PREM 19/1538

MT

PART 9

SECRET

Confidential Filing.

The Future of British Leyland.

INDUSTRIAL POLICY

Part 1: Sept 1979

Part 9: April 1985

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~3.4.85~~							
~~4.4.85~~							
~~17.4.85~~							
~~19.4.85~~							
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~~1.5.85~~							
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~~3.6.85~~							
~~6.6.85~~							
~~10.6.85~~							
~~13.6.85~~							
~~14/6/85~~							
~~17.6.85~~							
~~3.7.85~~							
4.7.85							
File Ends							

PART 9 ends:-

AT Note for record. -undated

PART 10 begins:-

JR to PM. 3.9.85

P Warry to DM 6/9/85

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(A)(85) 28	17/05/1985
E(A)(85) 29	17/05/1985

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed J. Gray Date 12/2/2014

PREM Records Team

F.R.

File

NOTE FOR THE FILE

xref

VARLEY MARSHALL ASSURANCES

Plan end 1984

	LR-L	Unipart	ARG	BL
Creditors	262	46	329	695
Borrowings	387	8	256	522
Total	649	54	585	1217

Inventory deposits	130
Contingent Liabilities	40
Contracts placed	50
Total	1437

cc MASTER

10

RECORD OF MEETING HELD IN THE PRIME MINISTER'S ROOM AT THE HOUSE OF COMMONS ON 4 JULY 1985

LAND ROVER-LEYLAND

Present were: Prime Minister
Secretary of State for Trade and Industry
Mr. Lamont

Mr. Lamont said the original idea for collaboration between GM (Bedford) and LRL had come from the latter but since it had emerged last summer progress had been very slow. In order to push matters along, he had gone to Detroit to talk to Mr. Attwood, a main Board member of General Motors. GM had told him that they had conducted a feasibility study of bringing the LRL and Bedford businesses together and were coming to the conclusion that there were advantages in this. Leyland would fill gaps in the Bedford range for both lorries and vans. It was likely that either the Leyland or Dunstable plants would have to close, most likely the latter. GM were also interested in the 4WD business but were likely to conclude against taking on Leyland Buses. GM were coming to a conclusion that it was best to proceed by a takeover rather than a joint venture. GM had promised to put forward a proposal in 8 weeks.

The Prime Minister hoped a deal could be reached with GM but was worried about the slowness of progress. GM should be held to their 8 weeks deadline. She asked whether there were other bidders who could now be approached. The Secretary of State for Trade and Industry said there were no other bidders known for Leyland trucks but Alcan had shown an interest in Land Rover and Laird, Weir and Volvo had shown an interest in the buses business. Of these the Laird approach was the most promising and he had authorised

Mr. Lamont to hold discussions with them. He noted that BL were not aware either of these discussions or of the fact that GM were now thinking terms of a takeover.

The Prime Minister asked whether a deal with GM would require provision of a dowry. The Secretary of State for Trade and Industry said there had so far been no discussions of the financial terms but he doubted whether a dowry would be required, though there might have to be some ~~right~~ write-off of debt.

AT

(Andrew Turnbull)

5 July 1985

10 DOWNING STREET

Prime Minister

The key issue is how more pressure can be brought to bear on GM to come to a decision. Peter Warry suggests setting a date after which other bidders should be approached.

Peter would like to attend this meeting but given Mr Tebbit's extremely sensitivity on anything related to BL this may not be wise.

AT
3/7

SECRET

9

PRIME MINISTER 3 July 1985

LAND ROVER-LEYLAND PRIVATISATION

The Land Rover-Leyland (LR-L) privatisation story so far:

Aug 1982	:	2 BL business groups to be sold by Aug '84 (so far only Jaguar has gone)
14 May 1984	:	(AT to DTI) BL to produce a proper privatisation study of LR-L within 3 months
Summer 1984	:	DTI initiates talks with GM
Sept 1984	:	David Young asked to chase up progress
28 Nov 1984	:	(AT to DTI) inquiring of progress on the privatisation study
17 Dec 1984	:	Privatisation study delivered concluding nothing should be done before 1989
20 Dec 1984	:	(DTI to AT) GM will respond by end-February
5 March 1985	:	(DTI to AT) GM will now respond by mid-May
23 May 1985	:	(meeting with NT) GM will now respond by end-June

Norman Lamont has just returned from seeing GM in the States. GM remain enthusiastic and are interested in all the separate LR-L businesses except Leyland Bus. They have now decided to explore the commercial implications; this will take until the beginning of September when, if all goes well and there are no further slippages, GM will finally enter into purchase negotiations.

Leyland Bus can be sold separately.

SECRET

In the meantime all approaches to buy parts of LR-L remain shelved or rebuffed. This is despite Private Secretary letters from yourself and the Financial Secretary in March requesting that there should be concurrent negotiations with all interested parties, a view repeated on 24 May 1985. BL and DTI are dedicated to pursuing negotiations purely with GM even though GM themselves are known to be carrying on parallel negotiations in Europe with MAN, DAF, and ENASA

It seems highly improbable that GM will want to take a decision on LR-L until they have reached conclusions on their other European negotiations: the UK industry is dependent upon exports and cannot be examined in isolation from the wider scene. If GM do conclude a deal with one of the European companies then they could well lose interest in some or all of the LR-L businesses.

DTI will argue that that the GM negotiations are too delicate to permit other prospective bidders to be given a chance, and that the resulting confusion would give BL directors an opportunity to scuttle the negotiations. But further delay can only mean further losses and yet more prospective bidders losing interest. Unless we have alternative offers how are we going to keep GM honest, and if they make a bid what are we to compare it against?

Recommendations

There are risks whatever decision is taken, but the right course is to inform GM that, now they have had almost a year's head start, we are opening the bidding to all comers. Initial bids will be required by end August and detailed negotiations will take place during September with a final decision at the end of the month.

As the Government's objective is to dispose of as many of the hotch potch of separate LR-L businesses as possible, GM will be at a significant advantage if it bids for the majority of those businesses. But these are separate businesses and there will be no commercial logic to making a bid, eg for Leyland Trucks dependent upon one for Land Rover.

If an immediate opening of the bidding for all-comers cannot be agreed then, at the very least, it should be opened on 1st September; GM should be informed of this intention now.

Peter Warry

PETER WARRY

cc Questions
Press

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

17 June 1985

Tim Flesher Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Dear Tim,

BL

.. I enclose now the final text of the Statement which my Secretary of State will make this afternoon on BL, and which is, I understand, to be repeated in the House of Lords.

.. 2 I enclose for Margaret O'Mara only, (PS/Chancellor) a copy of the notes for supplementaries which my Secretary of State will be using.

3 I am copying this letter to Joan McNaughton (PS/Lord President), Margaret O'Mara (PS/Chancellor of the Exchequer), Alison Smith (PS/Lord Privy Seal), Murdo Maclean (PS/Chief Whip) and Kate Cassidy (PS/Lord Lucas).

Yours ever,

Andrew Lansley

ANDREW D LANSLEY
Private Secretary

JH1CLU

999-1

FINAL

STATEMENT ON BL

With permission, Mr Speaker, I shall make a statement on the BL 1985 Corporate Plan. I am making available in the Library of the House and in the Vote Office a report by BL on its recent performance and details of the 1985 Corporate Plan.

The Company submitted its Corporate Plan in December 1984, at the end of a year in which BL's recovery had been slowed by continuing over-capacity and highly competitive conditions in most of BL's markets. There has however been a significant improvement in performance in the first part of this year.

In March the company put to us outline proposals for further collaboration between Austin Rover and the Honda Motor Company, extending the successful collaboration on the Acclaim, Rover 200 series and XX executive car project. The central element was a joint design and development programme on a further new car, embodying the best technology of both companies. It was also proposed that ARG would manufacture in the UK the Honda version of the new vehicle and Honda would manufacture in Japan for ARG. BL would also manufacture other Honda models for European sale.

JH5BCR

Honda also said it was considering setting up its own engine manufacturing plant in Swindon to supply engines for these Honda vehicles and the Rover 213 which currently uses an imported engine.

The Government welcomed these negotiations and has given its approval in principle to these proposals, which, now also agreed in principle between Honda and BL, provide for collaboration on the new model, the manufacture of certain other cars for Honda by BL and Honda's further consideration of the engine factory at Swindon.

The Government undertook with the company an examination of both the basic Corporate Plan and possible variants. In the light of this the Government has given approval to the Plan as amended by BL to incorporate the substance of the collaborative proposals.

As the House knows, one of the BL Board's objectives is to return the business to the private sector as soon as practical. Further steps towards this objective are under consideration and I will keep the House informed of progress.

JH5BCR

CONFIDENTIAL

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PS/
Secretary of State for Trade and Industry

14 June 1985

Tim Flesher Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Prime Minister

This statement looks a little on the short side to us and lacking in rousing lines for the Government side. But that is how Mr Tebbit wants it.

14/6

Dear Tim,

BL

... I enclose the text of a Commons' Statement which my Secretary of State proposes to make on the afternoon of Monday, 17 June. The announcement contained in it remains a matter of great sensitivity. I must therefore ask you and recipients to restrict knowledge both of the statement and its content.

2 I understand that it is expected that the statement will be repeated in the House of Lords by Lord Lucas, Parliamentary Under Secretaery of State for Trade and Industry.

3 I am copying this letter to Joan McNaughton (Lord President), Alison Smith (PS/Lord Privy Seal), Murdo Maclean (PS/Chief Whip) Margaret O'Mara (Chancellor of the Exchequer), and Kate Cassidy (PS/Lord Lucas).

Yours ever,

A. Lansley

ANDREW D LANSLEY
Private Secretary

JH5BCX

999-1

STATEMENT ON BL

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The Company submitted its Corporate Plan in December 1984, at the end of a year in which BL's recovery had been slowed by continuing over-capacity and highly competitive conditions in most of BL's markets and industrial relations problems at Austin Rover.

In March the company put to us outline proposals for further collaboration between Austin Rover and the Honda Motor Company, extending the successful collaboraation on the Acclaim, Rover 200 series and XX executive car project. The central element was a joint design and development programme on a further new car, embodying the best technology of both companies. It was also proposed that ARG would manufacture in the UK the Honda version of the new vehicle and other Honda models for European sale. Honda also said it was considering setting up its own engine manufacturing plant in Swindon to supply engines for these Honda vehicles and the Rover 213 which currently uses an imported engine.

JH5BCR

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As the House knows, one of the BL Board's objectives is to return the business to the private sector as soon as practical. Further steps towards this objective are under consideration and I will keep the House informed of progress.

JH5BCR

SRWACW (SLH)

File

SUBJECT

cc Master Set

8

10 DOWNING STREET

From the Private Secretary

13 June 1985

BL/HONDA

The Prime Minister this afternoon discussed your letter to me of 13 June with your Secretary of State and the Chancellor. It was agreed that the option of taking engines from Honda should be dealt with by a letter from Mr Musgrove to Honda rather than by seeking an amendment to the Memorandum of Understanding or by attaching the side letter formally to it. (The Prime Minister remarked that while Honda were unwilling to contemplate an amendment on this issue they were insisting on an amendment elsewhere which would incorporate a reference to a "possible" engine plant.

Your Secretary of State thought that the engine plant would eventually be built, but to increase pressure on Honda it should be made clear that, after a transitional period, less than 80 per cent local content would be unacceptable to HMG. There would not be a separate requirement about the origin of the engine. Honda would thus be subject to the same conditions as Nissan. This was agreed.

Your Secretary of State said it was intended to sign the Memorandum of Understanding on Friday. Honda had agreed to delay their announcement to allow him first to make a statement in the House on Monday.

Your Secretary of State said that Ministers had earlier agreed that BL's EFL should be set at £680 million but that this figure should be adjusted to take account of the impact of asset sales of which Unipart was the most immediate. The formula for making the adjustment had to take account not only of the cash received on sale but also of debt repaid and future cash inflow or outflow foregone. The Prime Minister invited the Secretary of State and the Chancellor to agree on a formula.

I am copying this letter to Rachel Lomax (H M Treasury) Leigh Lewis (Office of the Minister without Portfolio) and Richard Hatfield (Cabinet Office).

Andrew Turnbull

John Mogg, Esq.,
Department of Trade and Industry

JB

willing to discuss engine collaboration/supply in relation to any future models. My Secretary of State believes this letter makes it plain that ARG does not stand on the Memorandum of Understanding as stating a policy of refusal to purchase Honda engines. It is thus open to Honda to propose such a deal. The text of the proposed letter is attached.

Second, my Secretary of State believes that the most appropriate way of persuading Honda to invest in an engine assembly facility in the UK is to set demanding requirements for the local content of the vehicles to be produced in the UK either collaboratively or on a sub-contract basis. There would be difficulty in regarding vehicles as non-British solely because the engine was imported if, nonetheless, they achieved levels of local content previously regarded as high enough to be accepted as British. This would be clear discrimination against Honda compared with the treatment of Nissan and GM/Bedford (to build Isuzu vans) who have been set rigorous (80%) local content targets but who are free to decide how these are achieved. Moreover, internationally we could not adopt a position whereby we doubted whether vehicles of 60:80% local content were truly of "European" origin. Indeed we have in the past resisted French/Italian efforts to establish a "key components" policy under which vehicles with a non-EEC engine would fail to qualify as "European".

Nevertheless, in practice, the 80% local content regime exerts a considerable pressure on companies to carry out engine assembly or manufacture locally. Nissan in Phase 2 have plans to carry out engine assembly at their Washington Plant in order to meet their target. And, in the case of the Rover 200 series, BL have achieved only 70% British content in the Honda engined version (the 213) but 83% in the BL engined 216 version.

Can't be changed

We believe Honda will also wish to establish an engine facility at Swindon and that their insistence on a "possible" engine investment simply reflects boardroom sensitivities and perhaps confusion over HMG's inquiry about the supply of a small engine to BL.

To achieve the Prime Minister's objective, my Secretary of State therefore intends that Mr Okamura should be advised at his meeting with DTI on Friday 14 June: -

- that HMG will wish to negotiate a formal MOU with Honda/BL covering the local content requirements to be set for all vehicles covered by their co-operation with ARG including the new collaborative vehicle and the sub-contract cars;

c. JR

7

DEPARTMENT OF TRADE AND INDUSTRY
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JU680
Secretary of State for Trade and Industry

13 June 1985

SECRET

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Andrew,

BL/HONDA

Thank you for your letter of 10 June.

On the instructions of my Secretary of State, the final terms for the announcement of the Government's response to the BL Corporate Plan have now been agreed with the company. As you know, it is proposed that the Government response to the Plan, and the announcement by BL/Honda of their further collaborative proposals, should be made on Monday 17 June. My Secretary of State believes that an early announcement is necessary in order to limit any further damage which might be caused to BL by continued unhelpful press speculation about Government attitudes to the company.

