken account of a report prepared by Messrs. Deloitte Haskins and Sells on the introduction of commercial accounting into the PSA. Copies of that report have been placed in the Libraries of both Houses of Parliament. We have also paid special attention to the report on PSA which the Select Committee on the Environment prepared under the chairmanship of my hon. Friend the Member for Hornsey and Wood Green (Sir H. Rossi).

Last July my right hon. Friend the Chief Secretary to the Treasury announced that, from 1 April this year, there would be a new relationship between Departments and the PSA on major civil projects. Those payment and untying arrangements will now be extended to cover the range of services, defence as well as civil, offered by the PSA. The extended arrangements will be fully in place by 1 April 1990. By 1 April 1990, also, PSA will be reorganised into three businesses, as recommended by Deloitte. Two of these will be services businesses, covering project services and estates services. For the third, PSA will continue to manage, on behalf of the Government, the common user element of the civil estate. A substantial amount of property, however, will become the responsibility of individual Departments. I hope to make substantial progress in implementing that reorganisation before the completion date of 1 April 1990.

PSA will continue to seek opportunities to contract out functions to the private sector. I shall keep the process of contracting out under continuous review.

The changes are designed to expose the PSA to outside competition as rapidly as possible, and to equip the PSA to compete effectively, but further measures are needed if the PSA is to operate on a fully commercial basis. I have therefore decided that the PSA should become a Government trading fund, as proposed both by Deloitte and by the Select Committee. In line with the timetable set out by Deloitte, I look to the PSA to put as much of its operations as practicable on a trading fund basis no later than 1 April 1993.

My right hon. Friend the Prime Minister has agreed that my right hon. Friend the Secretary of State for Defence should take over responsibility from me in two areas. First, estate agency functions on the defence estate, both in the United Kingdom and overseas, will transfer on 1 October 1988. Secondly, some 200 industrial staff who are employed in the PSA's directly employed labour force to carry out specific and permanent tasks at defence establishments will transfer on 1 April 1989. By 1 April 1990, as arrangements are developed to put PSA's relationship with MOD on to an untied basis, up to 800 more of those industrial staff will be transferred.

Dr. John Cunningham (Copeland): Is the Secretary of State aware that the reasons set out for the creation of the PSA in its present form are as valid now as they were when it was created by the Conservative Government in 1972?

Its role is to provide, manage and maintain Government property including defence establishments, courts, research laboratories, training centres and land. We see a continuing need for such a role in the public interest.

Is the Secretary of State aware that we support the aim of greater efficiency in the Civil Service and within the public sector? Surely the proposals are aimed at preparing the PSA for its dismemberment and ultimate sale. If better commercial practice and performance is the objective, will the Secretary of State assure the House that the restructured PSA, as announced today, will be totally free to compete on equal terms with the private sector, without ministerial interference, and as recommended by the House of Commons Environment Select Committee? If he cannot give the House that assurance, are not his arguments for better performance on commercial terms simply exposed as bogus?

The PSA has been trusted to build the Clyde submarine base, which is intended for

"The UK Trident strategic system and the expanding fleet of nuclear and conventional submarines. The development is one of the most challenging projects ever undertaken."

If the PSA has been trusted to do that work, is it efficient in carrying it out? If it is inefficient, why was it trusted with such a critical and expensive project in the first place? Perhaps the Secretary of State will explain that decision in favour of the PSA undertaking such complicated expensive work which the Government have already endorsed.

If the Ministry of Defence, which currently provides some 60 per cent. of PSA work, is no longer obliged to use it, what are the implications for jobs, especially regional employment, and the implications for security matters? There are, for example, more than 1,600 jobs in the north-east of England that will be at risk as a result of the Government's decision and as many more in Scotland. How many of the 24,000 PSA jobs does the Secretary of State estimate will eventually go as a result of that decision?

In general, the PSA gives the taxpayer a good deal. Its chief executive—a distinguished civil servant—is Sir Gordon Manzie, who is trusted and whose annual report has been endorsed by the Secretary of State. In that report Sir Gordon says:

"comparisons have shown PSA to be competitive with its private sector counterparts."

If that is true, what can be achieved by the Government announcement today? Surely that announcement exposes as bogus the Secretary of State's claims about commercial improvement. The Government's statement is simply a triumph of dogma and ideology over British public interest.

Mr. Ridley: The hon. Member for Copeland (Dr. Cunningham) managed to wax himself into a paroxysm of apprehension about what I believe to be a helpful and progressive statement regarding improvements to the efficiency and management of the Government's estate. I agree that it is the PSA's defined role—laid down when it was set up in 1972—that we are now seeking to develop. I welcome the hon. Gentleman's acknowledgement that greater efficiency is something that we should strive for, and that is what the statement seeks to achieve.

Curiously enough, I also welcome the hon. Gentleman's call for the PSA to be able to compete with the private sector. In effect, that is a request for a future Government to privatise suitable parts of the PSA. I

come that request from the hon. Gentleman, just as I welcomed his enormous concern about the critical and important nature of the Trident base—he was right to stress its importance. I have no doubt in the abilities of the PSA both in that respect and in respect of the many other functions that it performs for Government Departments, including the Ministry of Defence. I believe that it will supply sponsor Departments with the very best service, and in that case it will continue to prosper.

I believe that there will be no threat to jobs. The hon. Gentleman got the figures regarding jobs connected with the Ministry of Defence slightly wrong. In future, however, my right hon. Friend the Secretary of State for Defence will answer for that. As I said in my statement, up to 1,750 PSA staff will probably transfer to the MOD. Those are the staff that the MOD will need to manage its estates. The PSA is already contracting out about 85 per cent. of its physical work, so perhaps the MOD will be able to improve upon that transfer figure slightly. A great deal of work is already contracted out and the people employed on such contracts manage the estates. Therefore, there will be no threat to their jobs.

Sir Hugh Rossi (Hornsey and Wood Green): I welcome my right hon. Friend's statement inasmuch as it accepts two main recommendations of the Select Committee: the creation of the PSA as a trading fund, and the untying of the defence establishments. Contrary to the statement made by the hon. Member for Copeland (Dr. Cunningham), the Labour Members who served on the Committee listened carefully to all the evidence, studied the effects of the recommendations and were completely in agreement with those recommendations and accordingly, no doubt, with the statement that my right hon. Friend has just made.

May I say to my right hon. Friend in criticism that the way in which answers to Select Committee reports are presented to the House in a piecemeal fashion is more than unsatisfactory. We have had a memorandum, a partial reply in a private Member's motion, and now a statement. It would be far more satisfactory if all these matters could be dealt with by way of Command Papers and we could then properly study the Government's replies to very carefully thought out recommendations of Select Committees. I am glad to see that my right hon. Friend the Leader of the House is in his place to hear that criticism of matters of procedure.

As far as I can tell, all the recommendations of the Select Committee on the PSA have now been accepted, except that I do not know where we stand on the recommendations that

"a central body of PSA expertise should be retained as one unit for specialist advice and as landlord of the Civil Office and Storage Estate; and . . . allowed to manage the Civil Office and Storage Estate more positively, as a major property resource".

Where do we stand on that recommendation—the last major recommendations of my Committee?

Mr. Ridley: I am grateful to my hon. Friend. I consider that the report on the PSA to which we are referring was one of the very best reports that Select Committees have produced for a long time. I pay tribute to all the members of that Select Committee. The report was so good that the Government have more or less agreed to every recommendation, although they were major recommendations.

I hope that my hon. Friend will excuse us for the delay in providing an answer, but the report raised some very complicated matters which had to be pursued and that took rather longer than I should have liked. The delay was to enable us to meet the recommendations. On the other hand, Select Committees like an early Government reply, so we were in a dilemma. I hope that my hon. Friend feels that the delay has been worth while to achieve the results that the Select Committee suggested.

Of course, the PSA will continue to give specialist advice to Government Departments about property management. That function will not be disturbed. The expertise is there at present and will continue.

In regard to the ownership of the civil estate, as I said in my statement a large common-user element of the Government's property will remain the responsibility of the PSA, but where facilities are purely for the use of Departments, such as in many defence matters, the ownership will transfer to the Department concerned. The exact dividing line between the common estate and the property which goes to individual Departments has yet to be defined, but I hope that that definition answers my hon. Friend in principle. As he said, we have accepted the recommendations about the trading fund and about untying.

Mr. James Wallace (Orkney and Shetland): Does the Secretary of State accept that if his proposals will lead to Government Departments, not least the Ministry of Defence, having greater flexibility to economise through engaging contractors which offer a price lower than that of the PSA, that will generally be welcomed?

Can the right hon. Gentleman give any guarantee that the reservoir of expertise mentioned by the hon. Member for Hornsey and Wood Green (Sir H. Rossi) will be retained and that there will not be a proliferation of mini-PSAs which could lead to the loss of the advantages achieved through economies of scale?

Has the Secretary of State had an opportunity to speculate on the implications of commercialisation for the care and maintenance of this building? Does he foresee charges for the showers, for example?

Mr. Ridley: On the first point, any Department will be able to obtain the best price it can for maintenance or work to its own property as a result of untying. The hon. Gentleman welcomed that.

Secondly, the PSA will remain as a body and will continue to have specialist knowledge which will be available to those from any branch of Government who want to consult it and to Government Departments which will be free to use the PSA as the agent for managing their properties. Thirdly, I propose no change in the arrangements under which the Palace of Westminster is run. In this case, the landlord is a royal one and the PSA manages the building on behalf of the landlord in conjunction with the Services Committee of the House.

Mr. Michael Heseltine (Henley): I strongly support my right hon. Friend's announcement. May I put two questions to him? First, is it not more likely that jobs in the economy will be increased by his announcement as the skills within the public sector will be transferred to the private sector and will not only become available to the public sector but will be exploited through the British civil engineering industry across the world?

[*Michael Heseltine*]

Secondly, will my right hon. and learned Friend consider, in the dispersal of the Government estate to separate Departments, urging those Departments to use contract management from the private sector for the management of those estates, as well as enjoying the additional freedom of overall responsibility that he has given them?

Mr. Ridley: I am grateful to my right hon. Friend. It is very likely that the development of the policy will lead to a strengthening of the private sector. There is no reason why it should lead to a reduction in the numbers employed by the PSA if it can continue to justify its activities by winning work from Departments.

On my right hon. Friend's second question, it will be up to the Departments to manage their own property from now on. I hope that he will urge Departments to follow the course of obtaining the best offer for managing their estates, whether it be from the PSA or from the private sector, as well as contracting out maintenance and new construction work.

Mr. Peter L. Pike (Burnley): The Secretary of State said that the Select Committee report was a good report. As a member of the Select Committee, I must say that even better reports are still awaiting his response. Will the right hon. Gentleman give a categorical assurance that the statement is not a prelude to privatisation? Will he further give an assurance that the trade unions will be consulted fully and their views given due consideration?

Will the right hon. Gentleman also recognise that one of the major problems that the PSA faces is that the Departments that it serves are sometimes very unclear in giving to the PSA work requirements, both in their initial instructions and when changing their minds? That causes major problems for the PSA. Will the Minister try to ensure that it does not occur in future?

Mr. Ridley: Whether reports from Select Committees are good ones must await my view. The hon. Gentleman cannot put those words into my mouth before I have decided.

