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Tobacco Strategy Review

Funding of R&D

Situation preceding decentralisation

Until 1985, the Group had a central research establishment engaged on fundamental research based in Southampton and five other laboratories in the CAC countries, each concentrating on applied research and technology. The CAC countries funded the central R&D programme at Southampton on a turnover-related formula.

Decentralisation Plan

The concept agreed in March 1985 was that Southampton should become integrated with BATUKE (with a responsibility also for BATCo companies) and that the six laboratories on an equal footing would carry that part of the Group programme for which they had particular need and expertise. Any projects not picked up by the CAC laboratories and not specifically relevant to BATUKE/BATCo would be terminated. The Research Co-ordinator would ensure that in this process any research activity that in his view should be pursued for Group benefit would be identified and justified for retention at Southampton.

Current position

We are now 18 months into the new arrangements with the following results:-

1. The Southampton laboratory is fully integrated with BATUKE.
2. Projects from the former Group programme have been retained, transferred to CAC's or terminated.
3. There has been practically no increase in R&D staff at the CAC laboratories despite the fact that Southampton lost 120 staff (it had been the intention of the Laboratories to increase resources but local economic pressures have so far prevented this).
4. Each R&D Centre has projects which are identified as Group-relevant and each pools its findings. However, these activities respond to the perceived needs of its parent company; practically none of this work is done for Group reasons or benefit.
5. Southampton and Brazil represent exceptions in that they each retain a proportion of fundamental research projects (and appropriate staff) that are more clearly defined as Group strategic rather than company strategic.

Group Strategic Projects

The work in Brazil is focussed on tobacco processing science and is beginning to generate ideas that have practical application, typical of which is the work on tobacco leaf quality improvement by processing treatments.

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The Southampton programme of fundamental research is long term but is directed at business goals. Important topics include the formation and control of individual smoke components which we anticipate becoming a subject of regulatory intervention, the formation, and composition and control of sidestream/ambient smoke, again increasingly the subject of regulatory interest, and enhancement of smoke sensory attributes by modifications to aerosol formation. The latter, which relates to nicotine release from smoke, is considered a key approach to product taste and flavour improvement and will be particularly relevant as regulatory authorities create consumer interest in low tar/regular nicotine products.

Following the closure of the main biological activity at Southampton, a responsibility remains to monitor external developments in biological testing and this is part of the Fundamental Research activity. Finally, the kind of basic research on process science that produced both APEX, our own expansion process, and DEER, our new tobacco extrusion/expansion process, lie within this activity.

The activities have been scrutinised by CAC experts since Project Styx and the specific programmes for the most part re-directed.

Options for Funding

We have looked at the concept of pooling the total costs of Group projects (both those described as Group-relevant, but carried out solely for the parent company's needs, and those termed Group strategic) across the six centres and redistributing on a turnover basis. This would call for strong accounting control and would generate debate over proportions of work truly defined as Group relevant. Our intention in identifying Group projects is to ensure maximum communication of information and this would be 'distorted' if financial considerations were to be linked. This 'cross-charging' approach was therefore not pursued.

The second option was simply to let 'costs lie where they fall'; this has considerable merit in view of the fact that currently, Group relevant projects are simply those responding to a company's specific interests but of broad value to the Group.

Recognising the special situation at Southampton and Brazil, we should consider a refinement to the costs 'lie where they fall' concept. The cost of the Brazilian Group programme is £0.55 m p.a. The costs amounting to approximately £2 m p.a. associated with the Group fundamental research work at Southampton should be isolated since they are not simply attributable to BATUKE or BATCo. In terms of funding this activity, we have the following options:

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1. To stop this work and dispose of the facility.

The high calibre of the team at Southampton, coupled with its flexibility in responding to fundamental and challenging research needs, suggests that this team should be retained. It amounts to 6% of total Group R&D spend and is still the strongest fundamental research resource we have.

2. Disperse the activity to other R&D Centres.

This was examined in April 1985 and, whilst it may, over many years, be possible to build up this capability in the other R&D Centres, this is not possible in the short term. It was recognised that this is the core work for which Southampton is best equipped.

3. Seek funding from CAC companies.

With the exception of B&W, who are yet to reply, all CAC countries give full support to the Southampton fundamental research programme and are prepared to assist in its funding.

4. Seek BAT Industries (or BATCo funding on behalf of BAT Industries).

If this were agreed, the responsibility would lie with the Research Co-ordinator to ensure that the work programme is focused and that findings are applied.

Recommendation

1. With one exception (see 3), no cross-charging between R&D Centres should be considered.
2. The Group Strategic Projects in Brazil valued at £0.55 p.a. should continue to be funded by Souza Cruz.
3. The Group Strategic Projects at Southampton, valued at £2 m p.a., should be retained, and these costs should be met by CAC countries on an appropriate formula (see attached) and the projects monitored by a small CAC Steering Group.

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ALH/DET
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Appendix

The simplest formula for deriving the contributions from the CAC countries (excluding Brazil) is to divide the £2 m into 5 equal shares of £0.4 m, i.e.

BATco	0.4 m	(0.7 m)
USA	0.4 m	(0.4 m)
Germany	0.4 m	(0.4 m)
Canada	0.4 m	(0.3 m)
Australia	0.4 m	(0.2 m)

In practice, we may anticipate a settlement from Canada at 0.3 m and Australia at 0.2 m. It is proposed that the shortfall is reflected in an increased contribution from BATCo.

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