Your letter records that the Prime Minister wanted reassurance on a number of points. First, that the agreement between BL and Honda should not close off the possibility at some future date of an engine supply deal between Honda and BL. Second, that Honda should be pressured to go ahead with an investment in an engine facility at Swindon. Third, that the BL Board should agree arrangements for the control of BL borrowings in line with the agreement reached recently by Ministers.

i. can't change the Honda side or engines now

On the first point, my Secretary of State has accepted that, given the tight timetable to which everyone is now working, it would not be possible to engineer amendments to the proposed Memorandum of Understanding between BL and Honda (which would need to be approved by the Honda Board), or an equivalent side-letter, without risking further misunderstandings and uncertainty in the minds of the Japanese. However, BL has agreed that it should put Honda on notice - in Mr Musgrove's reply to Mr Kume's recent letter on Honda's engine policy - that ARG is

- that, after a transitional period, 80% local content would be the norm. Anything less would be unacceptable to HMG;
- that proceeding with an engine assembly facility would obviously be one way of making a significant contribution to local content and HMG would welcome it if Honda were to proceed with such an investment at Swindon.

On the question of borrowing limits, my Secretary of State expects to reach an agreement with the company which would prescribe a formula to which he hopes the Chancellor will agree by which the impact of Unipart privatisation would adjust the EFL limit in line with the decision already taken by Ministers collectively. That formula would be applicable to other disposals, whether of profitable or loss making operations.

My Secretary of State therefore believes that the outstanding questions raised by the Prime Minister have in substance been met and that the way is now clear for an agreed announcement which will put an end to the uncertainties which have affected the company's public image over recent months.

I am copying this letter with enclosures to Rachel Lomax (HM Treasury), Leigh Lewis (Office of the Minister without Portfolio) and Richard Hatfield (Cabinet Office).

Yours ever,

John Mogg

J F MOGG
Private Secretary

680.2

DRAFT LETTER TO MR KUME FROM H J MUSGROVE

I am writing to thank you for the courteous reception which you gave to me and my colleagues on our recent visit and for the extensive and thorough discussions which took place with you and so many of your senior Honda colleagues. This gave us a clear understanding of Honda's position on engines and on the proposed future collaboration with ARG. Further, I should particularly like to thank you for your letter of 7 June confirming the Honda policy on engines which had been described at the meeting.

I accept that the attitude of Honda to the possible supply of engines for the Metro replacement is negative, thought not unequivocally so, and ARG will not press the matter at this stage. However, I should be happy to discuss the supply of engines by Honda for ARG cars with you further at some future date if, in the light of our respective policies on engine development and manufacture, you felt this might be fruitful.

SUBJECT
cc Master

6

SECRET

file K/o
a Mr Redwood

10 DOWNING STREET

From the Private Secretary

10 June 1985

Dear John,

BL/HONDA

Your Secretary of State came to see the Prime Minister this afternoon to report on negotiations between BL and Honda. The meeting had before it the letter from the President of Honda, which was sent under cover of your letter to me of 10 June.

Your Secretary of State said Honda had reacted to BL's letter about the supply of small engines with a mixture of puzzlement and concern. Mr. Kume's letter made it clear that Honda were not prepared to develop engines jointly or allow ARG to manufacture Honda engines under licence, which they regarded as equivalent to collaboration. Although they had not brought themselves to giving a categorical refusal it was clear that Honda did not want to supply engines for the Metro replacement from Swindon on the grounds that this would greatly increase their commitment to investment and could impair the separate identities of the two companies. Honda were issuing a denial of the report in the Times of 10 June which claimed they were prepared to supply small engines. There were also signs that Honda were backing away from certain aspects of the collaboration agreement. In the Memorandum of Understanding which was supposed to be signed on Friday, they were proposing that references to the engine plant at Swindon should be to a "possible" engine plant.

The Prime Minister thought it strange that Honda should react to an opportunity for more business by threatening to withdraw from the degree of collaboration that they were previously prepared to contemplate. She noted, however, that a lower degree of collaboration might leave HMG with greater freeedom should it decide to sell ARG.

Your Secretary of State thought that Honda's reaction could be explained by a fear that the company were being sucked into the problems of BL. The Swindon project would have to be several times bigger than originally planned if it were to supply the engine for the Metro replacement. Having made this substantial investment, Honda might be afraid that a future Government might withdraw support from BL, leaving Honda either stranded with its larger engine plant or forced to help BL financially. This fear had allowed more conservative elements in the Honda organisation to call for a re-appraisal of the whole scheme.

/The Prime

SECRET

The Prime Minister said that without a firm commitment to an engine facility, the collaboration deal would be pointless. There could be no question of allowing Honda to import engines for cars being assembled by ARG. Such cars would not satisfy the requirements about domestic content and would therefore be classed as imports and be offset against Honda's quota. This should be made clear to Honda.

Summing up the discussion, the Prime Minister said it was Honda's commercial decision not to extend its involvement with, and dependence on, BL by supplying small engines. The Memorandum of Understanding should not, however, be drafted in a way which closed off the option of acquiring engines from Honda should the company be prepared to expand its commitment to Swindon at some future date. It should also be made clear, either by amending the text or by a side letter, that paragraph 1.7(a) of the MOU referred to accepting Honda engines in existing ARG models. Honda should be pressed to go ahead with collaboration on the basis previously envisaged; but if they wished to refer to a "possible" engine facility, it should be made very clear that the resulting cars assembled by ARG would not be classified as domestically produced. The BL Board should complete its consideration of the Corporate Plan and should signify its acceptance on the EFL agreed at the earlier meeting of Ministers. In the absence of an agreement with Honda for the acquisition of small engines, BL should continue to develop its own K engine. Your Secretary of State was invited to examine the options for selling off ARG with a dowry, with the Varley/Marshal assurances being brought to an end.

I am copying this letter to Rachel Lomax (H.M. Treasury), Leigh Lewis (Office of the Minister Without Portfolio) and Richard Hatfield (Cabinet Office).

Yours sincerely
Andrew Turnbull

ANDREW TURNBULL

John Mogg, Esq.,
Department of Trade and Industry.

CONFIDENTIAL file

SH
MJ2APE
cc PU

10 DOWNING STREET

From the Private Secretary

10 June 1985

Dear John,

BL/HONDA

The Prime Minister has seen your Secretary of State's minute of 6 June. She agrees with your Secretary of State that leaks like the one in the Financial Times referred to in your Secretary of State's minute are damaging, and particularly so when commercial negotiations are involved. She welcomes the steps your Secretary of State is taking to stop unauthorised disclosures from within BL, the Department and its advisers.

The Prime Minister has asked me to say that she has been assured, and firmly believes, that none of the leaks have come from within No.10, and that none will. The few people involved here handle a wide range of material of this sort which does not leak; and they are deeply conscious of the damage to the Government's standing and policies, and to their own relationship and trust with herself and departments, which responsibility for a leak of this sort would do. The allegation in the article in this week's Spectator, to which you drew my attention on Thursday evening, that Mr. Redwood and Mr. Warry of the Policy Unit here have been leaking such material to the Financial Times has no foundation, and we are consulting the Law Officers and the Secretary of the Cabinet about the terms of a letter which would correct these allegations.

The Prime Minister certainly does not believe that the nature of the views described in the Financial Times' article gives a reliable clue to the source of the information. She has noted that a number of the elements in the story have already been the subject of earlier reports. For example, references were made to Honda's Swindon plans in the Financial Times of 23 April and the possbility that the new small engine could be acquired from Honda was reported in the Financial Times of 4 May and has been discussed publicly by one of the department's advisers (Financial Times of 11 May). In the light of this, without qualifying at all her condemnation of such leaks, the Prime Minister is a little surprised that Honda should have reacted so adversely to the article in last week's Financial Times, particularly when it would appear to provide an opportunity for them to increase their sales. But she hopes that the talks between BL and Honda will now

CONFIDENTIAL

progress smoothly and that the necessary consideration of all reasonable options will not be obstructed by further incidents of this sort.

I am copying this letter to Rachel Lomax (HM Treasury) and Leigh Lewis (Minister without Portfolio).

Yours sincerely

Andrew Turnbull

Andrew Turnbull

John Mogg, Esq.,
Department of Trade and Industry

O&O

cc Rachel Lomax (HMT)
Leigh Lewis (MWP)
Richard Hatfield (CO)

cc JR

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JU655

Secretary of State for Trade and Industry

10 June 1985

CONFIDENTIAL
Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Andrew,

BL : HONDA

My Secretary of State is to see the Prime Minister this afternoon at 3.45. He wishes to discuss the present position regarding collaboration between BL and Honda, particularly in the light of Mr Kume's letter of 7 June to Mr Musgrove, the Chairman of the Austin Rover Group. (Copy enclosed).

Yours ever

John Mogg

JOHN MOGG
Private Secretary

HONDA
HONDA MOTOR CO., LTD.

No. 27-8, 6 Chome, Jingumae, Shibuya-ku, Tokyo, Japan
Cable Address/HONDAMOTOR TOKYO
Tel./TOKYO (03) 499-0111
Telex/J22678 HONDAMTR

June 7, 1985

Mr. Harold J. Musgrove
Chairman
Austin Rover Group Limited
Fletchamstead Highway
Coventry CV4 9DB
England

Dear Mr. Musgrove:

Thank you for your letter of June 3. I am glad to hear that your Government is prepared to approve in principle the BL corporate plan and favors further collaboration between our two companies.

As you know, we are working to finalize the details of the Statement of Understanding and expect to sign it shortly.

The question of possible engine supply is, of course, a very important and serious matter. As the Statement of Understanding says, it is not Honda's policy to engage in joint development of engines with another manufacturer, because we believe it essential to preserve our own engine technologies. Manufacture by ARG of Honda engines under license would run counter to this policy. Therefore, in answer to your question, Honda could not agree to ARG manufacturing our engines under license.

The answer about supply from our own engine manufacturing plant in the U.K., to which we are not committed, is not so clear, because such arrangement would involve many factors such as the size of investment which would be beyond what we have contemplated and problems of maintaining each company's identity. While it is difficult to give a definite answer at this time, our initial reaction is negative, although we are not in a posisiton to say "No" unequivocally.

Very truly yours,

T. Kume

Tadashi Kume
President

TK/kt

5

PRIME MINISTER

Mr. Tebbit is coming to see you at 1545 pm to discuss BL/Honda. The latter have replied saying

- no to collaboration
- no to ARG manufacture under licence
- probably no to supply from Swindon (though without saying so categorically)

Mr. Tebbit will argue that the buying in option has been fully explored and found not to be feasible; and that it will be damaging to the proposed collaboration to go on arguing.

You have the following options

i) To accept the Secretary of State's advice

ii) To ask him to explore further why Honda have replied in the way they have

iii) To ask to see a senior representative from Honda yourself

If you do follow (ii) and still more so (iii), you should be aware of the damage this will do to your relationship with Mr. Tebbit. He will react strongly to any suggestion that you need to double check on his account of the discussions with Honda.

When Mr. Tebbit has gone, could you look at the draft letter to the Spectator. This has been shown to the Law Officers' Department and Sir Robert Armstrong. The aim is to ask the Spectator to do something they cannot reasonably refuse, ie print the letter of denial, rather than ask for a retraction which can only be secured by legal action which we do not want to take.

AT

10 June 1985

Press Statement by Honda

With reference to the article headed 'Honda deal in assembly at Cowley" Honda Motor Company wishes to categorically deny the report which appeared in the Times dated 10th June in which the following statement appeared:-

" It was also made clear that Honda were prepared to supply Austin Rover with engines for a Metro replacement in a few years."

This statement was not made to any member of the Press by any member of the Honda Motor Company and is untrue. While Honda are not prepared to discuss details of confidential commercial discussions with Austin Rover on this or any other subject, Honda wish to make it clear that they consider such engines to be fundamentally part of the identity of their company.

While Honda have been prepared to consider a range of collaborative activities with Austin Rover these specifically exclude collaboration on small engines.

An announcement regarding further collaboration between Honda and Austin Rover will be issued jointly by the two companies in the near future. This will cover a number of areas of joint activity but in view of Honda's position on engine collaboration this will be specifically excluded.

End

10th June 1985

Times 10 June 85

Continued on back

teachers

Proposals for a general teaching council, similar to the General Medical Council, which would have powers to set a code of practice, strike teachers off and set entry qualifications, are being discussed by teacher organizations to improve standards and enhance the profession's status Page 4

Canadian in Telegraph deal

An unnamed Canadian industrialist is poised to sign a £10 million agreement to give him a 13 per cent equity stake in the Daily Telegraph which hopes to raise a total of £110 million.

Flannery picked

Mr Martin Flannery, MP, aged 67, has been reselected as Labour candidate for Sheffield Hillsborough, easily beating off a challenge from a fellow left-winger, Mr Clive Betts, aged 35, Sheffield City Council housing chairman.

NUR warning

A fresh trial of strength between British Rail and the railway unions was predicted yesterday by Mr Jimmy Knapp, general secretary of the NUR Page 2

Hindley fight

Myra Hindley, the moors murderer, is to take her claim for release from jail to the European Court of Human Rights in Strasbourg. Page 2

Secret dialogue

Britain and Albania are holding secret talks to resolve a 39-year-old wrangle over seized gold bullion and destroyed Royal Navy warships Page 6

Gujarat inquiry

Gujarat's Chief Minister has ordered a judicial inquiry into inter-caste violence which has killed 160 people in three months. Eight people were burnt to death and six killed by police in the state yesterday.

England beaten

England lost the second successive match of their Mexican tour last night, when they were beaten 1–0 by the host nation. Page 17

Leader page, 11
Letters: On welfare review, from Ms S. McKechnie; Stansted airport, from Mr W. C. Woodruff, and others
Leading articles: Famine; Hungarian elections; Alcoholics Anonymous
Obituary, page 14
Dr Reginald Lightwood, Mr David Rokeah
Features, pages 8-10
Enforced calm in Tehran; Long and short of a naval conflict; England's lost reputation; Bruce Springsteen; Palumbo, on to the next plan
Classified, pages 19-21
Secretarial and educational appointments

Honda deal to assemble at Cowley

From Edward Townsend
Tokyo

A broad-based extension of the collaboration deal between BL's Austin Rover and Honda of Japan will be announced within the next few weeks. It is almost certain to include assembly of Honda cars at Cowley, Oxfordshire.

The new deal, which will continue at least until the end of the decade, involves a significant package of measures including continuing joint development of new cars and exchange of technology. Engine development is specifically excluded.

The most likely car to be assembled at Cowley is the Civic, Honda's Metro-sized small car and its best seller in Europe. Senior executives of Honda confirmed in Tokyo that the deal had been approved in principle by the British Government.

Mr Kiyoshi Ikemi, deputy general manager of Honda's planning office, said: "We hope to be able to reach a broad agreement within a month, if not sooner."

It was also made clear that Honda was prepared to supply Austin Rover with engines for a Metro replacement in a few years, but Mr Ikemi said that Austin Rover had not sought such an arrangement.