Privatisation may become a possibility which the staff prefer when the three businesses have been separated. They may well wish to go into the private sector to compete for a greater share of the work available. We cannot prejudge that as it will be many years before we reach that position. Trade unions will be consulted from this afternoon about the announcement that I have just made.

The lack of clarity of the intentions and needs of Government Departments which has made life very difficult for the PSA in looking after its buildings has been in part the cause of the changes that I have announced this afternoon. From now on, Departments will be responsible for managing their own buildings and for paying for that management. They will therefore have a much greater incentive to seek the best value for money than if the costs of whatever changes they make halfway through fall upon the PSA, which is hardly fair on it.

Several Hon. Members *rose*—

Mr. Speaker: Order. I remind the House that we have a busy day ahead of us. I ask for brief questions, and certainly not questions that have been asked before.

Mr. James Cochrane (Gillingham): I congratulate my right hon. Friend on his wise decision to take the PSA into a full commercial position. If I have a criticism, it is that it will take a very long time to establish it as a trading fund and 1993 seems a long way ahead. After all, we have fully privatised greater public utilities in rather less time.

In regard to the Ministry of Defence assuming responsibility for its estates, what will happen to those estate management matters which are currently in train? Will the MOD assume responsibility for those matters ahead of 1 October, or will the PSA take its responsibility beyond 1 October? My right hon. Friend is very well aware that there are matters in my constituency which are of significant importance to my constituents.

Mr. Ridley: I agree that it is a pity that it will take so long to attain a full trading fund, but that is the estimate of the PSA and our consultants, Messrs. Deloitte, who believe that it cannot be done quicker. That is the time that it will take to move a large organisation from vote accounting to having full commercial accounts in a trading fund because of the immense changes that are necessary, each of which underlines the difference between a Government Department and a commercial organisation.

I shall soon have to ask my hon. Friend to ask my right hon. Friend the Secretary of State for Defence how he will manage the contracts that he needs for the defence estate. I am sure that he will wish the smooth transitional arrangements to continue and contracts that are in train will obviously be treated differently from contracts that will be let after 1 October.

Mr. John Garrett (Norwich, South): What will be the required rate of return from the three businesses? Will it be rigged in order to make them uncompetitive compared with the private sector? Is it intended to make political appointments to head them?

Mr. Ridley: I shall be able to set targets for the three businesses once we have three businesses in a few years' time, but not now. The staff of the PSA will remain civil servants, as they are at present, until such time as the new era is reached.

Mr. Kenneth Warren (Hastings and Rye): Much as I applaud the management changes that my right hon. Friend has proposed today, will he, following his answer to the last question, make sure that the staff understand their forward terms and conditions of employment so that we avoid the turmoil that we are now experiencing on the privatisation of the Crown Suppliers?

Mr. Ridley: I confirm that there will be no change in the status or position of any PSA staff as a result of what I have announced this afternoon. They remain civil servants. The PSA is run by a permanent secretary, to whom I pay tribute, as did the hon. Member for Copeland (Dr. Cunningham). There is a small advisory board that is purely advisory, but, for the rest, all members, whether they go to the MOD or stay with the PSA, will remain in exactly the same position as at present — as civil servants.

Mr. Tam Dalyell (Linlithgow): How much were Deloitte paid for their report?

Mr. Ridley: I have no idea.

Mr. Michael Morris (Northampton, South): Is my right hon. Friend aware that, in evidence to the PAC, it was

over the years that the PSA needed to be released from some of its shackles, and to that extent my hon. Friend's statement is welcome? However, can he assure us that in one of the trading functions—the servicing of boilers, lifts and so on—that will not simply result in a major direct labour department under the PSA?

Mr. Ridley: I am grateful to my hon. Friend. It is time that we made the move that I have outlined. Some people are best directly employed in the maintenance and looking after of property, but equally there is always scope for contracting out and from now on it will be for individual Departments, which own their own properties to take those decisions. The PSA will continue to decide whether to contract out the sort of work to which my hon. Friend is referring in relation to the common user element in the civil estate.

Mr. Dennis Skinner (Bolsover): Why could not the Minister give a straight answer to my hon. Friend the Member for Norwich, South (Mr. Garrett) on who will be heading the three companies in preparation for privatisation? Will there be any friends of his, or civil servants, distinguished or otherwise, heading them up? Could ex-Ministers have a lucrative number in the future? Why cannot the right hon. Gentleman give a guarantee that nobody will be latching on to any of these slush funds?

Mr. Ridley: I have made it clear that as the PSA becomes three separate businesses the whole staff will be civil servants who will be interchangeable with civil servants from other Departments. If new arrangements are proposed in five years' time, that will be the time for the hon. Gentleman to expect an answer to his question.

Mr. Michael Fallon (Darlington): If, by his statement, my right hon. Friend is preparing the three businesses for early privatisation, is he not to be congratulated? If he is not, is he not astounded by his own moderation?

Mr. Ridley: I do not know which of my hon. Friend's interpretations to claim. It will take the five years until 1993 to obtain the accounts necessary and to separate the three businesses. I make it plain that the business that owns the common user estate is unlikely to be privatised because, clearly, we cannot make ourselves tenants throughout all Government properties, particularly in the Whitehall area. Whether the other two businesses should be privatised will become much clearer when they become established.

Mr. Ian Gow (Eastbourne): Can my right hon. Friend confirm that the great majority of the land and buildings used by Government Departments is used by individual Departments and so his announcement today means that almost all the owners of the Government estate will be at liberty to use the private sector? Secondly, will my right hon. Friend try to accelerate his timetable for setting up the trading fund? Will he acknowledge that many Conservative Members want him to accelerate a programme of full privatisation for the whole of the PSA?

Mr. Ridley: Those Departments with special user directed buildings, such as the courts buildings of the Lord Chancellor, or the buildings solely concerned with agriculture of my right hon. Friend the Minister of Agriculture, Fisheries and Food—those are just examples; there are many more—will pass to the Departments concerned. However, a Government office is unlikely to transfer because it may house one Department

for a period and later switch to another Department. As such, that is part of the common user estate. I shall be able to give more details of the precise split between departmental property and the common user estate after more work has been done.

I agree that it would be desirable to accelerate the proposals in the statement as fast as possible, but we have already tried to do that and our accountants, Messrs. Deloitte, have advised us that if we meet the target of 1993 for the trading fund, we shall be doing well. However, a Government of the same colour will still be in place then and will be ready to take the next step.

Mr. Keith Hampson (Leeds, North-West): Will my right hon. Friend accept that the regional office of the PSA in my constituency welcomes his proposals as being sensible? However, I am sure that the PSA staff would like the reassurance that, if they are to lose their traditional client base, they will be free to win contracts on a new wider client base within the private sector, such as in the nationalised industries, the National Health Service, and so on.

Mr. Ridley: It was on a visit to the regional office in my hon. Friend's constituency, when I discussed this matter a year or two ago with the staff, that I confirmed that this was the right direction for us to go and I am sure that they will feel the same now. The new businesses have a lot of work to do to become established and we should leave matters as they are at the moment. However, if there are invitations and strong pressure for those new businesses to compete in the private sector, that will be a compelling reason for privatising them.

Mr. Robert G. Hughes (Harrow, West): I welcome my right hon. Friend's statement, but does he agree that there is a possibility that, in the separation into three units, there may be an increase in the arm's length relationship between those placing the order and those doing the work that has been missing for some time? Secondly, may we hope that there will be a better use of resources and property, in particular, property going to the MOD? Does my right hon. Friend agree that it would be better to have people living in such property than to have it empty?

Mr. Ridley: I believe that the separation will lead to more arm's length relationships and less arm twisting, which I am sure is what my hon. Friend would like. It will help the Ministry of Defence to identify surplus property and make disposals, and to ensure that any empty houses are either occupied or sold. However, the majority of empty MOD houses are far away from distressed areas of housing shortage.

Several Hon. Members rose—

Mr. Speaker: Order. I appeal for brief questions. It would be helpful if these matters could be raised on the Adjournment.

Mr. David Heathcoat-Amory (Wells): I welcome this overdue move towards commercial management on a trading fund basis. Will my right hon. Friend elaborate on the third of his new PSA companies, that holding civil land and property? As there is an increasing shortage of commercial sites, particularly in the south of England, will my right hon. Friend oblige the new company to dispose of property wherever possible so that it can achieve its full potential in the market place?

Mr. Ridley: I agree with my hon. Friend, but disposals from the PSA are currently running at £40 million or £50 million per year, which is a remarkable figure. I pay tribute to the agency for the diligence with which it has disposed of surplus Government land and property. There is not much more scope for increasing that figure, and I do not imagine that my hon. Friend would want us to go as far as selling, for example, the freehold of the Treasury.

Mr. Toby Jessel (Twickenham): Is my right hon. Friend aware that many of my constituents will be heartily relieved if someone moves in to sort out and tighten up on the excesses of the Property Services Agency at Hampton Court palace? Can he say how his policy for improving the administration there will interact with his new proposals?

Mr. Ridley: As my hon. Friend knows, we have already taken steps to establish an agency to manage Hampton Court palace, and those arrangements are going well. That in itself means untying the PSA from being the monopoly building adviser and contractor at Hampton Court palace. In a sense, that decision pre-dates the statement I have just made. In either case, Hampton Court palace will be free to seek the advice, the design and the contracting work which it finds of greatest value for money in what it has to do.

Mr. Chris Butler (Warrington, South): Can my right hon. Friend tell the House how the management of the British Library project will be affected under the new commercial arrangements he has described? What would happen if the Property Services Agency ran severely over budget in respect of that project?

Mr. Ridley: Contracts already in existence and operating will continue to be managed as at present. That would apply to the British Library. If the Property Services Agency, having bid for the project, fails to make sufficient money to cover its costs and loses money, it will be necessary for it to account to the Treasury. In due course, the Treasury would decide whether or not to make good that which it had lost.

Mr. Richard Holt (Langbaugh): As a member of the Select Committee on the Environment, I endorse the

remarks of my hon. Friend the Member for Hornsey and Wood Green (Sir H. Rossi) and of the hon. Member for Copeland (Dr. Cunningham). When it comes to relocating the three new companies, will my right hon. Friend give serious consideration to making the north of England the area to which they are directed?

Mr. Ridley: I have asked the PSA to consider what scope there is for relocating its operations and staff well in advance of anything that may arise from my statement. That is now being done. I am sure that my hon. Friend does not expect me to suggest any particular locations, but both the PSA and the Government are keen to devolve as many functions and staff as they can to localities where the resultant jobs will be welcome and where houses will not be so expensive.

Mr. Kenneth Hind (Lancashire, West): I welcome my right hon. Friend's announcement. However, in the past there has been a major problem in dealing with defence property because of the PSA's influence. Will my right hon. Friend confirm that in future it will be easier to dispose of surplus land and houses currently owned by the MOD as a result of the PSA's reorganisation?

Mr. Ridley: It will certainly be no more difficult. The decision whether to dispose of land or property has always been one for the Ministry of Defence, which has always owned its own property. We are now giving it the personnel necessary to manage the estate agent, maintenance and new build functions. I hope that the Ministry will be able to dispose of surplus properties, as my hon. Friend suggests. I believe it will help the Ministry to be itself in control of the estate agent function in identifying and putting on to the market property which it does not need.

Mr. Dalyell: On a point of order, Mr. Speaker. There are eight officials in the Box. The Secretary of State for the Environment has a particularly athletic PPS. I asked a very short question about the cost of Deloitte's report. Could not one of the Minister's officials, through his PPS, have provided the information I sought?

