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Prime Minister

To note (Mr 1668)

Act 2nd

paper will be for discussion

at E (NI) tomorrow

MUS 2/12

2 December 1981

Qa 05735

To: MR SCHOLAR

From: J R IBBS

Nationalised Industries' Board Salaries

1. Your letter dated 25 November to Mr Wright conveyed some initial doubts expressed by the Prime Minister on the effectiveness of a payment-by-results scheme for the nationalised industries. The Prime Minister's scepticism seemed to be based on two observations:

(i) a fear that rising world oil price might make it easy for the energy producing nationalised industries (e.g. BGC and NCB) to meet targets;

(ii) more generally, that industries would seek to meet targets through substantial price increases.

2. It should be possible to overcome both these difficulties in a well designed scheme. The essential steps are to define clearly the objectives that the Government wishes an industry to achieve; to express these in terms of targets (quantified wherever possible); and to specify any necessary constraints on how objectives are to be achieved and to embody these constraints in the scheme.

3. For example, if one objective were a particular financing requirement, not only would there be a target figure with a scale of bonus points related to achieving or bettering it, but the scheme could also take account of -

(a) the extent to which the target was to be approached by means other than price rises (e.g. cost reductions or disposals). Price increases above a specified level, or in excess of a specified index, could be linked to penalty points; achievement of the financing target with lower prices could be linked to additional bonus points.

(b) A formula for excluding from bonus calculations price changes that related wholly to external factors over which the management had no control, for instance world oil prices.



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4. It is because of the need to take account of matters of this kind that objectives must be properly defined, and the nature of the business clearly understood, when a scheme is constructed.

5. I am sending a copy of this minute to Sir Robert Armstrong.

*SR*

conqueror