An engine deal is believed to be favoured by the government as a way of cutting £250 million from BL's proposed £1.8 billion investment plan in the run-up to privatization. But that is being resisted by BL. It is feared that by buying engines elsewhere, the company's engineering capabilities could be undermined.

Mr Ikemi said he was "reasonably optimistic" about assembling Civics at Cowley for sale in Europe. It is a car similar to the Rover 200 series which the companies are producing jointly. Mr Ikemi said, it would be classed as British.

The tie-up with BL, regarded by Honda as its sole European collaborative car venture, will, however, not involve the Japanese in acquiring an equity stake in BL.

Date of reshuffle n… set, says Thatche…

By Julian Haviland, Political Editor

The Prime Minister said yesterday that she did not know which ministers would be involved in the Cabinet reshuffle she plans to make in the approaching parliamentary recess, nor how extensive the changes would be.

"I do not know when I will do it. I will do it when I think it is most appropriate," Mrs Margaret Thatcher added.

She chided newspapers for writing about the expected changes, saying that some of what had been written was very wounding to those concerned. She said that she never made government reshuffles when Parliament was sitting.

"It is not fair to people to have to go into the House the next day, perhaps if they have lost a job or if they change a job and are not familiar with the detail of their new work."

The Times reported last Wednesday that an extensive reconstruction of the Cabinet was expected soon and that some sources had expected details to be announced during the Whitsun parliamentary recess which ended a week ago.

In the course of an interview, on TV-am with Mr David Frost, Mrs Thatcher was asked what had been the Government's mistakes so far. She replied: "I think it would have been better had we been able to hold public expenditure down more than we have, but against the background of recession and the speed of change we w… able to do so."

It had also been her a… further to reduce … "You are much more … get an enterprising Brita… people see a much … relationship between the… ings and what they hav… their pocket."

She added that whe… tax burden would be l… the next election than w… Conservatives came to … 1979 would depend on… in the economy, and p… world growth rates.

Mrs Thatcher denied … felt embattled because … Government's decline … opinion polls, the … council election defea… revolts in the party.

The Prime Minister, … of her belief in freedom… currency markets, disc… patriotic sensitivity to t… of sterling.

Recalling the most a… sterling's recent crise… described how she heard … report, on January 13, t… Government did not car… the pound going down… goodness, I was up lik… ning at the telephone, … that they had just better… to those people who c… television news and tel… we did care."

The level of the … against the dollar m… enormously. "It is part of… a fundamental part of pri…

Belgrano clash, …

Six Ethiopian stowawa… seek asylum in Ulste…

Six Ethiopian stowaways have arrived in Londonderry on board the Cyprus-registered ship MV Elise Shulte, and are asking for political asylum.

The six have been allowed to remain on board the vessel, as Mr John Hume, the Social Democratic and Labour Party leader, is expected to take up their case with the government.

A Home Office spokesman said the men had secretly boarded the ship when it was in port in northern Ethiopia. The crew discovered them, after they had set sail, hidd… stores and a ventilation … and wearing only trouser… slippers.

A written report on the … request to be granted asyl… due to arrive in London … and will immediately be … sidered by the Home C… The group were interview… immigration officers afte… vessel arrived in London… on Saturday night

The men were refused a… when the ship docked at … Port Said and Cyprus.

Right-wing fans 'fraternized'

By Ian Murray

English and Italian soccer supporters wearing badges of extreme right wing groups were seen fraternizing and drinking together in Brussels cafés before the riot at the Heysel stadium 10 days ago, in which 38 people died.

The mayor of B…

Ministers of the EEC at St… the lakeside resort, over… weekend. The Foreign … retary told them of Brit… shame and shock at … happened and he was ass… by the meeting that there… widespread appreciation o… swift response by the Br… Government to the tra…

MR TURNBULL   10 June 1985

BL/HONDA

Kume's letter can either be interpreted as meaning 'No, we don't want to sell you engines but would prefer not to say so bluntly', or alternatively, 'Yes, we would like to sell you engines but Musgrove has made clear his opposition and we cannot afford to upset him'.

If they really don't want to sell the engines, then it is odd that the Deputy General Manager of Honda should be quoted in today's Times (copy attached), saying that they would like to supply engines but Austin Rover had not sought such an arrangement. One explanation is that just as Honda interpreted last week's FT article as a statement of the Government's position over the heads of Austin Rover, likewise they are using the same media to give a more accurate statement of their own intentions.

The Prime Minister could either:

1. accept the Honda letter as meaning 'No' and let Austin Rover proceed with manufacturing their own engines or

2. offer to see, together with Norman Tebbit, the senior Honda representative who is coming over this week.

It would however be undesirable for the Prime Minister to seek a meeting with the Honda representative only after Norman Tebbit and DTI officials had seen him.

Peter Warry

PETER WARRY

CONFIDENTIAL

ecl

bc P. Warry

10 DOWNING STREET

From the Private Secretary 10 June 1985

UNIPART PRIVATISATION

The Prime Minister has seen your Secretary of State's letter to the Chancellor of 4 June. She is content with the proposal for BL to retain a stake in Unipart and with the proposals for Unipart's Articles of Association.

I am copying this letter to Rachel Lomax (H.M. Treasury), Leigh Lewis (Minister without Portfolio's office) and Richard Hatfield (Cabinet Office).

(Andrew Turnbull)

John Mogg, Esq.,
Department of Trade and Industry.

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10 DOWNING STREET

Prime Minister (1)

Content that this be sent as a Private Secretary letter?

AT

7/6

Yes MT

E.R.

DRAFT LETTER FROM PRIME MINISTER'S PS TO PS, SECRETARY OF STATE FOR TRADE AND INDUSTRY

BL/HONDA

The Prime Minister has seen your Secretary of State's minute of 6 June. She agrees with your Secretary of State that leaks like the one in the Financial Times attached to your Secretary of State's minute are damaging, and particularly so when commercial negotiations are involved. She welcomes the steps your Secretary of State is taking to stop unauthorised disclosures from within BL, the Department and its advisers.

The Prime Minister has asked me to say that she has been assured, and firmly believes, that none of the leaks have come from within No.10, and that none will. The few people involved here handle a wide range of material of this sort which does not leak; and they are deeply conscious of the damage to the Government's standing and policies, and to their own relationship and trust with herself and departments, which responsibility for a leak of this sort would do. The allegation in the article in this week's Spectator, to which you drew my attention on Thursday evening, that Mr. Redwood and Mr. Warry of the Policy Unit here have been leaking such material to the Financial Times has no foundation, and we are consulting the Attorney General and the Secretary of the Cabinet about the terms of a letter which would seek a retraction.

The Prime Minister certainly does not believe that the nature of the views described in the Financial Times' article gives a reliable clue to the source of the information. She has noted that a number of the elements in the story have already been the subject of earlier reports. For example, references were made to Honda's Swindon plans in the Financial Times of 23 April and the possbility that the new small engine could be acquired from Honda was reported in the Financial Times of 4 May and has been discussed publicly by one of the department's advisers (Financial Times of 11 May). In the light of this, without qualifying at all her condemnation of such leaks, the Prime Minister is a little surprised that Honda should have reacted so adversely to the article in last week's Financial Times, particularly when it would appear to provide an opportunity for them to increase their sales. But she hopes that the talks between BL and Honda will now progress smoothly and that the necessary consideration of all reasonable options will not be obstructed by further incidents of this sort.

I am copying this letter to Rachel Lomax (HM Treasury) and Leigh Lewis (Minister without Portfolio).

10 DOWNING STREET

From the Private Secretary

FGRB

Mr Tebbit's minute
(i) gave an account of how Honda had reacted to recent press reports
(ii) made an implied accusation about leaks from No 10.

I have prepared a letter which reflects today's discussion but have doubts about sending it. The issue at (ii) needs to tackled as in the first para but the second para challenging (i) will be seen as nit-picking. The third para clearly implies that Mr Tebbit can't be trusted to report faithfully so she will seek a direct report.

John Mogg reports extreme sensitivity on Mr Tebbit's part. At the end of the day the PM ~~will~~ may to chose between pushing through her view on BL and keeping in with Mr Tebbit. ~~For the moment~~ for deciding whether to press her view to a conclusion is not yet; for the time being I would confine any reply to para 1

AT
7/6

SECRET

DRAFT PRIVATE SECRETARY LETTER TO PS/SECRETARY OF STATE FOR TRADE AND INDUSTRY

BL/HONDA

The Prime Minister has seen your Secretary of State's minute of 6 June. She ~~has commented that any~~ agrees with your Secretary of State that such leaks about the Government's consideration of policy are damaging, and particularly so where commercial negotiations are involved. She therefore welcomes the steps your Secretary of State is taking to stop unauthorised disclosures from within BL, the Department and its advisers. She has asked me to say that she has been assured, and firmly believes, that ~~believes~~ none of the leaks have come from within No. 10, and ~~that~~ none will. The ~~small staff~~ few people involved in No. 10 handle a wide range of material of this sort which does not leak; and they are deeply conscious of the damage to the Government's standing and policies, and to their own relationship of trust with herself and Departments, which responsibility for a leak of this sort would do. They therefore have no ~~any~~ reason ~~[illegible]~~ at all to allow such a leak to occur; and the Prime Minister does not believe that the nature of the views disclosed gives any reliable clue to the source.

The Prime Minister was surprised that Honda should have reacted so adversely to a proposal which would appear to provide an opportunity for them to increase their sales. She was also surprised that the article in the FT of 5 June should have confused Honda. The article gave a reasonably accurate account of the issues which the Government is seeking to resolve. References have already been made in the press to Honda's Swindon plans (FT of 23 April) and the possibility that the new small engine could be acquired from Honda was reported in the FT of 4 May and has been discussed publicly by one of the Department's advisers (FT of 11 May).

The Prime Minister has also commented that, in view of the importance of the relationship with Honda to Britain's motor industry, she would welcome an opportunity to meet the Managing Director of Honda or a senior representative of the Company when they next come to Britain.

// The Prime Minister has noted that a number of the elements in the story have already been the subject of earlier reports. For example

without qualifying at all her condemnation of

But she hopes that the talks between ARG & Honda will ~~not~~ progress smoothly and that the necessary consideration of reasonable options will not be

10 DOWNING STREET

From the Private Secretary

Prime Minister

Mr Tebbit is angry about yesterday's FT story on BL and blames it for causing difficulties (somewhat illogically) in the discussions with Honda. He is clearly pointing the finger at the Policy Unit.

Possibly coincidentally, possibly not, the Spectator is running an article on the Policy Unit which makes the accusation of leaks by it on BL explicit.

Whatever the rights and wrongs of this case (on motive does not point to the Policy Unit), you may want to discuss with John its contacts with the Press, and emphasise the need for the Unit to be extremely circumspect. Even if untrue, accusations by your colleagues that they are being leaked against can only be harmful.

AT

6/6

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PRIME MINISTER

BL/HONDA

Austin Rover delivered the letter, whose text you approved, to Honda in Tokyo yesterday, 5 June, and had a discussion with Mr Kume, the Chairman of the company. It appears that the company were acutely embarrassed and compromised by the story in yesterday's Financial Times which they assumed to represent the views of the Government. The reports were taken by some members of the Honda Board to indicate that Mr Kume and his immediate colleagues had committed Honda, in the draft Memorandum of Understanding with BL about collaboration, to build an engine plant at Swindon on which the Board had not yet decided. The leaks therefore hit a particularly raw nerve within Honda. There was acute confusion about the intentions of the British Government, which they assumed the Financial Times article to represent; and they emphasised the basis of the long term understanding they had with Austin Rover, which was that the two companies should maintain their separate identities and that Honda were not willing on any basis to share their engine technology. The first session of the talks was exceedingly uncomfortable and came close, in ARG's view, to termination of

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all collaboration between the two companies.

After a long recess, Honda confirmed they were willing to continue discussions about collaboration and remained surprised and puzzled about why the request on engines had been made. They stressed that they were not willing to collaborate on engines or to allow manufacture under licence, but needed more time to consider how the request to supply an engine might affect their intended collaboration with BL. A reply to the ARG letter will be coming back to the UK over the weekend, but this may not contain an answer. A senior member of the Honda management will be coming to the UK towards the end of next week and this may clarify the position.

Meanwhile, it is clear that the story in the Financial Times has been most damaging to the relationship between ARG and Honda, and endangered the whole basis of future collaboration between them. I am disturbed and angry that this should have happened. I do not, of course, know where the Financial Times obtained their material, but it is clear that the views expressed towards the end of it do not represent the views of ARG, of my Department or of myself.

Any further leak which appears to represent the views of the British Government within the next week or so could well be the last straw for Honda. I am giving instructions in my own

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Department that there should be a complete blackout on information and opinions about the BL/Honda collaboration until decisions are reached and publicly announced, and I should be most grateful if my colleagues could do likewise. I am taking steps to ensure that BL observe a similar total embargo.

I am sending copies of this minute to Nigel Lawson and Lord Young.

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N T

6 June 1985

Department of Trade & Industry

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-6 JUN 1985

nge set g for firms

change "too cheaply." To loud applause Sir Nicholas said he would convey their view to Mr Robin Leigh-Pemberton, Governor of the Bank of England, without delay.

The exchange and the Bank have been trying to keep the cost of entry of outsiders to no more than £700,000 so as not to deter potential participants from using the exchange.

A surprise intervention came at yesterday's meeting from Mr Jeremy Lewis, a partner with stockbroker Seymour Pierce and a member of the ruling council. Mr Lewis was on the five-man constitutional committee which had drafted the proposals for Resolution 2. He urged members to vote against the resolution as the constitutional issues needed to be explored in greater detail.

One broker urged that the meeting and the vote should be adjourned until September but that was rejected by Sir Nicholas.

He asked the members present to vote on the resolutions by a show of hands, which one broker estimated went 80 to 90 per cent in favour of resolution 1 and about 70 per cent in favour of resolution 2. A full vote of the entire membership will be taken in a poll today and no count was taken.

slows target

target range of 5 to 9 per cent. The annual growth rate over the last three months was 19 per cent.

Figures due out later this month are widely expected to show a further acceleration in the annual inflation rate, perhaps to 7¼ per cent. That would leave room for only a very small—perhaps ¼ point—cut in base rates.

Broker James Capel estimated that if the Treasury was to meet its target of keeping sterling M3's average annual growth rate over 1985-86 down to 9 per cent or below, there was scope for monthly increases of only ¾ per cent for the rest of the year.

In Whitehall, however, officials were playing down the significance of the recent strong growth in the broad money supply measure and of

Cost of Pilkington job cuts to rise

BY IAN RODGER

THE COST of financing redundancies at Pilkington Brothers, the leading UK glass-making group, will rise to £31m in the next two years. The group has already spent more than £60m on reducing its workforce over the past five years.

It had been widely assumed that Pilkington's redundancy charges were on a downward trend, especially since the £104.8m rights issue last December.