Mr. Speaker: The PPS looks to be in very good shape, but I cannot answer the hon. Gentleman's question.

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cc QW
MCA
pro's
P.G.
edit



2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434
My ref:

Your ref:

P A Bearpark Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON
SW1A 2AA

25 May 1988

PA 25/5
Dear Andy,

FUTURE OF THE PSA

I attach a final version of the statement which my Secretary of State intends to make this afternoon. This follows the discussions between my Secretary of State, the Prime Minister, the Secretary of State for Defence and the Chief Secretary and has been cleared by all Cabinet Ministers.

Yours,
Deborah.

DEBORAH LAMB
Private Secretary



STATEMENT ON THE FUTURE OF PSA

THE GOVERNMENT HAVE DECIDED THAT THE PROPERTY SERVICES AGENCY SHOULD BECOME A COMMERCIAL ORGANISATION. IN REACHING THIS DECISION, WE HAVE TAKEN ACCOUNT OF A REPORT PREPARED BY MESSRS DELOITTE HASKINS AND SELLS ON THE INTRODUCTION OF COMMERCIAL ACCOUNTING INTO THE PSA. COPIES OF THAT REPORT HAVE BEEN PLACED IN THE LIBRARIES OF BOTH HOUSES OF PARLIAMENT. WE HAVE ALSO PAID SPECIAL ATTENTION TO THE REPORT ON PSA WHICH THE SELECT COMMITTEE ON THE ENVIRONMENT PREPARED UNDER THE CHAIRMANSHIP OF MY HON FRIEND THE MEMBER FOR HORNSEY AND WOOD GREEN.

LAST JULY MY RT HON FRIEND THE CHIEF SECRETARY ANNOUNCED THAT, FROM 1 APRIL THIS YEAR, THERE WOULD BE A NEW RELATIONSHIP BETWEEN DEPARTMENTS AND THE PSA ON MAJOR CIVIL PROJECTS. THESE PAYMENT AND UNTYING ARRANGEMENTS WILL NOW BE EXTENDED TO COVER THE RANGE OF SERVICES, DEFENCE AS WELL AS CIVIL, OFFERED BY THE PSA. THE EXTENDED ARRANGEMENTS WILL BE FULLY IN PLACE BY 1 APRIL 1990.

BY 1 APRIL 1990, ALSO, PSA WILL BE REORGANISED INTO THREE BUSINESSES, AS RECOMMENDED BY DELOITTES. TWO OF THESE WILL BE SERVICE BUSINESSES, COVERING PROJECT SERVICES AND ESTATES SERVICES. FOR THE THIRD, PSA WILL CONTINUE TO MANAGE, ON BEHALF OF THE GOVERNMENT AS A WHOLE THE COMMON USER ELEMENT OF THE CIVIL ESTATE. A SUBSTANTIAL AMOUNT OF PROPERTY, HOWEVER, WILL BECOME THE RESPONSIBILITY OF INDIVIDUAL DEPARTMENTS. I HOPE TO MAKE SUBSTANTIAL PROGRESS IN IMPLEMENTING THIS RE-ORGANISATION BEFORE THE COMPLETION DATE OF 1 APRIL 1990.

PSA WILL CONTINUE TO SEEK OPPORTUNITIES TO CONTRACT OUT FUNCTIONS TO THE PRIVATE SECTOR. I SHALL KEEP THE PROCESS OF CONTRACTING OUT UNDER CONTINUOUS REVIEW.

THESE CHANGES ARE DESIGNED TO EXPOSE THE PSA TO OUTSIDE COMPETITION AS RAPIDLY AS POSSIBLE; AND TO EQUIP THE PSA TO COMPETE EFFECTIVELY. BUT FURTHER MEASURES ARE NEEDED IF THE PSA IS TO OPERATE ON A FULLY COMMERCIAL BASIS. I HAVE THEREFORE DECIDED THAT PSA SHOULD BECOME A GOVERNMENT TRADING FUND, AS PROPOSED BOTH BY DELOITTES AND BY THE SELECT COMMITTEE. IN LINE WITH THE TIMETABLE SET OUT BY DELOITTES, I LOOK TO PSA TO PUT AS MUCH OF THEIR OPERATIONS AS PRACTICABLE ON A TRADING FUND BASIS NO LATER THAN 1 APRIL 1993.

FINALLY, MY RT HON FRIEND THE PRIME MINISTER HAS AGREED THAT MY RT HON FRIEND THE SECRETARY OF STATE FOR DEFENCE SHOULD TAKE OVER RESPONSIBILITY FROM ME IN TWO AREAS. FIRST, ESTATE AGENCY FUNCTIONS ON THE DEFENCE ESTATE, BOTH IN THE UNITED KINGDOM AND OVERSEAS, WILL TRANSFER ON 1 OCTOBER 1988. SECOND SOME 200 INDUSTRIAL STAFF WHO ARE EMPLOYED IN THE PSA'S DIRECTLY EMPLOYED LABOUR FORCE TO CARRY OUT SPECIFIC AND PERMANENT TASKS AT DEFENCE ESTABLISHMENTS WILL TRANSFER ON 1 APRIL 1989. BY 1 APRIL 1990, AS ARRANGEMENTS ARE DEVELOPED TO PUT PSA'S RELATIONSHIP WITH MOD ONTO AN UNTIED BASIS, UP TO 800 MORE OF THESE INDUSTRIAL STAFF WILL BE TRANSFERRED.

NBPM

MINISTRY OF DEFENCE
 MAIN BUILDING WHITEHALL LONDON SW1A 2HB

Telephone 01-218 2111/3

MO 10L

23rd May 1988

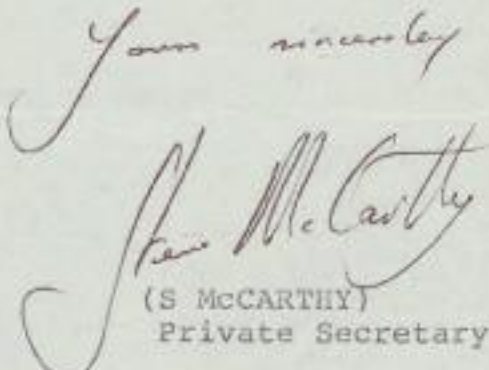
Dear Nigel

FUTURE OF THE PSA

In your minute of 13th May to Sir Robin Butler, you indicated that, subject to the views of the Defence Secretary and others, the Prime Minister agreed that action should proceed as proposed in Sir Robin's minute of 10th May. The Defence Secretary is content with Sir Robin's proposals.

The Defence Secretary is also content with the draft announcement attached to the Environment Secretary's letter of 17th May to the Chancellor.

I am sending copies of this letter to the Private Secretaries to the Secretary of State for the Environment, the Chief Secretary and Sir Robin Butler.

Your sincerely

 (S MCCARTHY)
 Private Secretary

Nigel Wicks Esq
 10 Downing Street

C SERVICE : PSA pr 3



CONDIMENT

11

C.B.G.


CABINET OFFICE
OFFICE of the MINISTER
for the CIVIL SERVICE

The Minister of State
Privy Council Office
The Rt. Hon. Richard Luce MP

Horse Guards Road
London SW1P 3AL

Telephone: 01-270 5929

C88/2744

The Rt Hon Nicholas Ridley MP
Secretary of State for the Environment
2 Marsham Street
LONDON
SW1 3EB

NBRM

23 May 1988

Dear Secretary of State,

FUTURE OF PROPERTY SERVICES AGENCY

You sent me a copy of your letter of 17 May to the Chancellor of the Exchequer enclosing the draft of the statement which you are planning to make to Parliament on the future of the PSA.

The draft statement causes me no problems in relation to the interests of OMCS and OAL as PSA clients.

However, I note that the draft announcement does not refer to the possibility of executive agency status for the PSA under the "Next Steps" initiative. While I can see that such an announcement could be premature at this stage, PSA has many of the characteristics of a good candidate; and much of the work planned for the next few months will be relevant to decisions on agency status. I trust that once the preparatory work is completed, active consideration will be given to making one or more agencies out of the PSA. Meanwhile I hope that if you are questioned on this point in the House or by the press, you will be able to confirm that the PSA is regarded as a potential candidate.

Copies of this letter go to the Prime Minister, all department Ministers, John Wakeham, David Waddington, John Belsted, Bertie Denham and to Sir Robin Butler.

Yours sincerely

Richard Luce

RICHARD LUCE
(approved by the Minister
and signed in his absence)

CIVIL SERVICES : PSA PTD





ceBG

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

20 May 1988

*CDP
20/5*

Dear Secretary of State,

at Head

I have seen a copy of your letter of 17 May to Nigel Lawson about the future of the Property Services Agency. I am broadly content with your proposals and agree that you should make an oral statement to the House on Wednesday, 25 May.

My specific concern is over the implications of your proposals for the Palace of Westminster and associated parliamentary buildings. I understand that no change is, in fact, contemplated to the Allied Service basis on which works services are presently provided. However, I should be grateful if you could keep me in touch about proposals for the common user estate, as they may have implications for the Parliamentary buildings not part of the Palace itself.

In addition, I am sure that you will be questioned on this by Members when you make your statement; you may wish to reassure the House that the new future of PSA will not have any detrimental effect on the service provided, that the continuation of the present arrangement is for the moment secure, and that no future decisions will be taken without consulting the House. I know that John Belstead shares these views.

Yours sincerely,

NJS Denton

pp JOHN WAKEHAM

Approved by the Lord President and signed in his absence.

The Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

CIVIL SERVICE : PSA Restructuring P.3



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From The Secretary of State for Wales

The Rt Hon Peter Walker MBE MP

20 May 1988

MANAGEMENT IN CONFIDENCE

COP
20/5

FUTURE OF THE PROPERTY SERVICES AGENCY

Thank you for sending me a copy of your letter of 17 May to Nigel Lawson.

I welcome the moves to make PSA more commercially orientated, and to give Departments more responsibility for their own affairs. I am content with your proposed announcement.

I hope I can take it that departments will be fully consulted about the implementation of these changes. In addition to the service and resource implications for my Department, I will want to be aware of any proposals which might impact adversely upon local areas of high unemployment.

I am copying this letter to the Prime Minister, all other colleagues with Departmental responsibilities, John Wakeham, David Waddington, John Belstead, Bertie Denham and to Sir Robin Butler.

The Rt Hon Nicholas Ridley MP
Secretary of State for the Environment

CIVIL SERVICE : PSA FT3



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CONFIDENTIAL



will be
cc'd

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

20 May 1988

Thank you for your letter of 19 May
about the CPS Report on the PSA. The
Prime Minister has seen and noted this.

P. A. Bearpark

Miss Deborah Lamb,
Department of the Environment.

CONFIDENTIAL

Ch



2 MARSHAM STREET
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01-212 3434

Prime Minister²

My ref:

Your ref:

P A Bearpark Esq
Private Secretary to
The Prime Minister
10 Downing Street
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19 May 1988

at flap
Dear Andy,

Thank you for your letter of 3 May. My Secretary of State has seen the paper which the Centre for Policy Studies published recently on the PSA, and which they had shown in draft to Mr Christopher Chope beforehand.

The Secretary of State and Mr Chope were disappointed in the overall quality of the paper. They agree, however, that the idea of forming discrete groups of PSA employees into private consultancies on the Milton Keynes Development Corporation model is an interesting one. They note that this would involve pump priming by means of a guaranteed workload for a limited period of time. Milton Keynes are not alone in this field. Among local authorities Kensington and Chelsea have put into practice a similar scheme for their design and technical services, and other local authorities may follow suit.

My Secretary of State intends PSA to study experience to date and examine how this approach might be applied to their circumstances as part of the contracting out exercise covered in Sir Robin Butler's report of 10 May to Nigel Wicks (paragraphs 16 to 18).

Yours,

Deborah.

DEBORAH LAMB
Private Secretary

CIVIL SERVICE: PSA Review

PT 3

1911



Duty Clerk

NBDD

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

PL cc. Mr Ingham

My ref:

Your ref:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

NLW

18-5

pa.

17 May 1988

Dear Nigel

FUTURE OF PROPERTY SERVICES AGENCY

I am writing to let colleagues know of decisions which the Prime Minister has recently taken on the future of the Property Services Agency.

The decisions in question are set out in the enclosed draft announcement. This explains that the PSA should become a commercial organisation in respect of its business both for civil and for defence clients; and should move to Trading Fund status by 1 April 1993. It also deals with two Machinery of Government changes involving transfers of responsibility from me to George Younger.

In the draft there are several points to which I should like to draw attention. The Prime Minister has agreed that, as a first step, the new payment relationship which was established for major civil works projects on 1 April this year should be extended to cover all PSA's other activities, both defence and civil. This relationship is to be fully in place, and Departments are to have the freedom to untie from PSA for all services, by 1 April 1990 at the latest. The precise form of untying for some activities, especially maintenance, still needs to be worked out with Departments. Further work is also needed to establish whether phased implementation is practicable and to explore the general resource implications for Departments.

In setting 1 April 1990 as the final date for introduction of payment and untying, I am looking to PSA to introduce by the same date advance quotations for their services to which they will be held in the same way as private consultants. Outline work between PSA, Treasury and the MOD is encouraging, and the way is now clear for the PSA to develop the techniques on which the advance quotations will be based. I have, however, asked the PSA to consider with the Treasury and other Departments whether such advance quotations could apply earlier than 1 April 1990 for some activities.



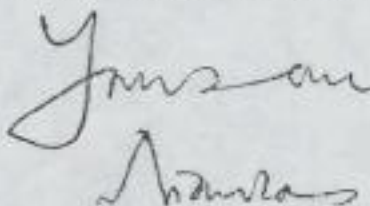
By 1 April 1990 also, PSA is to complete its reorganisation into the three businesses recommended by Deloitte. Two of these will be service business, covering project services and estate services. The third will involve the ownership of civil property. PSA will continue to act as the Government landlord, and thus will continue to manage on behalf of Government as a whole, the common user element of the existing civil estate. But a significant part of the existing civil estate will become the responsibility of individual occupying Departments. The detailed implications of this step, including the precise criteria for allocation, still need to be worked out, and the scope for phased transfers of properties to Departments before 1 April 1990 needs to be assessed. Officials from PSA, Treasury and other Departments will have to carry out a detailed examination in order to put recommendations to Ministers.

Deloitte's advice last year was that the earliest practicable date for establishing a PSA trading fund was April 1993, given the need to introduce first a system of full commercial accounts which in turn depends on implementation of PSA's Information Technology strategy. I regard the target date of 1 April 1993 as a latest date. If at all possible I should like to see the programme brought forward. In the meantime, the next key step is for Treasury and PSA officials to discuss how to take forward the IT strategy which is crucial to achieving PSA's objectives.

The matters covered by the draft and the interest which they are likely to attract seem to justify my making an oral statement (which may have to be made simultaneously by Malcolm Caithness in the House of Lords). I am particularly concerned that the announcement should be made early next week so that the very considerable work needed to plan and implement changes can be pressed forward without delay; and so as to end mounting uncertainty and rumours which can only sap staff morale. I shall, of course, discuss the form of announcement and the choice of a precise date with John Wakeham and David Waddington.

In the meantime, I should be grateful for any comments on the draft by close of play on Friday 20 May.

I am copying this letter to the Prime Minister, all other colleagues with Departmental responsibilities, John Wakeham, David Waddington, John Belstead, Bertie Denham and Sir Robin Butler.



NICHOLAS RIDLEY

DRAFT STATEMENT ON THE FUTURE OF PSA

1. The Government have decided that the Property Services Agency should become a commercial organisation. In reaching this decision, we have taken account of a report prepared by Messrs Deloitte Haskins and Sells on the introduction of commercial accounting into the PSA. Copies of that report have been placed in the Libraries of both Houses of Parliament. We have also paid special attention to the Report on PSA which the Select Committee on the Environment prepared under the chairmanship of my hon Friend the Member for Hornsey and Wood Green.
2. Last July my rt hon Friend the Chief Secretary announced that, from 1 April this year, there would be a new relationship between departments and the PSA on major civil projects. These payment and untying arrangements will now be extended to cover the range of services, defence as well as civil, offered by the PSA. The extended arrangements will be fully in place by 1 April 1990.
3. By 1 April 1990, also, PSA will be reorganised into three businesses, as recommended by Deloitte. Two of these will be service businesses, covering project services and estates services. For the third, PSA will continue to manage, on behalf of the Government as a whole the common user element of the civil estate. A substantial amount of property, however, will become the responsibility of individual Departments. I hope to make substantial progress in implementing this reorganisation before the completion date of 1 April 1990.
4. PSA will continue to seek opportunities to contract out functions to the private sector. I shall keep the process of contracting out under continuous review.
5. These changes are designed to expose the PSA to outside competition as rapidly as possible; and to equip the PSA to compete effectively. But further measures are needed if the PSA is to operate on a fully commercial basis. I have therefore decided that PSA should become a Government Trading Fund, as proposed both by Deloitte and by the Select Committee. In line with the timetable set out by Deloitte, I look to PSA to put as much of their operations as practicable on a Trading Fund basis no later than 1 April 1993.

6. Finally, my rt hon Friend the Prime Minister has agreed that my rt hon Friend the Secretary of State for Defence should take over responsibility from me in two areas. First, estate agency functions on the defence estate, both in the United Kingdom and overseas, will transfer on 1 October 1988. Second some 200 industrial staff who are employed in the PSA's Directly Employed Labour (DEL) force to carry out specific and permanent tasks at defence establishments will transfer on 1 April 1989. By 1 April 1990, as arrangements are developed to put PSA's relationship with MOD on to an untied basis, up to 800 more of these industrial staff will be transferred.

7. The Trade Unions will be consulted about the staffing implications of the changes which I have described.

8. With the uncertainty about the future of PSA now ended, successful implementation of a demanding programme will place a considerable responsibility on PSA staff at all levels. I am confident that PSA will rise to the challenge and prove that it can hold its own in a commercial environment.



Rle

10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

SIR ROBIN BUTLER

FUTURE OF THE PSA

I have shown the Prime Minister your minute of 10 May about action regarding the future of the PSA. The Prime Minister agrees, subject to the views of the Secretaries of State for Defence and the Environment and the Chief Secretary, that action should proceed as you propose in your minute; and that, subject to Ministerial clearance generally, the Secretary of State for the Environment should make an oral Parliamentary statement, in terms of the draft attached to your minute.

I am sending copies of this minute to the Private Secretaries of the Secretaries of State for Defence and the Environment and to the Chief Secretary.

N.L.W.

(N.L. WICKS)

13 May 1988

ca

Prime Minister

Ref. AO88/1451

MR WICKS

Yes not

Content for Mr Ridley to
make the oral statement at
Flag A, subject to clearance
with Departments?Future of the PSAFlag
N.C.U

11-5.

The Prime Minister asked me for a report on the action being taken under the six headings discussed at her meeting on 8 March about the future of the PSA (your minute to me of that date).

attached
at Flag B.

2. Following the decisions reached at that meeting, much detailed and constructive work has gone ahead between PSA, MOD and Treasury. It is already clear that the practical problems which exist should, with hard work, be capable of resolution in the timescales envisaged. While it has only been possible to make a start over the last two months, the point has now been reached where an early Parliamentary Statement is both possible and necessary, and I attach to this report a first draft of such a statement, prepared by the PSA and which would most naturally be made by the Secretary of State for Environment.

related
to
very

3. Taking each of the six issues discussed on 8 March in turn:

i) Transfers of responsibility

4. I was asked to define the precise functions to be transferred from PSA to MOD in respect of

- a) defence estate management
- b) certain Directly Employed Labour (DEL) operations engaged on specific permanent tasks.

5. Estate Management is a well defined function within PSA, and no major problems are foreseen in implementing the transfer of function. Approximately 650 posts will transfer to MOD, plus

locally engaged staff overseas and related ancillary staff (messengers, reprographics etc). The transfer is being planned to take place on 1 October 1988.

6. "Directly Employed Labour with specific permanent tasks" are a less homogeneous group, and the planning for transfers has also to take account of the need for suitable supervision by the MOD, including arrangements covering maintenance advice and health and safety standards.

7. About 200 DEL (primarily sewerage and water operatives, and groundsmen at major sports grounds) can be transferred without a need for consequent changes to the existing MOD management structure: this move is being planned for 1 April 1989. Transfers of up to an additional 800 DEL (including such categories as boiler operatives) are planned to take place between that date and 1 April 1990, once appropriate local technical supervision and management arrangements are in place.

8. The formal transfers of functions in all cases can be achieved by administrative means, individual staff will generally transfer with their work in the usual way, and straightforward financial transfers will also need to be negotiated.

ii) Untying of all PSA work (civil and defence) by 1 April 1990

9. An essential prerequisite for untying (ie the introduction of competition to the PSA) is that client Departments should be operating a system of payment whereby they hold Vote cover themselves for their property services costs. At present, only major civil works are on a full payment system and also untied, though departments are of course charged for their accommodation under the PRS arrangements.



10. Payment for all PSA defence activities and the remaining civil activities will be introduced by 1 April 1990 at the latest. It would be ideal if it could be done simultaneously. Further work by PSA, involving the civil departments as well as MOD, will be needed to establish whether an earlier date is feasible for some activities without causing undue disruption of services.

11. Similarly, work is needed to establish the earliest date on which it will be feasible to untie both the remaining services for civil clients and all defence works. But the intention is that all civil and defence services would be untied from 1 April 1990 at the latest.

12. The precise form of untying for some activities, especially maintenance, is not yet clear. Further study is required to work up detailed arrangements, and to examine how best to deal with those areas (eg defence work overseas) where there may be particular difficulties in converting the principle of untying into practice. The present arrangements for work for the US Forces will need to be reviewed, in consultation with the US authorities.

iii) Implementation of a PSA trading fund based on commercial accounts by 1993

13. In line with the report from Deloitte's, and as broadly endorsed by the Prime Minister, PSA in agreement with the Treasury propose to reorganise into three businesses:

- a) project services (ie management of major works);
- b) estate services (ie management of minor works, and maintenance, and civil estate agency);

c) property ownership of the common user element of the civil estate (ie properties not transferred to the ownership of specific departments). It is not clear whether this business could become part of the trading fund.


14. PSA plan to have the three businesses fully operational by 1 April 1990, with shadow running before that date, and transfer of non-"common-user" properties to individual Departments also completed by that date.