However, Mr Antony Pilkington, the chairman, said yesterday that the group had identified all the positions it needed to eliminate so as to make its glass and fibre-glass plants among the most productive in the world. "So we have decided to have one last big push to persuade people to go. Then we will be finished."

The group next week publishes its preliminary financial results for the year to March 31, 1985, in which it will indicate that redundancy charges will amount to about £20m this year and another £11m in 1986. Pilkington has halved the 18,000 workforce at its main manufacturing base in St Helens, Merseyside, over the past five years, but another 2,000 jobs are to go.

Mr Pilkington said redundancy charges were a form of capital investment for the group. Money spent on this in the past few years had helped bring about substantial increases in profits through improved productivity. UK trading profits more than doubled to £11.6m in the first half of the current year against a background of falling prices and weak demand for many Pilkington products. He predicted that the pay-off from the new redundancy programme would start in 1986.

Mr Pilkington acknowledged that the group could be criticised for having taken a long time, by comparison with other leading UK manufacturing companies, to reduce its manning to international levels.

However, he said the group had been constrained by the concentration of most of its factories in the St Helen's area. "We have an important civic responsibility. We can't just pass on our problems to the local authorities."

"The difficult thing is to shake up working practices and manning levels while keeping a happy company," he said.

BL plan agreed subject to Honda engine deal

FINANCIAL TIMES REPORTER

THE GOVERNMENT is understood to have approved BL'sfive-year corporate plan, subject to BL's agreement that Austin Rover, its volume cars company, purchase from Honda of Japan engines and gearboxes needed for its end-of-decade Metro replacement.

Such a move could cut about £250m from BLs planned £1.8bn investment programme. It would run counter to the known wish of Mr Harold Musgrove, Austin Rover's chairman, that his company retain the ability to design its own engines.

Given that the key request about the Honda engine is met, the Government is thought to be ready to:

● Support a proposal that Austin Rover assemble Honda cars under contract. The first cars would go into the Longbridge plant at Birmingham next year.

● Agree that a middle-range car, code-named the YY, be developed jointly by Austin Rover and Honda. The YY would eventually replace Maestro and Rover 200 models.

The recommendation that BL seek an engines deal with Honda was made by the Department of Trade and Industry, which has been studying the BL corporate plan since it was submitted in November.

It reflects the Department's concern about Austin Rover's market performance, and was one of a series of possible economies originally suggested by the policy unit of 10 Downing Street.

The idea was first rejected by BL. Mr Musgrove is expected to open talks with Honda, but the possibility of a deal eventually being struck remains in doubt.

The Austin Rover chairman has said that without the ability to design its own engines, the UK would become a mere assembler, dependent on outside technology.

This has become a political issue, with the Labour Party and the trade unions backing Mr Musgrove's belief that engine design and construction capability should be retained by Austin Rover.

Support seems to have grown within the Government for the view that increased Honda and Austin Rover collaboration would strengthen the state-owned company in the short term; and pave the way for eventual privatisation.

It is stated that there would be no overall loss of jobs at Longbridge, where the Metro engines and gearboxes are manufactured because additional labour would be required to assemble Honda cars.

A Metro replacement with an Austin Rover body design and a Japanese engine (Honda enjoys a high reputation for quality) is thought likely to prove a success in the market place. This is seen as the key to Austin Rover's future viability, and to job security in the dependent components industry.

Honda engines would be manufactured at Swindon, Wiltshire, where the Japanese company has acquired a site. Materials would be supplied in the UK rather than imported.

Where the assembly of Honda cars under contract is concerned, Austin Rover would have to invest more than £30m in facilities. The proposal states that volume could climb to about 100,000 a year within three years. Honda would have no equity stake.

For Austin Rover the deal would provide better throughput for its existing production facilities, which are underused. For Honda, a platform would be provided from which it could sell into the European Economic Community.

Despite the resolution of most of the corporate plan difficulties between the Government and Austin Rover, the precise position of Honda in relation to the plan does not appear to have been finalised, except for agreement on joint development of the mid-range YY car to succeed the Maestro.

Honda sells 100,000 cars a year in Europe. It is open to question whether its dealer infrastructure could readily handle doubling of supplies.

Further, it is questioned whether the market could absorb 100,000 a year of one particular model, even with variants, which would provide the most advantageous economies of scale.

The viability, on production cost grounds, of dividing output between two models could also be questioned.

Nor is it clear whether Honda really would be prepared to rely on Austin Rover for such a large potential proportion of its sales. It is, for example, investing substantially in its 330-acre site at Swindon for post-production testing and checking of the joint XX executive cars.

The proposal could be seen as not necessarily meshing in well with its long-term plans to set up its own vehicle production plant on the Swindon site.

It is understood that Honda is more than willing to enter an agreement with Austin Rover to supply engines for the Metro replacement from Swindon.

This would strengthen its plans for engine manufacture at the site, which could include production of the engine now imported from Japan.

6 June 1985

MR TURNBULL

THE BL/HONDA PRESS REPORTS

As you will be aware, there have been a long line of detailed but misleading press reports about the BL Corporate Plan over the last 3 months. With the exception of a report in yesterday's Financial Times, almost all of these have been unhelpful or, at best, neutral for the policy line that the Unit was taking. BL unions and Labour MPs have appeared well-briefed on the subject, and I understand that many of the reports first occurred in the Birmingham press. You will recall that Dan Jones - the economist employed by Barings to review the BL Plan - was also reported as making some very explicit comments on the Plan.

The innuendo in Norman Tebbit's letter is that No.10 has been responsible for this latest leak. The Spectator is carrying an article suggesting that John Redwood and I have been responsible for leaks over the past 2 months. Neither John Redwood nor I have given any stories to the press on BL, nor have we been the source of these stories. It is noteworthy that the Spectator article - which DTI knew about in advance - was written before the FT story yesterday, which is the only one that has ever come near to being helpful to the Policy Unit line.

Why Honda should be "embarrassed", still less threatening to call off collaboration when they are being offered more business is difficult to understand. AT

It is difficult to understand the "embarrassment" that Norman Tebbit claims the FT article has caused Honda. Honda's intentions on collaboration with BL have been well publicised: they even held a press conference when they broke the first ground at the Swindon plant. And as the article came far closer than any previous press coverage to accurately reporting what is meant to be the Government's position on negotiations with Honda, it is surprising that it could have caused "acute confusion about the intentions of the British Government".

Peter Warry

PETER WARRY

10 DOWNING STREET

(1)

Prime Minister

Were you content with these?

AT
6/6

CONFIDENTIAL

(1)

PRIME MINISTER 5 June 1985

Agree Mr Tebbit's proposals?

AT 5/6

UNIPART PRIVATISATION

Yes mt

It is unusual for a car manufacturer to sell off its parts operation. The proposal that BL should retain a stake in Unipart for a limited period following privatisation is both sensible and necessary: it should not be seen as under-cutting the objective of privatisation but rather as facilitating it.

One can quibble whether the stake should be as high as 25.1% and the period for which it should be retained, but in general we support Norman Tebbit's arguments. In view of other matters it might be helpful if a positive response were made to his note.

Peter Warry

PETER WARRY

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CC PW

DEPARTMENT OF TRADE AND INDUSTRY
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Secretary of State for Trade and Industry

4 June 1985

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

D Nigel.

UNIPART PRIVATISATION

We need to decide urgently on the main outlines of the plan the BL Board have put forward for the privatisation of Unipart.

2 As you know, the Board are now fully committed to privatising Unipart this year and are working towards a date in November. In order to achieve this a new Board for Unipart will have to be in place in good time; and it will in particular be necessary to start approaching potential Chairmen as early as possible this month. This cannot be done until the main points of principle have been settled, and I am therefore writing to you about these now. (We shall need to leave to a later round of correspondence such matters as the treatment of the proceeds from the sale.)

3 In outline, the proposals as put to us by the Board are as follows:

a. BL should retain a 25.1% stake in Unipart for a limited period after privatisation;

b. BL should have the right, enshrined in Unipart's Articles, to be represented on the Unipart Board; and

c. Unipart's Articles should contain a provision preventing any other party from acquiring more than 15 per cent of the shares.

The significance of a 25.1 per cent shareholding is of course that it would enable BL, for so long as the shareholding persisted, to block any changes to (b) or (c).

JH2ASR

991-1

4. I attach Samuel Montagu's advice on these proposals. They take the view that a retained shareholding by BL in Unipart, whether of 25.1 per cent or some other figure, would be seen by the City as a positive sign and would enhance Unipart's prospects. They also believe that there is a case for allowing Unipart a period of protection from takeover; and that in the early period after privatisation there would be a risk that BL's interests could be gravely damaged by a hostile take-over. They therefore endorse the proposal for a 15 per cent limitation on shareholdings (which would parallel the limitations in other privatisations, including Jaguar). They do however question whether this might be secured by a "golden share", which would permit a lower BL holding than 25 per cent, rather than by the mechanism proposed by BL. I have considered this suggestion, but reject it for three main reasons. First, although golden shares are increasingly common they are considerably less easy to defend (to the Stock Market, among others) for companies like Unipart than for some earlier cases, as the industries become less "strategic". Second, the intention behind the proposed Articles is primarily to protect BL's commercial interests, not wider Governmental or national interests, and it would therefore be sensible for the veto over changes to be in their, rather than in our hands. Third, Samuel Montagu believes that BL ought in any event to retain a shareholding. I therefore propose that we should accept the Board's proposals on these points.

5 You will note that Samuel Montagu are doubtful about the need for BL representation on the Unipart Board. Frankly, I believe that they over-rate the likely effectiveness of the consultative arrangements they propose. In a normal commercial relationship Board representation is of course not necessary to ensure that contractual relations run smoothly. But the interdependence between BL and Unipart, and the nature of their business, is such that the relationship will, though commercial, be highly unusual. Indeed the separation of a mass vehicle manufacturer and its parts operation will be unique in the European industry. In these circumstances I think that good relations between the companies would be facilitated if BL were represented on the Unipart Board. I also believe that, like the retained shareholding, such representation would be regarded by the City (and also by BL's dealers) as reassurance that the relationship would continue. I therefore propose that we should accept the Board's proposals here also.

6 The outstanding question concerns the timing of the eventual disposal of the residual BL shareholding. Just as the Government is constrained, when disposing of part of a business, to reserve its position on the timing of residual sales, the Board will feel constrained not to commit itself publicly, or even privately, to a date. However, I would propose with your agreement to seek to establish with the Board as clear an understanding as can be negotiated about the timing of the sale of the BL shareholding.

JH2ASR

The object will be to ensure that BL do not retain the shareholding beyond the point where Unipart is fully established and both companies could cope if necessary with a termination of the BL/Unipart contracts.

7. I am sending copies of this letter to the Prime Minister, to Lord Young and to Sir Robert Armstrong. Because of the urgency I should be grateful for a reply this week if at all possible.

Yours, Norman

NORMAN TEBBIT

JH2ASR

cc PW

C

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I. A. N. McINTOSH
MANAGING DIRECTOR

IMcI/SAC/VS

Mr Long
cc for RJM

31 May 1985

RJM
3.6.

Mr R J Meadway
Department of Trade and Industry
Ashdown House
123 Victoria Street
London
SW1E 6RB

Dear Mr Meadway

You have asked us to provide advice to you in relation to the first set of proposals submitted by BL in relation to the privatisation of Unipart in November 1985. These proposals are described in detail in a letter from Mr N J Carver to yourself dated 3 May 1985 together with three supporting attachments.

This letter summarises our views and recommendations on the aforementioned proposals and in particular addresses two principal points. These points are firstly, that BL should retain (for a limited duration) a minority interest in Unipart of 25.1 per cent, and secondly that an upper limit should be imposed on third party shareholdings of 15 per cent.

THE ARG/UNIPART CONTRACT

Paramount to the privatisation of Unipart is the need to provide for its independence and ability to stand alone in the private sector. This in turn involves the establishment of an arms-length relationship between BL and Unipart to provide Unipart with the freedom to develop its own new products and markets, whilst at the same time recognising the commercial interests of both parties and the need for co-operation. One of the most important tools to achieve this series of objectives has been identified as the ARG/Unipart contract. Obviously we have not yet had an opportunity to review the ARG/Unipart contract and so our comments are necessarily tentative.

THE RATIONALE FOR A RETAINED INTEREST

The two principal arguments put forward by BL in justifying the need for a retained interest are:-

(a) to help to ensure the smooth operation of the ARG/Unipart contract; and

(b) to provide an effective means to prevent a takeover of Unipart by a hostile bidder.

1/6

In relation to the first of these points, we believe that the smooth operation of the contract could be safeguarded by effective and comprehensive drafting of the contract itself at the outset. This might involve, for example, clear provision for regular "co-operation" meetings between members of the management teams of the two companies in order to ensure undistorted flows of communication in both directions. Indeed it is debatable whether board participation to which BL would be entitled through its retained interest would achieve this objective on its own. As an independent company, the Board of Unipart should be fully committed to the protection of the interests of its own shareholders whilst satisfying the terms of its contractual obligations.

The rationale for setting the level of the retained interest at 25.1 per cent in relation to the second argument above stems from company law and is related in turn to the proposal to limit third party shareholdings to a maximum 15 per cent through a clause in the company's articles. With this article in place, a change of control could not be achieved without the consent of BL because a special resolution would be required to change the articles and the passing of such a resolution would need a 75 per cent majority vote. The restriction of holdings to 15 per cent is considered below.

THE 15 PER CENT RESTRICTION

The retention of a 25.1 per cent interest by BL would not in itself provide protection against a hostile bidder - in practice by offering a sufficiently attractive price a bidder would be able to achieve 50 per cent control which would be all important in terms of ultimate control over management. For this reason, it is necessary to impose a restriction over the level of third party shareholdings in Unipart and under the BL proposals the retention of a 25.1 per cent stake would be used to preserve this restriction.

It could be argued that if BL has the right to terminate the ARG/Unipart contract upon a change of control of Unipart then it holds the ultimate deterrent to a hostile bidder, in that the commercial success of Unipart is itself presently heavily dependent on the existence of the contract. However, the acquisition of Unipart could be seen by a competitor of BL as a 'one-off' cost of inflicting possibly irreversible damage to BL's business. Given the finite life of the proposed contract, BL, as a responsible commercial organisation, will inevitably need to take steps to protect itself against the eventuality of termination (or the contract not being renewed by Unipart at its first break point) and thus seek ways of alternative parts sourcing. BL's assertion that the deterrent of termination is unworkable in practice (because of the time it would take to re-establish a parts distribution service) is not therefore wholly tenable. In the short term however, whilst contingency plans are put in place, some sympathy may be held for this argument.

We believe that a stronger argument to justify a restriction over third party shareholdings is that Unipart should be allowed an interim period during which it can fully establish itself as an independent company by diversifying its own business.

To Mr R J Meadway

An alternative method of protecting Unipart against a hostile bidder would be the creation of a 'golden share'. The holder of this share would be the Secretary of State and not BL. Although the proposals submitted by BL suggest that a golden share would not be acceptable in the circumstances of Unipart, we believe that this matter could be investigated further. If this alternative were to be pursued, the actual level of BL's retained interest would become less critical and might for example be set at below 25 per cent.

In order to preserve the attractiveness of Unipart as a private sector investment, we believe it important that a time limit should be set for any restriction over third party shareholdings. The proposed restriction of 15 per cent and, if adopted, the existence of a golden share, should be for a limited duration only, such period being designed primarily to permit Unipart to develop into a fully independent company in the private sector. The extent of the period might be set for example, to coincide with the first break point of the ARG/Unipart contract, assuming that this arises after, say, three years. We do not believe that a restriction of this nature for a limited period would be viewed unfavourably in itself.

UNIPART FROM THE PRIVATE SECTOR VIEWPOINT

We believe that the private sector will associate the future prospects of Unipart with those of BL and thus the retention of an interest by BL would provide a useful demonstration by BL of a continuing financial commitment to Unipart's future success and would recognise their interdependence. The retention of an interest should also help to allay doubts that may exist over the concept of a vehicle manufacturer which relies on an independent company for its supply of parts. It should also provide comfort against the worries among ARG dealers identified in Mr Carver's letter of 3 May 1985.

With regard to the duration of a retained interest by BL, if the BL proposals are adopted we believe that the period should be designed to coincide with that discussed under the 15 per cent restriction above. If the golden share approach were pursued it would be appropriate to provide for a review of the position say at the time of the first break point of the contract.

CONCLUSION

Whilst there are arguments which suggest that in the longer term the continuing commercial interests of BL might be capable of protection wholly by way of the ARG/Unipart contract, in the short term there is justification for some additional form of protection. The protection of Unipart against a takeover for a limited period will allow BL to provide contingency plans against possible termination of the contract and will also allow Unipart to develop further as an independent company. There are arguments in favour of BL retaining an interest in Unipart, in particular with regard to the optimum presentation of the company to the private sector.

S.M.& Co No 4 31 May 1985

To Mr R J Meadway

Whilst the BL proposals represent one method of achieving the stated objectives, an alternative method would be through the use of a golden share. Under this alternative, the actual level of any retained interest becomes less critical (and could be set below 25 per cent if desired) and any decision over change of control would be made by an independent body (ie the Secretary of State) which might ultimately be in the interest of Unipart itself.

Yours sincerely

ec. MR. WARRY

08

10 DOWNING STREET

From the Private Secretary

3 June 1985

BL CORPORATE PLAN

The Prime Minister has seen the draft letter to Honda which was attached to your letter to me of 30 May. She discussed this with your Secretary of State on Friday. She felt that the draft letter could express in a more straightforward way the question being put to Honda of whether it could or could not supply an engine for the Metro replacement which could be supplied from Swindon, or made available to ARG for manufacture under licence.

She has seen the revised text sent under cover of Andrew Lansley's minute to me of 31 May. She was content with this draft.

The Prime Minister was also content that a draft announcement should be made outlining the proposed collaboration with Honda.

I am sending copies of this letter to Rachel Lomax (HM Treasury), Leigh Lewis (Office of the Minister without Portfolio), and Richard Hatfield (Cabinet Office).

(Andrew Turnbull)

JB

John Mogg, Esq.,
Department of Trade and Industry.

10 DOWNING STREET

From the Private Secretary

Prime Minister (1)

Mr Tebbit has personally redrafted the letter to Honda. It is much clearer and comes straight to the point about using a Honda engine in the Metro replacement. Are you now content for it to be sent?

One remaining danger is that BL misrepresent HMG's stance. Agree that the reply to Mr Tebbit warns against this and asks him to consider what steps can be taken to prevent this?

AT
31/5

I think any further warnings would provoke a sharp reaction.

Agree the letter now

cc PH

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

JU589

Secretary of State for Trade and Industry

31 May 1985

CONFIDENTIAL

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

with AT?

Dear Andrew,

BL CORPORATE PLAN

Following my Secretary of State's conversation with the Prime Minister before lunch today, I enclose a copy of a further draft of a letter to go from Mr Harold Musgrove, Chairman of the Austin Rover Group to Mr Kume, President of Honda. As John Mogg said in his letter of 30 May enclosing an earlier draft, my Secretary of State would like us to be in a position to be able to inform the company as to whether this draft is acceptable no later than mid-day on Monday 3 June.

PP

Yours ever,

Andrew Lansley

ANDREW LANSLEY
Private Secretary

991-1

JU588

DRAFT

LETTER FROM MR MUSGROVE TO MR KUME (PRESIDENT OF HONDA)

I am very pleased to inform you that Her Majesty's Government is prepared to approve, in principle, the latest BL Corporate Plan. In reaching this decision on the Plan, Ministers paid special attention to the proposals for extended collaboration between Austin Rover Group and Honda and it has been made clear to us that further collaboration between the two companies is favoured by the Government. This means that we can proceed to finalise and sign the proposed Statement of Understanding.

As you know Austin Rover has a development programme for their cars outside the collaborative programme. The most important of these is the new small car. Austin Rover has begun preliminary design work on a new engine for that project but would also like to explore the possibility of using a Honda engine.

In broad terms, the need is for a family of engines, with two displacements of about 1.0 litre and just below 1.4 litres, capable of meeting coming European emission standards, and providing competitive performance and fuel economy in European conditions. Further details of the characteristics of the engine are attached. The engine must be available for volume production by the summer of 1988 with at least 200 pilot build units for extended test by autumn 1987. The annual requirements for the engine would be in the region of 250,000 to 300,000.

Since our new collaborative agreement excludes collaborative development of such an engine we wish to ask

a whether Honda has an engine suitable for this car, and if so, whether you are willing to make it available to Austin Rover;

b if so, on what terms, whether by ARG manufacture under licence or Honda manufacture in UK?

I appreciate that, in our discussions to date, some of these points have been covered, but I believe that present circumstances make it appropriate for there to be further consideration of the subject. I should therefore be extremely grateful for your initial reaction to the points I have raised as soon as possible.

ENGINE CHARACTERISTICS

The main characteristics/standards to be achieved by the engine are:-

- Two engine capacities - the first of 1.0 litres/1.1 litres, the second to be marginally below 1.4 litres.
- Capable of meeting proposed European emissions requirements in the most effective, practical way which, in ARG's judgment, is by lean burn technology, avoiding the need for a catalytic converter, either oxidation or three-way.
- Dimensional requirements:
  - Length - Engine front pulley to back face of block - 475mm
  - Height - Centre line of crank to highest point (assumed to be the induction system) - 440mm
  - Capable of installation 15^{o} forward from vertical.
- Specific power outputs of about 50 PS per litre with single carburettor up to 73 PS per litre (naturally aspirated) with multi point fuel injection.

- Ideally the engine/engines would need to rotate in a conventional (clockwise) manner. Alternatively, if this were not possible, then Austin Rover Group would have to consider changing its present small gear box plans and request Honda to supply or to allow Austin Rover to manufacture under licence Honda gearboxes also.

- Fuel consumption characteristics of the engine to be such that it will permit the most economical version of the Metro replacement to achieve a target of 80 mpg (imperial) at a steady 90 kph.

4

SECRET

PRIME MINISTER

MEETING WITH MR. TEBBIT

I. BL Corporate Plan. Mr. Tebbit will be seeking clearance for the draft letter to Honda - Flag A. A note by Peter Warry is at Flag B. While this is consistent with the outcome of last week's meeting, Longbridge Robots seemed to have played a part in its drafting. Paragraph 2, for example, is extremely tortuous, and will defy translation. You should ask Mr. Tebbit if it can be simplified. We seek a simple answer to a simple question - can Honda supply either an engine design for ARG to manufacture under licence, or an engine for sale from Swindon. All the talk about "collaboration would be nicer, but ......" merely complicates the picture.

Mr. Tebbit also wants agreement to an early statement on collaboration with Honda. This seems sensible in order to prevent Honda delaying agreement on all the non-controversial parts of the Memorandum of Understanding while the engines issue is argued out.

II. Steel. Mr. Tebbit will want to report on the difficult choices ahead on steel. BSC believe a major plant will have to close, not simply for their own commercial results, but in order to meet community requirements. BSC have been planning to buy Alphasteel in order to close it, and acquire its quota. The asking price of the owners of Alphasteel has become too high, and negotiations have reached a dead end. Peter Warry's note (Flag C) indicates this might be a blessing in disguise. Alphasteel is losing money, and the best course might be to allow it to fold of its own accord.

Duty Clerk
pp Andrew Turnbull.

30 May, 1985.

SECRET

A cc PW.

A

CONFIDENTIAL

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
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PS/
Secretary of State for Trade and Industry

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
Whitehall
LONDON
SW1

30 May 1985.

Dear Andrew,

BL CORPORATE PLAN

Thank you for your letter of 24 May about the meeting the Prime Minister held the previous day.

2 Ministers here have explained the position to the BL Board to the degree necessary and the attached draft letter from Mr Musgrove, Chairman of Austin Rover to Mr Kume, President of Honda is the result. My Secretary of State considers it is in accordance with the conclusions of the meeting of 23 May. Once Honda receive such a letter the ball will be in their court and protracted discussions may follow, since they will clearly be puzzled to assess our intentions. In view of Parliamentary pressures and the needs of Austin Rover's commercial position we may wish to consider announcing the acceptance of the BL Corporate Plan with this point left for later resolution.

3 More urgently than that, however, BL take the view that in order to secure Honda's commitment to the proposed medium car collaboration it is essential for them to proceed soon to announce the outline proposals and to sign a statement of understanding with Honda. They recognise of course that both the announcement (a ... draft indicating the intended substance is attached) and the statement of understanding will have to be in terms which do not exclude the possibility that Honda would supply the engine for the Metro replacement. Subject to that proviso, my Secretary of State believes that it would be reasonable for BL to proceed as they propose. The earlier stages of the collaboration with Honda have been announced purely as commercial arrangements between the companies, and have not called for a statement to Parliament, so he considers that this can legitimately precede telling Parliament our decisions on the Plan.

JH2ARM

991-1

CONFIDENTIAL

4 Clearly considerable urgency attaches to clearing the letter to Honda. If the Prime Minister and colleagues are content with the proposals in this letter, my Secretary of State would like us to be in a position to inform the company no later than mid-day Monday, 3 June.

5 Copies go to Rachel Lomax (Treasury), Leigh Lewis (Minister without Portfolio's office) and Richard Hatfield (Cabinet Office).

Yours ever
John Mogg

J F MOGG
Private Secretary

Encl

JH2ARM

999-49

A

DRAFT

LETTER FROM MR MUSGROVE TO MR KUME (PRESIDENT OF HONDA)

1 I am very pleased to inform you that Her Majesty's Government is prepared to approve, in principle, the latest BL Corporate Plan. In reaching this decision on the Plan, Ministers paid special attention to the proposals for extended collaboration between Austin Rover Group and Honda and it has been made clear to us that further collaboration between the two companies is favoured by the Government. This means that we can proceed to finalise and sign the proposed Statement of Understanding.

2 Although the draft Statement of Understanding includes the point that Honda has no intention of jointly developing engines with another manufacturer at the present time, the favourable Government response and the further detailed considerations we have given to our plans for engine development and manufacture during the time the Government has been carrying out its review makes it appropriate, we believe, for us to return to the question of whether Honda might be willing to extend the field of collaboration to include working with Austin Rover on a programme for [illegible] the new small engine which Austin Rover needs.

3 In broad terms, the need is for a family of engines, with two displacements of about 1.0 litre and just below 1.4 litres, capable of meeting coming European emission standards, and providing competitive performance and fuel economy in European conditions. Further details of the characteristics of the engine are attached. The engine must be available for volume production by the summer of 1988 with at least 200 pilot build units for extended test by autumn 1987. The annual requirements for the engine would be in the region of 250,000 to 300,000.

4 Ideally, Austin Rover Group would like to collaborate with Honda on a joint design, development and manufacturing programme for such an engine. Only in this way do we believe that compromises on the design of the cars in which the engine will be used can be avoided. You will fully understand the importance of that point. Nevertheless, knowing that you have so far not favoured collaboration programmes on engine, and in order to make a complete analysis of possibilities, we should also like to explore the implications of taking a Honda design. All this, of course, assumes that you will have such an engine or would be prepared to embark on such an engine programme in the time frame indicated, and be willing to make the engine available to Austin Rover.

If the use of a Honda design is in your view acceptable and feasible, we would like to explore the following possibilities for manufacture:-

- ARG manufacture under license
- Honda manufacture in the UK

(Supply from Japan should not be totally ruled out although the implications for local conte~~s~~t may make this impractical).

ENGINE CHARACTERISTICS

The main characteristics/standards to be achieved by the engine are:-

- Two engine capacities - the first of 1.0 litres/1.1 litres, the second to be marginally below 1.4 litres.
- Capable of meeting proposed European emissions requirements in the most effective, practical way which, in ARG's judgment, is by lean burn technology, avoiding the need for a catalytic converter, either oxidation or three-way.
- Dimensional requirements:
  - Length - Engine front pulley to back face of block - 475mm
  - Height - Centre line of crank to highest point (assumed to be the induction system) - 440mm
  - Capable of installation 15^{o} forward from vertical.
- Specific power outputs of about 50 PS per litre with single carburettor up to 73 PS per litre (naturally aspirated) with multi point fuel injection.

In the case of your supplying the engine to us, rather than manufacture by ARG, we should make it clear that the price which we would expect to pay would need to be commercially viable compared with our own in-house manufacture. In our view that would inevitably involve a price significantly less than that which we are paying for the current 1342cc engine from you and it would require any unique investment and design and development costs to be covered in the unit price.

I appreciate that, in our discussions to date, some of these points have been covered, but I believe that present circumstances make it appropriate for there to be further consideration of the subject. I should therefore be extremely grateful for your initial reaction to the points I have raised as soon as possible.

30.5.85

- Ideally the engine/engines would need to rotate in a conventional (clockwise) manner. Alternatively, if this were not possible, then Austin Rover Group would have to consider changing its present small gear box plans and request Honda to supply or to allow Austin Rover to manufacture under licence Honda gearboxes also.

- Fuel consumption characteristics of the engine to be such that it will permit the most economical version of the Metro replacement to achieve a target of 80 mpg (imperial) at a steady 90 kph.

B

PROPOSED PRESS STATEMENT BY ARG AND HONDA

As a result of the collaboration which has successfully developed between ARG and the Honda Motor Company over the past six years, represented by the Acclaim, the Rover 200 Series and the very impressive progress to date on the jointly designed and developed XX car project, ARG and Honda have been discussing plans which would take collaboration between the two companies to a further stage. Several possibilities have been discussed, of which the main ones are:-

o As a further development of the encouraging progress on the XX project, the establishment of another joint design and development programme on a new car, bringing to it the best appropriate technology of both companies.

o The establishment by Honda of an engine manufacturing facility at Swindon to provide UK sourced engines for the Rover 213 and vehicles built by ARG for Honda.

o The build by ARG of Honda vehicles for sale by Honda.