15. The key requirement for the introduction of full commercial accounts (planned for 1 April 1992), Trading Fund status (1 April 1993) and the development of a commercial track record is the implementation of PSA's strategy on information technology. Purchase of new hardware will need to begin in the autumn of this year, for installation in 1990. This will require prior Treasury agreement to the strategy, and agreement with Treasury and MOD on arrangements for PSA to take over sole financial responsibility for their IT expenditure.

iv) Contracting out of internal PSA functions

16. PSA's approach to contracting out will be to do so as part of the broader policy (iii above) of developing the project services and estates services businesses on commercial lines. In particular, they intend to prune those functions which can be contracted out quickly without impairing commercial performance.

17. The Directly Employed Labour (DEL) force has been reduced from some 19,000 in 1979 to some 8,600 now as a result of contracting out. PSA's future policy will be to continue to reduce the DEL to the absolute minimum that meets client requirements; while reductions have hitherto been effected by



natural wastage, compulsory redundancies will almost certainly be required in the future (see section vi below). By 1 October 1988 PSA intend to set target dates for reduction over the next three years for both civil and defence activities, taking account in the latter case of MOD's transition to war needs and also the UK needs of the US Forces.

18. PSA also intend to reduce their design offices from 25 now (as against 50 in 1987) to above¹⁰⁰ 10 or less by 1 April 1990; as planning develops, they will be able to set more precise targets for reductions in staff numbers. In addition, PSA plan to examine the scope for additional contracting out of their civil estate agency functions and in their local works offices.

v) Advance Quotations by PSA

19. PSA and Treasury have devised arrangements to ensure that PSA is able after untying to quote firm prices which will avoid client Departments being faced with an undue proportion of PSA's overheads. From 1 April 1990 at the latest PSA will offer all client Departments advance quotations (including an appropriate element for overheads) to which they can be held on a similar basis as private sector consultants. It may be necessary to devise additional arrangements to ensure that an undue share of overheads is not charged to activities where untying may prove difficult in practice, though this will be related to the further detailed work on the specifics of untying.

20. PSA will separately develop estimating and pricing techniques to minimise the risks of overall overspends on the PSA Vote before the Trading Fund is established. But in the last resort, if there is a potential overspend which cannot be offset by savings, supplementary estimates may be needed in the interim period between 1990 and 1993.

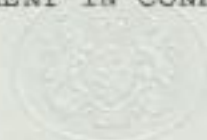
vi) Changes in Policies on PSA redundancies

21. An accelerated rundown of the DEL has hitherto been rejected in view of assurances previously given that the introduction of the Property Repayment System (PRS) would not of itself lead to compulsory redundancies. Now that PRS is fully operational, that inhibition can be removed; and PSA will need confirmation that compulsory redundancies in the DEL can be effected. Indeed, in general, PSA will need to have the same ability to reduce staff (industrial and non-industrial) as any private sector consultant would have, but the precise form of the greater flexibility required will need to be assessed in the light of the Agency's overall strategy for moving to a more commercial mode of operation. This will have financial implications for which PSA does not at present have provision.

Future Handling

22. The Secretary of State for the Environment believes that this matter is of sufficient importance to warrant an oral statement and he will be consulting the business managers about that. I attach a first draft of such a statement which the PSA have prepared.

23. We also need to consider how best to consult civil departments. They will need to be closely involved in the next and more detailed stage of work. But provided they are assured of that and particularly that the detailed implication for them will be considered, the broad outline of principles we shall want to announce should cause them little difficulty. As soon as the Prime Minister has taken a decision on these proposals I suggest that the Secretary of State for the Environment should be invited to circulate the draft statement to Ministerial colleagues together with some explanation of the background.



The trade unions will be informed simultaneously with the statement being made and will be offered consultation on the staffing implications of the policy.

24. Consideration has been given to the possibility of including in the Statement some reference to PSA being designated as a potential Executive Agency under the Next Steps Initiative. The Secretary of State for the Environment has been consulted on this. His view is that the proposals outlined above add up to a formidable agenda for change and that it would be premature to consider giving PSA executive agency status until it has gone a little further towards planning how to restructure its business in the light of the Deloittes report. Much of the preparatory work to transform PSA into three business should be relevant to decisions on executive agencies as it is towards the creation of one or more trading funds. When this work is complete, Mr Ridley will then actively consider the scope for making one or more agencies out of PSA. I think that this is the right approach, which Mr Kemp will follow up with the PSA after the announcement has been made.

25. I am sending copies of this minute to the Secretaries of State for Defence and Environment, and to the Chief Secretary.

R.R.B.

ROBIN BUTLER

10 May 1988

C SERVICE : PSA Review

pt 3



COMMUNICATIONS



DRAFT STATEMENT ON THE FUTURE OF PSA

The Government have decided that the Property Services Agency should become a commercial organisation whose future will depend upon its performance in the market place. In reaching this decision, we have taken account of a report prepared by Messrs Deloitte Haskins and Sells on the introduction of commercial accounting into the PSA. Copies of that report have been placed in the Libraries of both Houses of Parliament. We have also paid especial attention to the Second Report for the Session 1986/87 which the Select Committee on the Environment prepared on the PSA under the chairmanship of my hon Friend the Member for Hornsey and Wood Green.

My rt hon Friend the Chief Secretary has already announced on 23 July 1987 (Hansard, Cols 433 and 434) from 1 April this year a new payment relationship for major civil projects between Departments and the PSA. Under this payment regime, Departments meet the cost of major construction works from their own votes, and are untied from the PSA, ie they have the freedom to use agents other than the PSA where it appears cost effective and in the interests of good management to do so. Payment and untying arrangements will now be introduced for all PSA services provided to the Ministry of Defence as well as to civil departments. The extended arrangements will be fully in place by 1 April 1990.

By 1 April 1990 also, PSA will be reorganised into three distinct businesses, as recommended by Messrs Deloitte, Haskins and Sells. Two of these will be service businesses, covering project services (broadly, design and management of major construction works) and estate services (broadly, estate agency functions on the Government's civil estate, plus management of minor construction works and of maintenance). The third business will involve civil ownership of property. PSA will continue to manage a common user element of the existing civil estate, a substantial amount however, will become the responsibility of individual Departments.

I hope to make substantial progress in implementing this re-organisation before the completion date of 1 April 1990.

In operating its businesses, the PSA will be under explicit instructions to contract out, in line with Government policy generally, functions to the private sector wherever this offers better value for money and does not impair the PSA's own commercial viability. I shall keep the progress of contracting out under continuous review.

The extension of payment and untying and the planned re-organisation into three businesses are designed to expose the PSA to outside competition as rapidly as possible; and to equip the PSA to compete effectively. In addition we have also decided that if the PSA is to operate on a fully commercial basis, it should become a Government Trading Fund, as proposed both by Messrs Deloittee, Haskins and Sells and by the Select Committee on the Environment.

In line with the timetable set out by Deloittee, I look to PSA establishing as much of their operations as practicable under a Trading Fund no later than 1 April 1993.

Finally, my rt hon Friend the Prime Minister has decided that my rt hon Friend the Secretary of State for Defence should take over responsibility in two areas. The first of these is management of the defence estate both in the United Kingdom and overseas. Transfer both of this function and of the staff needed to discharge it will take place on 1 October 1988. The actual staff involved in transfer will be settled as early as possible in the intervening period.

The second transfer relates to the industrial staff who are employed in the PSA's Directly Employed labour (DEL) force to carry out specific and permanent tasks (mainly relating to plant, equipment and grounds upkeep) in defence establishments. By 1 April 1989 some 200 industrial staff will transfer from PSA to MOD. Further staff will be transferred by 1 April 1990 as arrangements are developed to put PSA's relationship with MOD on to an untied basis.

The Trade Unions will be consulted about the staffing implications of the changes which I have described.

Planning the changes has inevitably entailed uncertainty about the future of the PSA. With this uncertainty now ended, successful implementation of a demanding programme will place a considerable responsibility on PSA staff at all levels. I am confident that PSA will rise to the challenge and prove that it can hold its own in a commercial environment.

RESTRICTED



Cite M

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

3 May 1988

The Prime Minister has seen the Centre for Policy Studies' paper 'the Property Services Agency - case for demolition'. She has asked me to check that your Secretary of State has also seen this, and has noted that the most striking point is whether the Government can follow the path Henry Chilver pioneered in the Milton Keynes Development Corporation. Paragraph 3 on page 14 refers.

P. A. BEARPARK

Roger Bright, Esq.,
Department of the Environment

RESTRICTED

[Handwritten signature]

PRIME MINISTER

You may like to see the latest pamphlet which has been published by the Centre for Policy Studies: "The Property Services Agency - a case for demolition".

AH
ARCHIE HAMILTON
29.4.88

Could you make sure
that Nick has seen
this? The main
stakeholder point is whether
we could follow the path being
taken pioneered in the Milton
Keynes Development Corp.
not



Date: **April 88** Centre for Policy Studies, 8 Wilfred Street, London SW1E 6PL (01-828 1176)

The Property Services Agency
—
a case for demolition.

Keith Boyfield

Price: **£2.95**

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THE PROPERTY SERVICES AGENCY

-- A CASE FOR DEMOLITION

Keith Boyfield

CENTRE FOR POLICY STUDIES
8 Wilfred Street, London SW1E 6PL
1988

PREFACE

The primary aim of this paper is to focus on the PSA's management of the central government's accommodation requirement. It is less concerned with the PSA's record as a building manager, or with its management of the Defence Estate, or with the Crown Suppliers.

THE AUTHOR

Keith Boyfield is an honorary Research Fellow of the Centre for Policy Studies. A graduate of the London School of Economics, specialising in government, he was awarded a Social Science Research Council Studentship to conduct research into the performance of nationalised industries. He has served as personal assistant to The Rt Hon Tom King MP and The Rt Hon Lynda Chalker MP. He now runs his own consulting practice, PROBE. His previous publications include Telecommunications in Britain, BL: Changing Gear, and Put Pits into Profit.

ACKNOWLEDGEMENTS

For their help and advice in compiling this study I would like to thank all the members of the CPS working party set up to study the PSA; and especially Richard Ehrman, Ruth Mellor and Angus Miller.

This study was prepared for the Nationalised Industries Study Group of the Centre for Policy Studies. Support toward research was provided by the Institute of Policy Research.

The Centre for Policy Studies never expresses a corporate view in any of its publications. Contributions are chosen for independence of thought and cogency of argument.

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1.

SOME HISTORY

The origins of the Property Services Agency can fairly be traced back to the Middle Ages when the Sovereign employed a Clerk of the Works to maintain the royal palaces. In the nineteenth century the Office of Works expanded to become a department of central government. The next major landmark can be placed in 1940, when the Office of Works was established as a separate Ministry. In 1963 it assumed responsibility for the works departments of the armed services, and in the process changed its name to The Ministry of Public Buildings and Works. In turn, this Ministry was absorbed into the giant Department of the Environment created by Edward Heath's Conservative Government in 1970.

CREATION OF THE PSA

A series of studies were commissioned in the early 1970s to review the property requirements of government departments. In 1970 Derek Rayner[1], who was then a Managing director of Marks & Spencer, was asked to investigate ways of improving the organisation and management of procurement and supplies by government. His review recommended the establishment of three separate departments: one would be responsible for procurement, one for construction and the third for supplies.

The Deputy Chairman of Bovis, Herbert Cruikshank, was then asked to review the structure, organisation and management of the construction activities of the new Department of Environment. He recommended that building requirements for all government departments should continue to be met by a sub-department of the Department of the Environment.