The above points are satisfactory in principle to the Boards of both BL and Honda. Her Majesty's Government has also indicated its approval to this further collaboration with Honda.

It is anticipated that a statement covering the principles of the next stage of collaboration will be signed by the two companies in the near future.

IND. POL: BL: Pt 9.

B

B

PRIME MINISTER 30 May 1985

AUSTIN ROVER (ARG) - ENGINES

Draft Letter

Honda could be excused if, when reading the letter in translation, they thought the proposal remains about collaborating on engines. The possibility of supplying engines only merits the second indent at the bottom of the second page of the letter. It could be amended in the following manner.

1. Second paragraph, delete last three lines and replace with "... whether Honda might be willing to supply the new small engine which Austin Rover needs, a view which HM Government endorses".

2. The third paragraph should be modified to require the engine to be available in the summer of 1989, not 1988 as proposed, and pilot build in autumn 1988, not 1987. (ARG had planned to launch the replacement Metro in late 1989 so it is unreasonable to ask Honda to beat that timing).

3. The fourth paragraph is ~~highly misleading~~ unnecessary and should be deleted. It talks about collaboration and an alternative of ARG taking a Honda design but does not mention a straight supply of engines. A small consequential change to the subsequent paragraph would also be necessary.

4. The attachment on engine characteristics is surprisingly precise given that the car has yet to be designed (and should therefore be able to accommodate any sensibly competitive engine). The stipulation that the economy version of the car should be able to achieve 80 MPG is

unrealistic, particularly as lean burn will <u>reduce</u> engine economy. Would it not be better to be more general and say "the engine should package in a Metro type car, meet European emission standards through lean burn, and have a fully competitive performance?"

BL and ARG Directors are flying to Japan no doubt to try and persuade Honda to make the response ARG want, under threat of losing the more valuable (to Honda) sub-contract car manufacture. Honda's response will need to be viewed in this light.

The attachment details our understanding of Honda and ARG's engine plans.

<u>Collaboration Announcement</u>

An announcement of the proposed collaboration with Honda seems reasonable, provided that in the underlying Memorandum of Understanding the embargo on ARG buying Honda engines is deleted and the stipulation for the new Maestro/Rover 200 replacement to take both Honda and ARG power trains is softened.

Peter Warry

PETER WARRY

ATTACHMENT

ENGINE PLANS

Although the Metro currently takes 1.0L and 1.3L engines, ARG's revised plans for the new Metro envisage 1.1L and 1.4L K series engines to accommodate the 1.4L division in the emissions legislation. (Both K series engines will be made from the same casting and the design is compromised if there is too wide a difference in engine sizes).

Honda have two separate engines in this sector - the 1.342L currently fitted in the Rover 213 and a 1.2L fitted in the Honda City. They have plans to produce a 1.1L version of this smaller engine and possibly a 1.3L version as well. They would be happy to manufacture the smaller engine at Swindon in addition to the others already planned (they will also be manufacturing the 1.2L in the United States). We are told the engines will be fully competitive on both emissions and performance.

Extract from ARG submission to DTI 10/5

SUB CONTRACT MANUFACTURE PROFITABILITY

Under this heading there are three separate questions which have been asked :

1 Details of the profitability of the sub contract manufacture to ARG and how this would relate to Honda's profitability.

2 Outline details on how "the 80% local content" would be made up.

3 Indications on where the Honda capital expenditure related to sub contract manufacture would be spent.

It is essential that we re-emphasise that, to date we have reached the stage of a Draft Memorandum of Understanding with Honda. Following signature of that MOU we will then enter into progressively more detailed discussions/negotiations on the individual contracts which will stem from that MOU. The following information is, therefore, provided from our own knowledge of the profitability of this industry in Europe, coupled with our experience of arrangements which have been made with Honda on previous occasions and, above all, on how, from our past experience of negotiating with Honda, we believe that they will view the situation and therefore what their negotiating position is likely to be.

It must be understood that Honda do not view financial consequences in the same way that would be understood in the UK. In particular, they regard one-off costs such as tooling manufactured in their own toolrooms, or facility costs, or, indeed, the proposed engine plant at Swindon, as long term strategic investments which they would not necessarily relate in their own evaluation to a specific individual action.

On the other hand, they are very much orientated to the achievement of profits in each part of their business and they will, therefore, expect to more than recover costs on the pack they supply to us and, indeed, in their sales companies. The sensitivity of the information which is being supplied cannot, therefore, be over-emphasised.

1 PROFITABILITY OF CONTRACT BUILD TO ARG

- Based on Rover 200 pack prices from Honda and our own variable manufacturing costs, the total average variable cost per unit is estimated at £3050 at 1985 economics to ARG.

- The average available net sales revenue would be £3950 to the Honda sales companies. We would anticipate selling the finished vehicles to Honda at a price of £3450, effectively giving them an average 12% margin in their PDI/sales companies.

- The economic profit per unit to ARG is, therefore, estimated at around £400 per unit or, on the full volume of 100,000 per annum, £40m per annum.

- The incremental fixed costs to ARG are £8m on manufacturing, a provision of £3m to cover administration, purchasing etc, and depreciation of £5m per annum.

- The incremental profit to ARG is, therefore, estimated at £24m per annum on the full volume of 100,000.

- If ARG were manufacturing such vehicles ourselves, on the anticipated Honda market mix we would expect to achieve an average EP of 27% or £1050 per unit.

- From the above analysis it can be seen that of this £1050 we would anticipate ARG will actually receive £400. Honda will, therefore, probably achieve an economic profit per unit of £650 assuming that their cost efficiency is comparable to ARG.

- Honda will incur incremental engineering, administration and manufacturing fixed costs associated with the European versions of the cars which we would estimate at £10-15m per annum. They will also incur selling and marketing costs of around £35m per annum.

- Thus the total incremental profit available on the sub contract cars is estimated to be £44m (that is EP £105m, less ARG incremental costs £16m, less Honda incremental costs of £45m). On the basis of the estimates above ARG would receive £24m per annum of this profit and Honda c £20m per annum.

2 OUTLINE DETAILS ON HOW "THE 80% LOCAL CONTENT" WOULD BE MADE UP

Obviously ARG has no specific knowledge of how Honda would achieve such a target in detail. However, based on our own knowledge, the level of work to be carried out by ARG, the supply of the engine ex-Swindon, the supply of the fascia ex-Honda in Belgium, plus locally sourced parts such as wheels and tyres, glass, seat and trim materials, exhaust system, fuel tank, battery, radiator etc, would generate a local content of around 72%. The remaining 8% could be achieved in a variety of ways. For example local sourcing of steering and suspension components would generate a content of 7% or, alternatively, a combination of a variety of other bought-out parts could equally be sourced from within Europe.

i.e body panels will be supplied from Japan

3 INDICATIONS ON WHERE THE HONDA CAPITAL EXPENDITURE RELATED TO SUB CONTRACT MANUFACTURE WOULD BE SPENT

Answering this question is coming very close to piling estimate upon estimate. It stems, presumably, from the comment made that the tooling costs to be paid for by Honda for the two contract assembly models would probably be, at the very least, double the amount which ARG has estimated it will spend in providing the facilities for the sub contract vehicles.

This comment stems from our own knowledge of the cost of tooling for two such models in terms of both body-in-white tooling and vendor tooling. It does not include the investment which Honda will be making at Swindon although, on reflection, perhaps in this context it should.

However, as an assumption, we would believe that it is almost certain that the body-in-white tooling will be manufactured in Japan, certainly on panels and assemblies, which will have already been tooled for the Japanese and US markets. This would account for some 70% of the total tooling costs to Honda. Of the remainder, it would depend upon the precise sourcing adopted by Honda as to where the tooling costs would be incurred. A very rough guess would imply that 15-20% of the total tooling cost may be incurred in the UK/Europe.

i.e minimal incremental investment for Honda.

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File

10 DOWNING STREET

From the Private Secretary

24 May 1985

BRITISH LEYLAND

There are one or two points which emerged from yesterday's meeting which I have not included in the record which has been sent to all members of E(A). Your Secretary of State said he expected to hear before the end of next month on the outcome of negotiations with GM. Although there were other potential buyers for parts of Land Rover-Leyland, he did not think it right to enter into negotiations with them until talks with GM were either completed or had broken down. This was not challenged at the meeting, though I do not think this necessarily implies that the Prime Minister has abandoned the view expressed in my letter of 11 March that other buyers should be sounded out against the contingency that GM do not acquire LR-L or wish to acquire only parts of it.

Your Secretary of State said that by the end of the year he hoped that Unipart and much of LR-L would have been disposed of. This would make it unnecessary to divide BL into two separate entities. At this point he proposed to bring about major changes in the composition of the BL Board. It was noted that while the disposal of Unipart would not trigger renegotiation of BL's loan stock, disposal of LR-L probably would.

Andrew Turnbull

CST

John Mogg, Esq.,
Department of Trade and Industry.

cc Master Set

SECRET

FILE

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DCAAAPM

cc PGO D/M SO
CO CAL D/N
DOT WPSO NIO
CST DOE HMT
MAFF WO MWP
cc PW.

10 DOWNING STREET

From the Private Secretary

24 May 1985

Dear John,

BL CORPORATE PLAN

The Prime Minister held a meeting yesterday to discuss the BL Corporate Plan. Present were the Secretary of State for Trade and Industry, Chancellor of the Exchequer, Minister Without Portfolio, and Minister of State for Industry. Mr. Wiggins (Cabinet Office) was also present.

The Prime Minister said that although BL's Corporate Plan did not imply any further injection of cash from the Government, she was very concerned, particularly given under performance of previous plans, at the growth of the company's borrowings and at the growth of total liabilities subject to the Varley-Marshall assurances. Borrowings were expected to rise by £220 million in the course of 1985 and over the next five years total liabilities were projected to rise by over £500 million to around £2 billion. Every effort should be made to reduce these totals and, where possible, limits should be set on them.

In particular BL's plan to develop a new small engine itself - the K series - should be seriously questioned. She doubted whether it made sense for ARG, as a volume producer, to make its own engines. Before agreeing to the Corporate Plan she wanted to be satisfied that a suitable small engine could not be acquired from Honda. She believed Honda would be able to supply an engine for the Metro replacement which would meet European emission standards at an acceptable level of performance. The meeting on the Memorandum of Understanding implied that it was reluctance on the part of ARG rather than willingness of Honda to supply that was the obstacle to this course. The Prime Minister did not believe that any weight could be put on the Barings Report. At numerous points in the report caveats had been made that the

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authors had not been able to analyse issues thoroughly though it had to be recognised that they were given insufficient time to complete their remit.

In discussion it was argued that growth in borrowings or in total liabilities did not itself indicate weakness or otherwise of the business. If sales were increasing the total owed to creditors would necessarily rise. In relation to turnover both the total covered by the Varley-Marshall assurances and the amount owed to creditors were projected to fall significantly between 1985 and 1989. It was not possible to place a limit on the total liabilities subject to the assurances. This was not a total which was computed continuously and lenders or creditors to the company would therefore be unable to establish whether additional credit extended would benefit from the assurances. The company would be unable to trade on this basis. If BL had been operated as a public corporation the limit on its EFL would apply to borrowing not to total liabilities including creditors.

On engines, the Secretary of State for Trade and Industry said BL required a one litre engine to drive the replacement for the Metro. The existing A series engines could not be adapted to meet future emission standards. The company did not believe that an alternative engine could be acquired from outside the company. They therefore proposed to develop their own K series engines.

Summing up this part of the discussion the Prime Minister said that the issue of whether an alternative engine could be acquired should be resolved as soon as possible. Honda should be asked whether they were willing and able to supply an engine which would be suitable for the Metro replacement. A letter should be sent from BL but Ministers would want to approve the text and to see the reply from Honda. If an alternative engine, to be manufactured in Britain, could be supplied it would be preferable to buy it rather than for BL to invest considerable sums to develop its own engine.

The Secretary of State for Trade and Industry set out prposals for collaboration with Honda. These involved joint development and manufacture of a model to replace the Maestro and the Rover 200: manufacture by ARG on a sub-contract basis of Honda models; and construction by Honda of a new engine plant at Swindon which would supply engines for the new collaborative car, the Rover 213 and the cars built under sub-contract for Honda by ARG.

It was argued that extensive collaboration with Honda along these lines was beneficial for BL and was preferable to the development of a greenfield site by Honda. Not only would such collaboration increase ARG's business but association with Honda, which had a high reputation for quality, would improve ARG's market standing.

Summing up this part of the discussion, the Prime Minister said that collaboration as proposed in the Memorandum of Understanding should go ahead but that ARG's stipulation about the engines it would acquire from Honda would need to be reconsidered when further information was available on the possibility of acquiring an alternative small engine.

The Secretary of State for Trade and Industry recommended that a cap should be set on BL's borrowings and that this should be set at £680 million, the figure to be adjusted to take account of future privatisations. In discussion it was suggested that this figure could be lower; £680 million did no more than accommodate the substantial rise in borrowing projected for 1985. If, however, the figure was set at £680 million and held constant in cash terms to the end of 1987 a progressive squeeze on the company would be achieved. This was agreed.

The Secretary of State for Trade and Industry reported on the prospects for Land Rover-Leyland and for privatisation of Unipart. It was agreed that the BL Board should be pressed to bring forward early proposals including an expected timetable.

Summing up the discussion, the Prime Minister said that the BL Corporate Plan in respect of the Austin Rover group was approved subject to the resolution of the outstanding issue of buying in an alternative to the K series engines. Immediate steps should be taken to establish with Honda whether they were willing and able to supply an alternative engine which could power the Metro replacement and meet forthcoming emission standards. The text of the letter to Honda should be cleared with those Ministers attending the meeting. If it were established that an alternative engine could be acquired from Honda, BL's plans to manufacture its own engines should be revised and the capital expenditure projected under the Corporate Plan scaled down. The broad outline of the collaboration proposals set out in the Memorandum of Understanding with Honda were approved though the statement on the engines which ARG would accept would need to be amended in the light of whatever was decided on the buying in of a small engine. A cap of £680 million should be set on BL's borrowings. This should run until the end of 1987 but be adjusted to take account of further privatisation. The BL Board should be invited to bring forward as soon as possible details, including the expected timetable, for privatisation of Unipart and proposals on Land Rover-Leyland Limited.

I am copying this letter to Private Secretaries to members of E(A) and Richard Hatfield (Cabinet Office).

Yours sincerely
Andrew Turnbull

(Andrew Turnbull)

John Mogg, Esq.,
Department of Trade and Industry.