Timothy Sainsbury[2], a director of the eponymous supermarket chain, was subsequently asked to study the way in which central government managed its property requirements. His review published three reports which recommended that the government estate should be handled by a separate Property Management Agency.

....

[1] Lord Rayner of Crowborough, created a Life Peer in 1983

[2] Conservative MP for Hove since 1973

Following this series of reviews an inter-departmental working party of officials recommended the creation of two agencies - PSA and HMSO. This proposal was given the seal of approval by a committee of permanent secretaries under Sir William Armstrong and the Government announced the formation of the PSA in May 1972.

From this account of its origins it can be seen that the PSA evolved in a straightforward manner. The Government has always had a body, whether it was a department, ministry or agency, to deal with the management of the government estate.

Individual departments have never been responsible for renting their own accommodation requirements; have never commissioned chartered surveyors, architects or other professional advisors; have never leased property in their own name. (It is, however, true that they do assume a measure of responsibility for maintenance, decoration and running expenses of some of the property they occupy.)

THE PSA TODAY

The PSA is part of the Department of the Environment, and has five main functions.

* It manages the government estate. It is responsible for all lands and buildings either owned or leased by the Government: in case of the civil estate in the name of the Secretary of State for the Environment; in the case of the defence estate in the name of the Secretary of State for Defence. It allocates land and property to meet departments' requirements, and is responsible for the purchase, leasing and disposal of all such land and property.

* It is in charge of the design of new buildings, as well as extensions and adaptations to present government properties.

* It maintains the civil and defence estates.

* It supervises all construction work undertaken by private contractors on behalf of government departments.

* It is responsible for supplies to government departments, including those of such diverse natures as catering equipment, fuel, furniture, engineering plant, motor vehicles and office equipment.

Thus the PSA is responsible for a huge estate, which (excluding defence land) consists of more than 8000 holdings spread over 11 million acres. In the last financial year the Agency's turnover exceeded £3 billion, yet it has no accounting system equivalent to any used by a commercial body. An outline summary of its expenditure by type of work for 1986/87 is shown opposite:-

PSA expenditure[3]
£million

	1986/87	1985/86
New construction	1115	1051
Maintenance	799	722
Rents & service charges	244	219
Fuel, furniture, transport and other purchases	186	177
	<u>2344</u>	<u>2169</u>

The PSA employs 24,707 staff, of whom 9479 are classified as industrial and 15,228 as non-industrial (e.g. architects, civil engineers, quantity surveyors and professional administrators). In an effort to simplify its bureaucracy, senior management has reorganised the regional network, merging the area and regional tiers and closing ten of the 24 area offices. Nevertheless, fewer than 100 jobs were eliminated by this rationalisation.

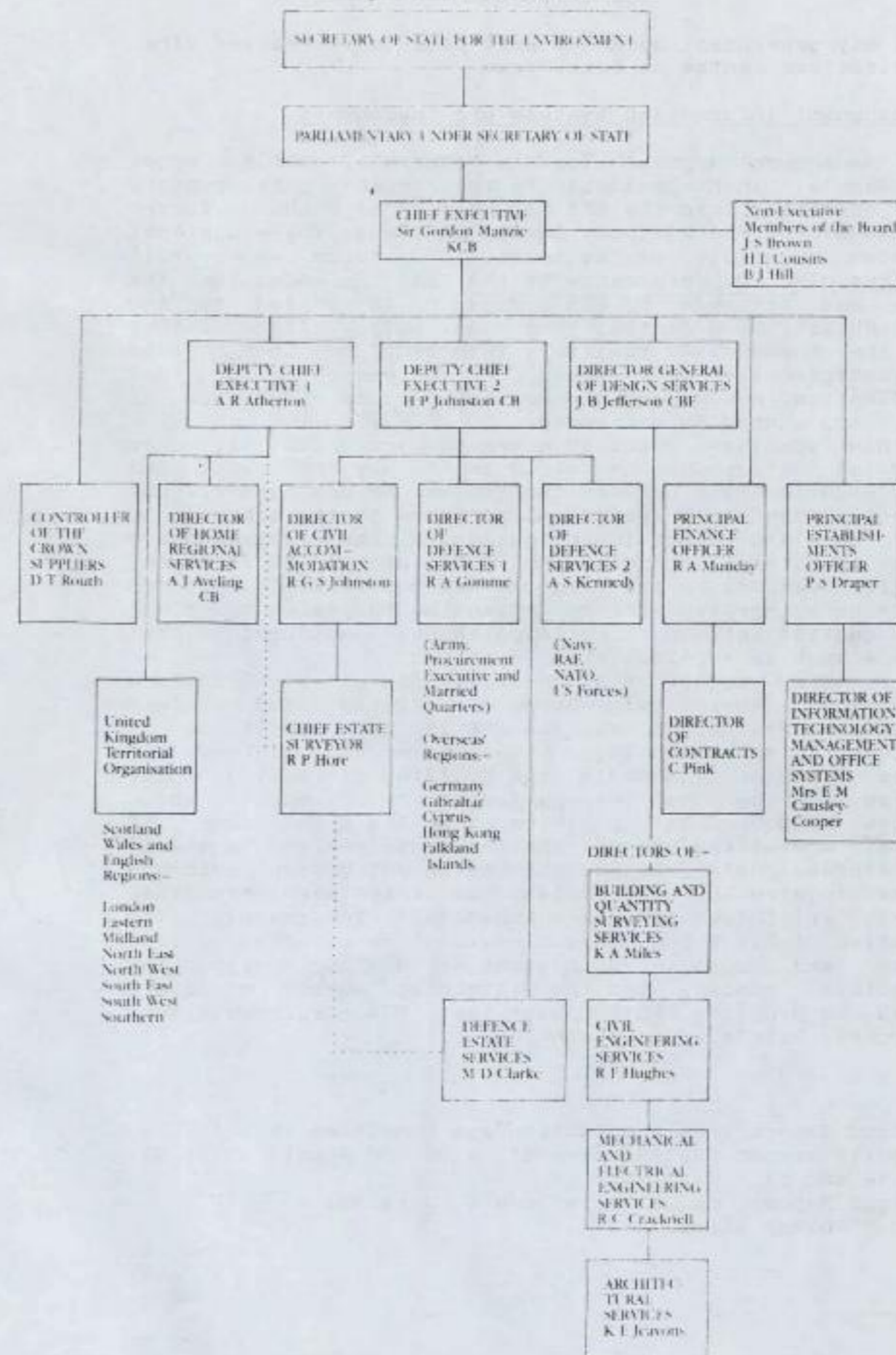
A chart of the PSA's elaborate management structure, taken from its latest annual report, is shown on the following page.

....

[3] Expenditure by type of work excludes PSA resource costs, consultants' fees and Crown Suppliers sales. These items when totalled with PSA expenditure give the turnover figure. (Crown Suppliers is already a separate Trading Fund.)

— ORGANISATION —

PSA Organisation as at 1 June 1987



2.
THE CRITICISMS

Few if any government agencies have come under heavier fire. The criticisms centre on four areas.

1. Management information systems are inadequate.

PSA's management approach lacks a commercial cutting edge. For example, in his evidence to the recent parliamentary select committee into the PSA [4], Sir Nigel Mobbs, a former chairman of the PSA advisory panel, said that there was 'not a system available at the moment to provide an overall objective view of performance by the PSA'. He added that the 'style and attitude of PSA management is geared to the accountability of a central government policy office rather than the commercial reality'. This led, he thought, to 'over-management, an excess of cross-checking and justification, a slow decision-making process and a lack of urgency and energy in management'.

This absolute priority given to accountability over commercial enterprise has stood in the way of trust and sound relationships between the PSA on the one hand, and the contractors and professional advisers on the other.

In both its recent investigations[5] the Parliamentary select committee found that the record of the PSA for cost and time overruns on its projects was poor. Lately, things seem to have improved; but too often the PSA seems to block close contact between client departments and professional advisers such as architects[6].

The picture that emerges is of a Byzantine bureaucracy. Where elsewhere architects and other consultants are appointed, the PSA inserts itself as an additional bureaucratic layer between user and professional adviser. Senior figures in the building professions have told us (during the preparation of this report) about meetings on government projects where the sheer number of PSA staff who attend ensures that no decisions can be made.

Professional firms and institutes which gave evidence to the inquiry by the select parliamentary committee severely criticised the PSA's management. For example, the Federation of Civil Engineering Contractors remarked on the lengthy and tedious administration dealing with the contractors' claims; and the disturbing number of staff changes on projects, which meant that PSA representatives were poorly briefed on certain jobs.[7]

.....

4. Second Report from the Environment Committee, 1986/87, HMSO
5. Fourth Report 1985/86 para 31; & Second Report 1986/87, paras 52 and 53.
6. Second Report, op. cit., volume I, para 53.
7. ibid., volume ii, p.118.

This criticism was echoed by the Royal Institute of Chartered Surveyors who pointed out that 'lines of communication are too long, responsibility is too diffuse and far too removed from those closely concerned with individual projects'.

The Royal Institute of British Architects conducted a survey amongst major practises into their experiences with the PSA. Respondents talked of serious shortcomings in the briefs which the PSA gave them, and of the inexperience of some of the interviewers who conducted the selection of architects. The RIBA also reported a 'lack of direct contact with the client department on certain types of work'. Diplomatically, the RIBA 'regretted' this.[8]

In their final report the Select Committee concluded that the PSA had failed the 'test of experience' in its role as property agent to government departments. They pulled no punches. 'The PSA has been found to be too impotent and too cumbersome, with lines of communication [again] that are far too long.[9]

One ironic complaint referred to the lack of effective management of the government estate; ironic because this had been one of the main reasons for setting up the agency in 1972.

The committee pointed out that the PSA had often been unable to identify opportunities in the property market and had neglected maintenance, mainly (it is true) due to pressures of annual Treasury budgets, but also through poor management. It was these deficiencies which led the agency to facing a 'consumer revolt'. Government departments demanded to commission outside contractors directly.

The National Audit Office (NAO) published a report in January 1986 which echoed many of these criticisms.[10]

This report found that buildings were deteriorating because maintenance was inadequate, that some surplus property had been disposed of very tardily indeed, that no reliable estimate had been made of the value of the MOD estate. The MOD is one of Britain's largest landowners, with 220,000 hectares under its control and rights to another 36,000 hectares. Although the MOD

.....

8. ibid, para 17, p 107.
9. Second report, op cit, vol 1, para 72.
10. Ministry of Defence and Property Services Agency: Control and Management of the Defence Estate, House of Commons, Paper 131, HMSO.

admit that their land-holdings are too large for their needs [11], no figures were published in the NAO report on the scope for reduction in their holdings. Information which would allow these sums to be done was not available. Nor was there any management system which could bring them to light. It must be added, however, that the policy responsibility for the defence estate rests with the MOD. PSA act only as agents after the MOD have handed property over as surplus to requirements; and the NAO give some credit to the PSA for their part in streamlining the process.

The National Audit Office recommended that MOD, with PSA should prepare a strategic plan for the whole estate' which aimed at its optimum rationalisation, 'including multi-service occupation of single sites, and achieving a cost-effective balance between capital investment and maintenance expenditure'. [12]

2. It is insensitive to the needs of conservation

The Society for the Protection of Ancient Buildings (SPAB) has pointed out that '...in spite of the PSA's glossy publicity proclaiming its achievements in conservation, it has a questionable reputation among those professionally involved in historic buildings. It also notes that the PSA tends to regard itself as an 'organisation above criticism' and has a 'marked reluctance to seek outside advice or enter into technical or other discussion'.