LEAD FREE PETROL

EC Directive : lead free petrol must be available from 1 Oct 89
EC Proposal : new models to use lead free from Oct 89
: new cars (eg retro) from Oct 91
UK Counterproposal : all cars from Oct 89.
In all cases derogations should be possible.

ADDRESSEE ONLY

EUROPEAN EMISSIONS

CURRENT AND PROPOSED LEGISLATION

The status of proposed legislation can be summarised as follows:-

EEC

On the 20 March 1985 the Council of Environmental Ministers agreed in principle the structure, the introduction timing, and a broad description of more severe emission legislation for the EEC.

. Engines over 2.0 litres:-

- emission levels equivalent to 1983 US Federal but on a new European drive cycle still to be defined
- no actual levels yet defined
- introduced for new homologations October 1988 and new registrations October 1989

This level of emission would demand three way catalysts and lead free fuel

. Engines between 1.4 litres and 2.0 litres:-

- emission levels which could be met by technologies different from that necessary for 1983 Federal (ie. by lean burn and oxidation catalysts)
- no actual levels defined
- introduced for new homologations Oct 1991 and new registrations 1993

The use of catalysts for these engines would demand lead free fuel

. Engines below 1.4 litres:-

- the previously proposed 'D'Avignon' emission levels requiring only lean burn technology or EGR
- actual levels are defined on the current European drive cycle (but equivalents may be necessary if a new drive cycle is adopted for this engine size category)
- introduced for new homologations Oct 1990 and new registrations 1991

Lead free fuel would not be technically necessary for these smaller engines.

OUTLINE PLAN

Cars		Launch	Cost
AR6	(Metro)	1989	£195M
AR8	(Maestro)	1989	£176M
AR9	(Rover 200)	1990	~~£[illegible]M~~
AR16/17	(Montego)	1991/2	£125M
XX	(Rover)	1986	£57M (residue)

Powertrain			
K Series	(Metro +)	1989	£139M
S Series	(1·6L)	Existing	£38M
O Series	(2·0L)	Existing	£12M + £14M
V6	2·3L	1991	£44M.
Small Gearbox	(Metro)	1989	£76M

ecPW

CONFIDENTIAL

MR TURNBULL

BL Engines

I have sought to clarify the position about BL engines with Department of Industry officials.

2. At present BL have three families of engines:-

i. the A series, of small engines essentially for the Metro;

ii. The S series, of 1.3-1.5 litres, which go into the Maestro and the lower end of the Montego range;

iii. the O series, which go into the upper part of the Montego range and also into the Rover.

The A series engines are now very old, and a replacement (the K series) is required to go into any small car built by BL after 1989, in order to meet the EC emissions requirements. The S series and O series engines are both said to be of relatively modern design, capable of being modified so as to meet the EC requirements using lean-burn and one stage catalysts. The O series engines would be supplied to Honda for one of their versions of the XX, which will replace the bigger Rovers. A diesel version of the O series engine is also being developed.

1991?

3. Some models of the XX car now under development will use a Honda V6 engine. There has been a delay in arrangements to introduce the XX, arising from Honda's failure to develop the V6 engine in the previously planned timescale. A decision has yet to be taken whether BL should buy in Honda

engines of this type in the medium term, or manufacture under license.

True

4. Department of Industry officials say that Honda has refused categorically to cooperate ie collaborate on the development of a small lean-burn engine for the European market. Therefore if BL were required to rely on Honda for engines for a Metro replacement, they would have simply to by in an engine - from Honda or another manufacturer - which has not yet been developed. Unless a collaborator can be found, rather than an engine supplier, it appears inevitable that ARG would not be able to have ready a successor to the Metro to put on the market in 1989. The effect would be that the company would then be out of this sector of the market, in which it has in recent years been comparatively successful.

Not agreed. PW thinks. suitable Honda engine will be ready in time.

5. Ford consider themselves to be in the lead on lean-burn technology, and their assessment is that BL - despite their limited resources - are not far behind. If BL were not to develop and produce a new small engine to meet the EC emissions requirements, a good deal of their engineering effort and expertise would risk being dissipated.

JW

A J WIGGINS
Cabinet Office.
23 May 1985

PRIME MINISTER 23 May 1985

BL CORPORATE PLAN

Private Office have suggested it would be better if I do not attend the meeting. The three areas to concentrate on are:

1. Engines,

2. Borrowings/Varley Marshall and

3. Future BL Structure/Privatisation

Engines

If ARG were prepared to buy British built engines from Honda then profit and cashflow could be substantially improved. "The Best Plan" (page 4 of my main brief) shows how this would be achieved.

NT is likely to say that Honda will not collaborate with ARG on engines, but the real issue is will Honda supply them, and would they be suitable? I believe Honda engines could be supplied from Swindon that would fully meet emissions standards and would help, not hinder, ARG (pages 3/4 of my note).

Collaboration with Honda is probably right, but it should include the supply of their engines. Honda could be informed of this qualified approval now so that the preliminary agreement could be signed, and then ARG be asked to work up a revised plan with Honda engines, perhaps for submission after the summer recess. In the meantime, ARG should not proceed with their plans for the K series and V6 engines.

Borrowings/Varley Marshall

As turnover rises so Varley Marshall assurances will increase. At the end of 1984 these assurances were some £560m for ARG and £1,550m for BL as a whole. The plan says these will rise to £1,060m for ARG and £2,150m for BL by 1989. Depending on how the sub-contract manufacture for Honda is structured, a further £1,200m could be added to these totals (but it need not be this much).

BL forecast a jump in borrowings of £220m between 1984 and 1985 to £679m. NT is proposing a cap of £680m which, if the £220m jump is justified, would require future small reductions in borrowings.

A different strategy could significantly reduce the borrowings in later years. You could argue for a tighter limit, say £600m, and then reduce that by the anticipated Unipart proceeds down to £500m.

Privatisation and BL Structure

Land Rover-Leyland negotiations with GM have been going on since last summer and look like lasting into this. At least five other bids have been put on the shelf in the meantime so as to give GM a clear run. Isn't it time that serious negotiations with all interested parties started?

The BL Board is little more than a postbox for its two operating arms; BL Cars and Land Rover-Leyland. Couldn't it be dismantled and BL divided into two entirely separate companies?

Peter Warry

PETER WARRY

PRIME MINISTER

BL: Austin Rover Review
(E(A)(85)28 and 29)

BACKGROUND

The recovery of BL had been proceeding with moderate success until 1984, at least on volume car production, although the heavy vehicles part of the business experienced increasing difficulty. Last year, however, the position deteriorated, mainly as a result of the Austin Rover Group's (ARG) sales and profits falling short of planned levels. The 1985 Corporate Plan showed a deterioration in projected cash flow, resulting in an increase in borrowings covered by the Varley-Marshall assurances of £243 million over the 5 year period to 1989 (and an overall increase in the Government's gross exposure, because of increased creditor levels, of £630 million). Since the 1985 Plan was prepared there have been two major developments affecting ARG in particular: the EC agreement on new and tighter emissions standards to be applied from 1989, and the prospect of further collaboration with Honda involving joint development of a replacement for the Maestro and assembly by ARG of certain Honda mid-range models. An outline 1986 plan has been prepared by BL taking these developments into account.

2. BL are meanwhile going ahead with preparations for the privatisation of Unipart before the end of this year; detailed proposals are expected to be put to Ministers within the next few weeks. The future of the remaining businesses (Land-Rover, Freight Rover, Leyland Trucks and Buses, etc) will be for consideration in the light of the results of the discussions now in progress with GM on the rationalisation of the commercial vehicle sector.

3. You held two discussions with the Secretary of State for Trade and Industry early in April, at which you expressed great disappointment about the deterioration in BL's prospects, the postponement of the Unipart privatisation, and the prospective increase in the Government's Varley-Marshall exposure. You asked for an urgent examination of possible means to reduce the ARG capital budget by £250 million over the Plan period and to BL's borrowings on a downward path; meanwhile no commitment could be entered into on collaboration with Honda.

MAIN ISSUES

4. The main issues before the Sub-Committee are:

i. whether there is a viable alternative to the outline ARG 1986 Plan which would bring ARG into a more satisfactory financial position and reduce the Government's financial exposure;

ii. depending on the answer to i., whether to approve the outline ARG Plan including the collaboration with Honda;

iii. what sort of limit to place on BL's borrowing, with a view to containing any increase in the Government's financial exposure.

Alterhative strategies

5. Until the recent set-back there had been some prospect that ARG's business might develop to the point where it would be ripe for privatisation towards the end of this decade. The prospect of this having receded, the implications of three alternative strategies which would reduce capital expenditure by £250 million over the Plan period, and so slim down ARG's operations, have been explored: not replacing the Metro; buying in engines and gearboxes, and in particular the engine for the Metro replacement; and restricting ARG's presence in the medium car range to a single model. ARG, the Department of Trade and Industry, and Baring Brothers have all concluded that none

of the options is preferable to the outline ARG Plan. The comparative figures are shown in the table in paragraph 5 of Mr Tebbit's paper.

6. On the question of the Metro replacement, differences of view are possible about the rate at which demand would fall away and the timing of the end of production; but ARG have had their greatest success with cars of this size, and there would be little prospect of maintaining a viable company (manufacturing operation, dealer network etc) if ARG withdrew from this sector. The financial projections show that the result would be a rapid movement into large losses, and a very large cash outflow within the Plan period. In other words there would be a very high risk that cutting back in this way on capital expenditure would precipitate the crystallisation of a large part of the Varley-Marshall liabilities.

7. It is perhaps somewhat more difficult to reach a firm judgment on the option requiring the buying in of engines and gearboxes. In principle savings might be made by ARG if they could find a collaborator on a small car engine meeting the new EC emissions standards; but there is no candidate in sight, and no precedent for large volume buying in of petrol engines. Nor is there an existing engine meeting those requirements around which ARG could design a new car, and ARG would be at an enormous market disadvantage if they had to wait for another manufacturer to develop such an engine before they could begin work on a Metro replacement. Finally, even if an engine could be bought in, ARG would be in a relatively weak bargaining position in approaching another manufacturer with whose cars ARG would be competing.

Policy Unit disputes these points.

8. Restricting the medium car range is the option least fully explored, in that ARG have assumed that the Honda collaboration would not go ahead, and that the car to be produced would be a compromise between the Maestro and Montego replacements. Other assumptions might be made, e.g. that the car would be

produced in collaboration with Honda; but the implications of either the strategy assumed by ARG,or any possible alternatives,for market coverage, dealer network etc. would certainly be adverse, and Honda's readiness to cooperate would be far from certain.

The Honda collaboration

9. This option involves

i. a collaborative programme to develop and manufacture successor to the Maestro and Rover 200, which would use both ARG and Honda engines;

ii. ARG to produce the Honda Ballade as sub-contractor, and perhaps subsequently other Honda models;

iii. Honda to establish an engines plant at Swindon to supply engines for the collaborative car, the Ballade and the Rover 213.

The alternative for Honda would be to establish a green field assembly plant à la Nissan. So far as ARG are concerned, the collaboration would reduce the cost of developing the Maestro replacement, and should help to inculcate throughout the Group Honda's higher quality standards, so contributing towards the improvement in the reputation of ARG's products which is essential for eventual successful privatisation. ARG would have to make some limited investment at Longbridge to produce the Ballade, but the pay off period would be short. Altogether it does not appear that ARG have anything to lose from the proposed collaboration, even if it did not lead to a continuing close relationship between the two companies in the 1990s; and having Honda use ARG's excess capacity at Longbridge would avoid the creation of yet further excess car manufacturing capacity in the UK.

Baring Brothers Report

9. It does not appear that Barings have any strong engineering expertise; and they have not had time to make exhaustive independent studies of the consequences for ARG of pursuing possible alternative strategies. Their report, circulated with Mr Tebbit's paper, should probably be seen, therefore, as a quick review by independent observers of the facts of ARG's situation; they approached these facts with fresh eyes, and without previous commitments, and saw no reason to dissent from the conclusions reached by ARG and Department of Trade and Industry officials. They do have considerable experience of the Japanese scene, and their judgment on Honda's approach to the situation should carry some weight.

The underlying choice

10. The position would be more satisfactory if the deterioration in ARG's prospects, and the extra burden of meeting the EC emissions requirements, could be offset by bringing forward the privatisation of some other part of BL, or otherwise scaling down the company's operations so as to reduce the Government's financial exposure. However, with the successful privatisation of Jaguar, and the forthcoming privatisation of Unipart, and with discussions continuing with GM on Land Rover and heavy vehicles, it does not appear practicable to find any further satisfactory half way house between continuing to support ARG at broadly its present level of operations, and running it down in a way which would precipitate early closure and result in the crystallisation of the Government's liabilities. It must be very doubtful whether Honda would be ready to commit themselves to a collaboration for the medium term with ARG, if the UK Government's approach was perceived to be one of restricting very tightly that company's access to the resources it needed to survive in the market. Although ARG's performance has been disappointing, it has to be acknowledged that the car market has been and remains very difficult, with a number of other European manufacturers doing very considerably worse than BL. Moreover, although ARG have not found a viable method of reducing capital expenditure by £250 million, £45 million extra to meet EC emissions standards, and £25 million to provide for the assembly of Honda cars has been absorbed

in a revised projection £28 million lower than in the 1985 Plan.

BL borrowing and the Government's exposure

11. Consideration was given to the possibility of reducing the Government's exposure by prescribing a declining borrowing limit within which BL would have to live, and leaving the company to adjust the scale of its business to fit in with such a limit. However, given the apparent impossibility of reconciling the Government's desires with the company's situation, this did not appear to provide a way forward. Nor, for reasons explained in paragraph 4.2 of E(A)(85)29, would putting limits on total Varley-Marshall exposure (i.e. including creditors) rather than on borrowings be a satisfactory form of control. Mr Tebbit therefore proposes to impose a borrowing limit akin to a nationalised industry EFL, which would be set at the level projected for the end of 1985. This would require BL to husband their financial resources carefully, and to economise on working capital, since it would keep maximum borrowings £67 million lower than the level projected in the 1986 outline Plan for 1986 and 1987. Trends in borrowing, and in other short-term financial flows will in any event need to continue to be maintained very closely; and the limit will need to be reviewed in the light of privatisations and decisions yet to be taken on the future of the commercial vehicle business.

Other Issues

12. Mr Tebbit in paragraph 17 of his paper proposes endorsement of the other, less major, recommendations in the official report. This refers to paragraph 5.2.3-17 of E(A)(85)29; the recommendations generally call for full coverage in the 1986 Corporate Plan of the options for investment, model development and rationalisation open to BL in respect of Land Rover, Freight Rover, Leyland Trucks and Leyland Bus. Specific decisions are not required at this stage, and indeed cannot be taken until BL have done the further work specified, and conclusions have been reached in the current discussions with GM.

HANDLING

13. You will wish to invite the Secretary of State for Trade and Industry to introduce his paper. The Chancellor of the Exchequer and the Secretary of State for Employment will wish to comment on the financial and employment aspects of the issues before the Sub-Committee. Other Ministers are likely to want to comment on the wider economic and political aspects of the future of BL/ARG.