The Society recommends that the PSA should be disbanded with the responsibility passing to other departments. [13]

These criticisms are echoed by the Georgian Group:- 'in general terms the PSA has a poor reputation amongst conservationists for its work in maintaining or repairing the historic buildings in its care'. Like the SPAB the Georgian Group 'consider that there is a strong case to be made for the disbanding of the PSA 'with the transfer of its responsibilities to other parties. [14]

.....

11. *ibid.* para 3.2., page 14.

12. *ibid.* para 20, page 5.

13. *op.cit.* second report, vol 11 1986/87.

14. *ibid.*, page 175.

3. Incentives and penalties to rationalise the estate are lacking

Are the incentives suitable? Are the penalties severe enough? The Property Repayment Services (PRS) has proved to be an inadequate substitute for the market. As Sir Nigel Mobbs and Idris Pearce pointed out, 'much needs to be done to ensure that PRS reflects the true opportunity cost of government property utilisation' [15]. Very many properties lie vacant across the country -- in September 1986 they amounted to 575,272 square metres - equivalent to 6,189,926 sq. ft! [16]

Nor is the case any better with residential property. The Empty Property Unit, a voluntary body funded by Shelter and the Department of the Environment and several charitable trusts, has shown that there is a greater proportion of empty homes in the public than in either the private or in the local authority sectors. (See Table below.) Indeed, official statistics underestimate the number of empty properties. Department of Environment returns indicate that, as of April 1987, the total number of empty public sector properties in England was 15,600. However it was earlier reported by Roger Freeman, Parliamentary Under-Secretary of State for the Armed Forces, that his own Ministry, the MOD, was responsible for 14,994 unoccupied homes throughout Britain at the end of 1986 [17]. Not all of these, of course, are the responsibility of the PSA. (e.g. New Towns and nationalised industries). It is evident, however, that, as things stand, the PSA lacks weight and authority to deal with the problem. As the Empty Property Unit points out, 'PSA involvement begins only when properties are declared surplus to requirements. Their role seems to be reactive, not proactive; they depend on other departments to release properties to them and they report that departments tend to guard their estates jealously. As one might expect, there is a reluctance to declare properties surplus to requirements'. [18]

.....

15. *ibid.*, page 72.

16. Table on p. 241 of the Select Committee second report, vol II.

17. *ibid.*, page 173. 18. *ibid.*, page 172.

Clearly the PSA cannot be blamed for this state of affairs; but it does point to the unsatisfactoriness of the role assigned to it.

TABLE

	Empty Homes England (April 1987)	% of stock
private	570,000	4.1%
local authority	112,400	2.5%
housing associations	12,900	2.7%
other public sector	15,600	5.8%

(Source: DOE)

ADEQUACY OF THE GOVERNMENT'S RESPONSE

Direction of present government policy on the future of the PSA was made clear by the Minister responsible, Christopher Chope, in his evidence to the parliamentary select committee inquiry. Mr Chope told how his Department had appointed Deloitte Haskins & Sells to look at 'the practicability and cost of introducing commercial accounts as a prelude to setting up a trading fund'. (Evidence para 124)

Trading funds were established under a 1973 Act. They are in effect government departments treated for statistical and planning purposes as public corporations. They are not entitled to receive subsidies. Examples are the Crown Suppliers (in fact part of the PSA), and HMSO.

Cross examined by the committee, Christopher Chope claimed that a trading fund 'will not only give greater understanding and knowledge of how efficient (the PSA) is but it would also give the staff in the PSA an understanding of how efficient they are compared with the private sector'.

Later, he said that if it was decided to set up a trading fund 'the PSA would remain... as a single organisation and its justification would depend upon it providing a service which departments felt could not be provided more efficiently elsewhere'.

These remarks anticipated two major reforms announced in July 1987 by John Major, Chief Secretary to the Treasury. First, as from the beginning of April 1988 'departments will be required to meet, directly from their votes, the costs of major civil building projects which are funded from their public expenditure programmes'. Previously, individual departments were responsible only for saying what they needed for accommodation, the PSA being charged with meeting such requirements (whether by the use of existing property, or leasing, or by new construction). Presently, public expenditure on civil projects falls on the PSA vote.

The second reform, even more fundamental, is that from 1 April 1988, departments will be allowed, for the first time, to employ firms in the private sector when they judge this to be more cost-effective than using the PSA.

These reforms are welcome. But there seems little impetus behind them. Mr Major spoke of "untying" departments from the obligation to use the PSA. And he went on to add that 'this process is expected to be evolutionary for three reasons'.

The three reasons given were:

1. It will take time for departments to acquire the necessary resources and skills: nor for some departments, especially small ones, and those with few building projects, may it be economical to do so.
2. Departments will need to satisfy the Treasury that they are capable of using alternative agencies.
3. The effects of changes in workload on PSA must be taken into account. Departments must therefore agree an advance programme of work with PSA.

Taking each point in turn we would argue that:

1. The aim should be not to create a series of mini-PSAs but to contract out property management services from the outset. Departments should follow the example of the private sector and appoint professional agents to advise them.

2. A non sequitur. Civil servants require no specialist skills to appoint managing agents and other professional advisers. Industry and commerce do so all the time.

3. Such a constraint only helps PSA retain its hold on government business; an excuse to retard opening up management of the government estate to competitive market forces. The Government would do better to encourage and support PSA staff to establish their own consulting practices. This would follow the example set by the Milton Keynes Development Corporation which has helped its professional staff to set up half a dozen new firms, (such as The Creative Company, formed by a number of graphic designers who previously worked for the Corporation). From within the PSA a clutch of successful consulting practices could be hatched.

We fear that if the PSA is established as a trading fund it will maintain much of its hold on the management and maintenance of the government estate. Consider that since 1980 the number of PSA's industrial staff has fallen by 43%, while the number of PSA's non-industrial staff has fallen by only 13%. Since the PSA now uses private contractors for all new construction, for 85% of maintenance and for 65% of new design work, what, one may ask, does the PSA's 15,412 administrative staff do - apart from representing a powerful vested interest for the continuation of the Agency?

4.

RECOMMENDATIONS

a) It is important that a commercial relationship be established by government departments and their property advisers. The Chief Secretary's proposals do not go far enough towards this. We believe that government departments should assume direct responsibility for their requirements for accommodation. The restrictions which prevent them from holding leases should be abolished; they should be required to negotiate commercial leases on the buildings which they occupy.

b) The PSA's 'strategic rationalisation' role should be transferred to the Treasury, the only government body powerful enough to tackle the challenge. Such a move would fit in with the government's recent announcement which transferred the management of the civil service to the Treasury from the Cabinet Office's Management and Personnel Service. The Treasury would thus become responsible for all freeholds, which they would be able to sell if they were surplus to requirements, or if it was necessary to realise certain assets in order to meet the government's overall targets for public expenditure. This would help to release a great amount of land and of unused office accommodation presently in the public sector. Note that 15% of the cost of government administration is attributable to property costs. [15]

c) The PSA should be given a narrowly defined role as the landlord's - i.e. the Treasury's agent. Thus it would buy and sell freeholds, negotiate leases, handle rent reviews and collect rents from government departments.

Its other function would be to maintain the royal palaces (albeit in competition with commercial firms): the role played by the old Office of Works.

d) The Government should follow the lead set by the Milton Keynes Development Corporation (see above) and encourage PSA staff to establish their own consultancy firms.

.....

19. Sir Nigel Mobbs in evidence to the Environment Committee, Second report, 1986/87, vol II, page 77.

PRIME MINISTER

You may like to see the latest pamphlet
which has been published by the
Centre for Policy Studies: "The Property
Services Agency - a case for demolition".



ARCHIE HAMILTON

29.4.88



10 DOWNING STREET
LONDON SW1A 2AA

25th April, 1988

Dear Nathalie

Thank you for your note of 22nd April with which you enclosed a copy of "The Property Services Agency - a case for demolition" which is to be published this week by the CPS.

I shall certainly place the pamphlet before the Prime Minister, although this will probably not be until the weekend.

*Yours ever
Archie*

ARCHIE HAMILTON
Parliamentary Private Secretary

Mrs Nathalie Brooke



CENTRE FOR POLICY STUDIES

8 Wilfred Street, London SW1E 6 PL. Tel: 01-828 1176


22 April 1988

Dear Archie,

I am enclosing a copy of The Property Services Agency - a case for demolition by Keith Boyfield, which is being published by the CPS next week.

I would be grateful if you would give the Prime Minister this publication. I hope she will find it of interest.

With best wishes,


Nathalie Brooke

The Hon Archie Hamilton MP



SUBJECT CC MASTER

File
S. W. B. H. T. 1
B.10 DOWNING STREET
LONDON SW1A 2AA*From the Principal Private Secretary*

SIR ROBIN BUTLER

FUTURE OF THE PSA

The Prime Minister discussed this afternoon the future of the PSA with the Secretaries of State for Defence and for the Environment, the Chief Secretary and yourself.

After some discussion, it was agreed to proceed as follows:

- (i) There should be a transfer of responsibility from PSA to MoD in respect of the following defence estate functions
- defence estate management
 - certain Directly Employed Labour (DEL) operatives with specific permanent tasks (e.g. boiler operators).

The Prime Minister asked you to define, in consultation with MoD and PSA, the precise functions to be transferred.

- (ii) The PSA should make arrangements for all remaining (defence and civil) work to be untied by 1990.

(iii) The PSA should introduce commercial accounts with a view to placing all their activities on to a trading fund basis, which reflected the Agency's three activities, property ownership, project management and estate agency work (with the ultimate intention of floating off the latter two functions in due course). The trading fund regime should be introduced as soon as possible and certainly by no later than 1993.

The PSA and the Treasury should come forward with proposals to put this into effect.

(iv) The PSA should produce a detailed plan to contract out internal PSA functions e.g. DEL and more of the design staff; the plan should include target levels for staff retained or proportions of work targeted out with dates for achievement.

(v) The PSA and the Treasury, in consultation with the MoD, should devise arrangements - both for the period after the PSA's activities had been placed on the commercial accounting basis described at (iii) above and for the interim period after untying in 1990 and the beginning of the introduction of commercial accounts - which would avoid a Department being charged with PSA's oncosts/overheads in those

~~SECRET~~

cases where it had placed contracts with contractors other than the PSA. The arrangements should operate so that the PSA's tender price comprised its total charge for services rendered in those cases where it had secured the contract; i.e. the arrangements should not permit the PSA to charge on costs/overheads in addition to the tender price which it had submitted.

(vi) PSA, the Treasury and yourself should consider whether changes were needed in present policies regarding PSA redundancies.

The Prime Minister asked you to prepare a report for her covering the action under the six headings above with a view to a Parliamentary statement (presumably by Written Answer) no later than two months' time. You should suggest at the same time how the Prime Minister might best take the opinions of the other interested Departments on the changes proposed.

I am sending a copy of this minute to the Private Secretaries to the Secretaries of State for Defence and for the Environment and to the Chief Secretary.

(N. L. WICKS)
8 March 1988

~~SECRET~~

Ref. A088/750

MR WICKS

The Future of the PSA

Your minute of 15 February (not copied to Departments) in reply to mine of 9 February said that the Prime Minister assumed that if the PSA work is untied:

- a. PSA would contract in size if it did not get business;
- b. There would be a mechanism to ensure that Departments do take advantage of untying and seek private tenders.

The Prime Minister noted from my minute that not all major client Departments are intending to take advantage of untying in 1988-89 for major civil works: she asked which these Departments were and why they were not untying.

2. I expect PSA to contract if it does not get business from client Departments after untying. Indeed, if PSA does not do so it will have increased overheads causing its prices for remaining work to go up, so making it less competitive, and that will result in still less work being placed with it. There will therefore be a strong incentive on PSA to forecast its manpower needs accurately, and adjust accordingly.

3. It is possible that Departments might take work away from PSA so rapidly that the adjustment needed in PSA's numbers outstripped its ability to achieve reductions through natural wastage, early retirement and voluntary redundancy. A political decision would be needed if compulsory redundancies were the only way PSA could adjust quickly enough to a falling workload

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from client Departments. Given its size, the MOD policy following untying is likely to be the critical factor.

4. The answer to the Prime Minister's question about which major client Departments are not intending to take advantage of untying for major civil works in 1988 is that the only major Department not yet contemplating market testing in 1988-89 is the Lord Chancellor's Department. They are giving priority to establishing arrangements for the repayment system for new work, which is mandatory from this April; they will then start recruiting project managers, whose expertise they need in order to test the market. (It should be noted that the Chief Secretary's statement last July said that "Departments will not necessarily be expected to test the market from the outset or use agents other than the PSA".) If the Prime Minister nonetheless wishes to follow this up, she might like you to write to the Lord Chancellor's office along the lines of the attached draft.

5. On a mechanism to ensure that Departments do take advantage of untying, no formal mechanism has been envisaged hitherto, because the larger client Departments generally have all along been keen to acquire this freedom - as we will no doubt hear from Mr Younger in relation to the defence estate at the meeting on 8 March. At this early stage, while Departments (and the PSA) are still gearing themselves up for these changes, I doubt whether any formal mechanism is needed: it is perhaps something to look at in the light of a year or two's experience. If the Prime Minister wishes to give the move to untying on 1 April some additional impetus, she might like you to write round to the main civil Departments nearer to 1 April to indicate her hope that Departments will make full use of the opportunities now available. I will supply a draft in due course if the Prime Minister would like this done.

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6. I have sent you separately some notes for the meeting on 8 March with the Secretaries of State for the Environment and Defence and the Chief Secretary.

R.R.B.

ROBIN BUTLER

4 March 1988

DRAFT LETTER FROM N L WICKS TO J P STOCKTON, PS/LORD
CHANCELLOR

As you will know, the Prime Minister regards it as important that Departments should make full use of the new freedoms they will acquire from 1 April to untie from the Property Services Agency, in respect of major new civil works, in order to achieve better value for money. She understands that your Department is not planning to move as rapidly as some others in this area.

The Prime Minister would be grateful if the Lord Chancellor could let her have a short report on his Department's plans for the new repayment and untying arrangements over the next two years.

Not necessary

1/13 MEETING ON 8 MARCH

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Ref. A088/749

MR WICKS

Future of the PSA: Prime Minister's Meeting on 8 March

Introduction

This meeting is to discuss the future of the PSA with the Secretaries of State for Environment and Defence, and the Chief Secretary. It arises from my report of 31 December (A087/3702) about responsibility for PSA work on the defence estate. Your letter of 19 February said that the Prime Minister is inclined against transferring responsibility from PSA to MOD, and suggested this meeting should focus on a strategy for PSA based on more contracting out and rapid introduction of private sector competition through untying.

2. I understand that Mr Younger, while expressing disappointment that the Prime Minister does not favour a major transfer of responsibilities, will probably not press the issue. This suggests that the Prime Minister might confirm her view at the outset, to head off unproductive discussion.

3. I suggest that the Prime Minister's objectives for this discussion might be:

i. to discourage further debate on the question of departmental responsibility (subject to ii(e) below);

ii. to launch work to:

(a) implement in relation to the Defence Estate untying, payment and project ownership by April 1990;

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(b) untie the remainder of work on the civil estate, so that at least 95 per cent of all PSA work is untied from 1990;

(c) introduce commercial accounts in PSA, and subsequently convert PSA into a trading fund;

(d) establish a programme to contract out PSA internal functions - PSA's directly employed labour (DEL) and design function are the obvious candidates;

(e) (if MOD request) examine limited transfers of responsibility from PSA to MOD in respect of

- defence estate management;
- certain DEL operatives with specific permanent tasks (eg boiler operators)

(there are respectable arguments in these two limited areas, with much less damaging offsets - as set out in para 18 of my second minute of 31 December (A087/3703)).

Of these five tasks, I suggest the Prime Minister asks the Chief Secretary and the Treasury to lead a working group with MOD and PSA to tackle (a) (which is likely to be much the most controversial between MOD and PSA) and to co-ordinate as necessary the work on (b) (which will be mainly for PSA); Mr Ridley could be asked to organise work on (c) in consultation with client Departments and Treasury, and to produce plans for (d); and any work on (e) should be remitted to me as machinery of government issues. In all cases, those responsible should be asked to report back to the Prime Minister in three months.

4. Mr Younger is likely to seek MOD leadership for the work on project ownership, payment and untying ((a) above), arguing that MOD as customer and the Department with financial responsibility should have the last word. History does not suggest that this

is likely to lead to swift resolution of the outstanding issues, and Mr Ridley will probably resist: hence the proposal above for Treasury to provide (relatively neutral) chairmanship.

5. Mr Younger is also likely to seek the transfer to MOD of the two relatively small areas of PSA work identified in (e) above. Both are troublesome under the present arrangements, and the benefits of change may quite possibly outweigh the costs. I do not expect Mr Ridley to be too resistant. It ought to be possible to provide relatively speedy advice to the Prime Minister (which I and my staff would undertake), without distracting PSA and MOD senior management from the more major issues they face. I recommend acceptance that these issues should be looked at, without prejudicing the outcome at this stage.

6. Mr Ridley is unlikely to have difficulties with the proposals in paragraph 3, though he will want the links between the various pieces of work to be properly recognised. He may also seek the Prime Minister's agreement to an early public announcement of the Government's eventual intention to convert PSA into a trading fund. This is the logical outcome of present policy, short of privatisation, and I recommend the Prime Minister to agree, subject to clearing the text.

--- 7. I attach an aide memoire covering some of this ground in terms of 'points to make'.

8. I am minuting separately on the questions in your minute of 15 February.

R.R.B

ROBIN BUTLER

4 March 1988

POINTS TO MAKE

Initial

1. Grateful for the work which went into the report sent to me by Sir Robin Butler on 31 December. Have considered the arguments carefully, and have concluded that the best way of introducing more competition, more privatisation and more contracting out is not to change the responsibilities for PSA's work, but to go for a rapid programme of untying and more contracting out. This would also avoid the costs of distraction of a very large scale transfer of work from PSA to MOD. The PSA should in due course become a trading fund, which would become a candidate for privatisation if it succeeds, or will wither away if not.

*Presumably
this would
mean
fewer people
at PSA*

2. Suggest discussion today should agree on work needed to carry this approach forward.

Programmes of Work

3. Four programmes of work are needed:

a. on the defence side, aim should be untying of all aspects of work, not just major ^{projects} profits, by April 1990. Arrangements already agreed for the civil estate will be relevant but need not be followed slavishly. Would like the Chief Secretary and the Treasury to lead a working group with MOD and PSA to start untying in 1989, and complete in 1990.

b. On untying rest of work on civil estate [minor new works and maintenance], Secretary of State for the Environment to set in hand, and Chief Secretary to co-ordinate with a.

c. On introduction of commercial accounts by PSA and subsequent creation of a trading fund, Secretary of State for Environment to set in hand, in consultation with MOD, other client Departments and Treasury.

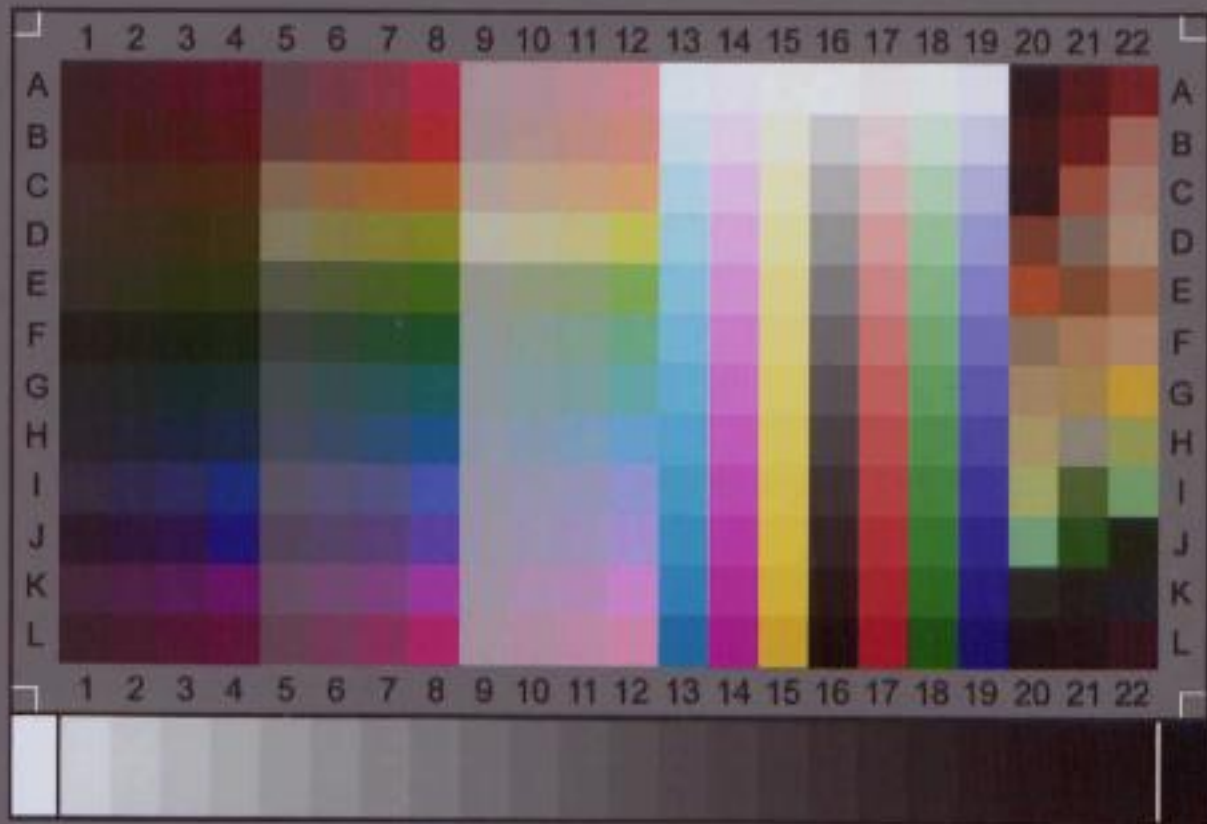
d. More intensive programme to contract out internal PSA functions, eg the Directly Employed Labour and more of the design staff; Secretary of State for Environment to produce

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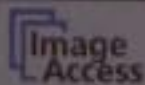
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