CONCLUSIONS

14. You will wish to reach conclusions on

i. whether a viable option can be found for scaling down ARG's investment programme, so reducing both the company's level of activity and the Government's financial exposure;

ii. if no such option can be found, whether to endorse the proposed Honda collaboration and the 1986 ARG Outline Plan;

iii. whether to impose a limit on BL's borrowings of £680 million, subject to review in the light of privatisations and other developments;

iv. the need for further discussion, as soon as possible, of BL's proposals for the Unipart privatisation and the future of the Land-Rover-Leyland businesses.

JW

(for P L GREGSON
Cabinet Office
22 May, 1985

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PRIME MINISTER 22 May 1985

BL: AUSTIN ROVER GROUP (ARG) REVIEW

Three canards in Norman Tebbit's note could be killed at the start of the meeting. E(A)(85) 28

A.

1. That ARG are asking for no more cash (paras 2 and 4) - true, but they are asking for guarantees on £500m of extra overdraft and creditors!

B

2. That Barings have offered independent and expert advice which should be relied on (para 1, 5 and 15) - none of the Barings team had any industrial experience or engineering expertise. Their motor industry knowledge was provided by Dan Jones, a Sussex University economist. He is not independent: see the statement below made in the middle of the 10 day Baring review.

UP TO 11,000 West Midlands motor industry jobs could be lost if the Government refuses BL's plan to develop a new car engine and gearbox, Mr Dan Jones, senior research fellow at Sussex University's Science Policy Unit, said yesterday.

If the Government insisted BL's Austin Rover lopped £250m from its investment budget and the engine development went to Honda of Japan instead "that would tear the heart out of the business. Austin Rover would cease to be a major car maker. It would be a national disaster," Mr Jones told a West Midlands County Council seminar on industrial decline.

However, if Austin Rover achieved a vehicle output of 550.000 by 1988 West Midlands could expect a net gain of 3,500 jobs even if the proportion of imported components in the car rose from the current level

Please find out whether Dan Jones has ever done work for B. Leyland or any part thereof.

Annex 6 E(A)(85) 28

You may also want to read out the caveats highlighted in the Barings report (attached), and to emphasise that their endorsement of the ARG plan is more of a negative statement that, from their limited knowledge, they could not refute ARG's claims.

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3. That, by inference, interdepartmental officials have agreed the report annexed to NT's paper (paras 1 and 5) - only the Official Group report (E(A)(85) 29) has been so agreed.

THE NEW 1986 'OUTLINE PLAN'

The outline plan shows profit £64m worse and cash £135m worse than the original 1985 plan. The 1985 plan itself had **profits a further £102m worse than the 1984 plan.** (Comparisons not on same basis). Dan Jones predicts a still lower market share (19/20%). Barings say, even on ARG's market share figures, that the plan will not necessarily ensure ARG's survival.

ARG claim emissions regulation was unexpected and not incorporated in the 1985 plan, and that they have done well to contain additional capital costs to £48m. Barings and DTI agree **but they all overlook that the 1985 plan already contained £62m on engineering test cells for just this purpose.** ARG also claim that they have had to defer the AR16/17 (Montego replacement) by two years, reducing profit by £160m, because engineering resources have to be diverted to handle the emissions problem. D

BL are back to Edwardes tactics: demanding total endorsement of their strategy or closure of the business. Additionally, they say if the plan is not approved then the Unipart sale could be prejudiced, and the negotiating position for the sale of Land Rover-Leyland would be seriously weakened.

COLLABORATION

The plan is for ARG to ultimately assemble 100,000 cars for Honda. ARG will spend £50m modifying facilities and claim Honda will have to spend £100m. **(In fact most of this will be in Japan and on press tools they already need**

'H'

for their own production). ARG will purchase the cars in kit form (say £3,000 each) and if Honda require the security of, say, a four year agreement then total contracted purchases over the period could be £1.2 billion, all of which could end up being guaranteed by HMG in addition to the £500m increase ARG already want.

Even if collaboration improves ARG's profitability, HMG should still withold approval unless it is sure that the ARG plan as a whole will produce a viable business.

ALTERNATIVE STRATEGIES AND ENGINES

All of the alternative strategies that ARG consider would show better results than the outline plan if realistic assumptions were adopted. However, buying engines is easily the best of these, and will be the deciding issue for the future course of ARG.

MOU. 1.7.

It is true that Honda will not collaborate on engines but they will supply them. It is ARG that are blocking it: the draft Memorandum of Understanding (MOU) that ARG wanted approved before Easter stated **"ARG would not in principle accept engines from such a facility** [Swindon] **for incorporation into ARG badged vehicles"**. See also Appendix II.

Arguments that 'the engine is the heart of the car', although literally true, can only have commercial logic if buyers are aware the engine is foreign (how many Vauxhall and Ford buyers are aware that their whole car may be foreign?) and that, if they knew, they would choose an ARG engine rather than a Honda one (which would contradict Barings argument that Honda adds to ARG's image!)

This is exactly the mistake Leyland Trucks made in the mid-70s: the economics of engine design and manufacture were forcing more and more manufacturers to consider buying engines, but Leyland Trucks held fast to the engine as a totem of their virility. Buying engines is now common practice for commercial vehicles and Leyland Trucks delay has cost the taxpayer dearly.

It defies economic logic to claim that it can be cheaper for ARG with its small volumes to manufacture engines than buying them from an efficient mass producer. Naturally the supplier will want guarantees on volume, but these should equate to no more than the incremental capital expenditure required. ARG would probably need double the expenditure to manufacture on their own, and this is money they have to pay out, not just guarantee! Other arguments on engines are rebutted in Appendix I.

THE BEST PLAN

If ARG accepts Honda supplied engines then:

1. Work on emissions is dramatically reduced
   Saving: capital £36m minimum, R&D work £30m

2. As a consequence the AR16/17 (Montego replacement) need not be deferred
   Saving: £160m profit reinstated

3. The K series engine and gearbox can be dropped
   Saving: Capital £215m (but offset by Honda purchases)

4. The V6 engine for the XX can be dropped
   Saving: Capital £44m (but offset by Honda purchases)

5. The AR8/9 (Maestro/Rover 200) collaboration need not be compromised to accept different Honda and ARG engines
   Saving: Some capital and also cheaper car

6. AR6 (Metro) can be deferred until end 1991 (see Appendix 1,d). Ideally this would be replaced by collaboration - the Honda Civic (a large Metro) is scheduled to commence sub-contract manufacture in 1992.

   Saving: Capital £195m deferred by two years, possible reduction.

The net effect of this revised strategy is **improvements of some £200m profit and £550m cash** over the period to 1991. If one accepts the very surprising £220m jump in BL borrowings between 1984 and 1985, then this strategy would give a revised BL borrowing requirement as below.

Borrowing
v V-M
Flag E

£ million	1984	1985	1986	1987	1988	1989
Original:	459	679	744	747	729	702
Revised:	459	679	711	629	494	329

RECOMMENDATIONS

1. Collaboration: this can only produce a viable plan if ARG are prepared to buy Honda engines. ARG should:

   a. **drop plans to manufacture their new K series and V6 engines and buy from Honda instead.** (If they are worried about being overcharged for engines, ARG should link the pricing of these to what they themselves are to charge for sub-contract assembly);

   b. **revise their other plans accordingly and explore collaboration on the Metro replacement.**

2. A borrowings cap: this is the right approach but £680m is too generous for 1985 in view of the £220m jump forecast between 1984 and 1985. You could:

a. start from a £600m limit;

b. deduct £100m proceeds of the Unipart sale from this. (BL are 'committed' to its sale by the year end and NT accepts that the cap should be adjusted for disposals);

c. therefore set a rigid cap of £500m and make clear that there will be no adjustment to the cap even if BL fail to sell Unipart by the agreed date;

d. hold the cap at £500m for 1986 and then reduce.

3. Land Rover-Leyland: the secret discussions with GM have been going on since last summer. This has been used as an excuse to shelve all other bids for parts of the business (we are aware of at least five). This has gone on too long: serious negotiations with all interested parties should start now.

4. Minor recommendations: the rest of the BL Official Group Report should be endorsed.

5. The BL Board is now little more than a postbox for its two operating arms - BL Cars and Land Rover-Leyland. It should be dismantled and BL divided into two entirely separate companies (as even Michael Edwardes wanted).

Peter Warry

PETER WARRY

APPENDIX I

REBUTTAL OF ARGUMENTS AGAINST ARG BUYING ENGINES

a. They don't know what Honda's engine plans are and Honda won't tell them

No: Para 11 of NT's notes lists the engines that will be made in Swindon. The MOU also makes it clear that there will be full cooperation in the transfer of information.

b. The Honda engines will not meet European emission requirements

No: Japan already has tougher standards than those proposed for Europe and their engines are already emissions compliant including the 1342 cc, which they supply for the Rover 213.

c. Even if they do meet emission standards they will not be optimised for European conditions

No: Europe is too important a market for Honda to allow second best. The Swindon plant proves this. Honda are one of the world's leading engine producers. The Rover 213 has better performance than its rivals (eg Ford Orion) even though the engine was originally designed for Japan.

d. Even if Honda did cooperate it is too late because the Metro replacement is needed in 1989.

No: The Honda 1342 cc engine can be used. In any event emissions standards below 1.4L do not bite until October 1991 (EC proposals for lead-free petrol would also come into force in 1991, but the UK are asking for 1989!). The Metro is not old: in 1989 it will be 9 years old compared to an average life cycle of 10 years for small cars (ARG figure) and 25 years for the Mini. The Mini, which has the same engine as the Metro, is currently sold in Japan (but actually it doesn't fully meet their emission standards).

e. It is unlikely that any other manufacturer would be prepared to supply them with engines.

No: There is already a small trade in engines - ARG itself buys engines from VM in addition to Honda - and significant evidence of a growing trend, eg Ford/Fiat, GM/Toyota.

f. **Even if they were prepared to supply they would demand a truly extortionate price.**

Unlikely: Economies of scale apply, so manufacturers would in fact make excess profits purely by charging ARG the same price as it would have cost ARG, with their small volumes, to make the engines themselves. In any event, competition and the laws of economics will not be suspended merely to justify ARG continuing as an engine manufacturer.

g. **If ARG cease engine manufacture then 4,000 jobs would be lost and two plants would close.**

No: ARG should continue manufacture of the 'O' and 'S' series engines, only the K series would be dropped. The labour content of the proposed K series is half that of the old A series it replaces and thus at most 1,000 jobs would be lost. This could be more than offset by manufacturing engine parts for Honda as envisaged in the MOU.

h. **Buying engines will not solve the emissions problem because a lot of the work goes into vehicle engineering**

No: if this were so, every model variant (eg 1.OL Metro, 1.3L Metro etc) would require a similar massive resource input. Expert opinion (eg Robin Nicholson) confirms the only significant changes are to the engine, not the vehicle.

Some questions for ARG:

1. Why do ARG propose to spend £44m to build their own version of V6 for the XX?

2. Why are ARG compromising the design of the AR8/9 (Maestro/Rover 200 replacement) by insisting it should take both ARG and Honda power trains?

Appendix II

This is a telex (dated Tuesday 21 May) from Professor Bhattacharyya in Japan. To preserve his identity it would be best to say only that you have received information directly from Japan confirming that Mr Ishykowa (the Managing Director of Honda) would happily supply any engines ARG wants and that the engines would meet European emissions standards and have a fully competitive performance.

The Telex reads:

As part of my Japanese tour I today met the senior Managing Director of Honda and his staff. In our discussion he mentioned that Honda's 1.3L, 1.5L, and 1.6L engines are so well advanced as not to need any further major development. Honda is going to manufacture all three engines at Swindon.

The three engines would meet all the European emissions standards and have a fully competitive performance. It is essential that this is so, as these engines will be incorporated in Honda vehicles. 90% of Honda cars are for export.

The senior Managing Director of Honda hopes that Austin Rover will purchase 1.3L, 1.5L and 1.6L engines beyond the current contractual agreements.

PRIME MINISTER

BL

This will be a difficult meeting. Mr. Tebbit's paper considers various ways in which BL's capital expenditure could be cut back, thereby reducing the growth in liabilities covered by the Varley/Marshall assurances. The "no small car" and the "restricted medium car range" options do not look effective as ways of achieving this. Discussion is likely to centre on the issue of buying-in engines and gearboxes.

ARG, supported by Barings (although somewhat luke-warmly), supported by Mr. Tebbit, argue that buying-in engines would be bad for ARG in the long run and impossible anyway because Honda would not supply.

Policy Unit are sticking to their guns in arguing that the outstanding liabilities can be reduced if collaboration with Honda is extended to buying-in engines. They argue that not only is Honda willing to supply but that this will produce significant benefits for ARG. Discussion will be difficult when there is not even agreement on the facts. This is an issue which will have to be argued through.

The other key issue, on which you will have Lord Young's support, is whether BL should be divided into two parts, ARG and Land Rover-Leyland. This would effectively wind up BL as a holding company. The business is already operated in this way and bringing the legal framework into line would finally lay the ghost of the old philosophy of bigger is better.

There is a lot of paper but it can be read selectively.

Essential

i) Mr. Tebbit's paper, ie the first seven pages of E(A)(85)28.

ii) Cabinet Office brief

iii) Policy Unit brief

Optional

i) Summary of the Corporate Plan beginning on page 72 of E(A)(85)29.

ii) A summary of Barings' report ie the first page of Annex B to E(A)(85)28.

(iii) The draft Memorandum of Understanding which you have already seen.

We have set aside 45 minutes in the diary tomorrow before Cabinet for you to look again at the papers and to discuss the issues with John Redwood and Peter Warry.

AT

ANDREW TURNBULL

22 May 1985

VC2AGS

10 DOWNING STREET

Prime Minister (4)

BL comes up for discussion on Thursday in E(A).

Pages i – vii of Alfred Sherman's foreword analyse the BL issue

The summary of Mr Moses' report is right at the start.

AT

17/5

Policy — Search Papers 1

BL: A Case Study in Frustration.

by Trevor Morse
with a foreword by Sir Alfred Sherman

POLICY – SEARCH

"Cogitare qui audet omnia audebit"

POLICY-SEARCH PAPERS NO. 1

BL: A Case Study in Frustration

by

Trevor Morse

with a foreword by

Sir Alfred Sherman

18 Great Portland Street
London W1N 5AB

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Summary of Conclusions and Recommendations

The slump in BL's financial performance in 1984 makes it unlikely that its anticipated recovery can proceed as envisaged in 1981, or that the company can be privatised as a single unit. It is now time for a fundamental reappraisal of BL's future. The most effective way to achieve the objectives of offering BL's constituent businesses every chance to achieve viability, and at the same time to ensure their return to the private sector as soon as possible, is to consider their future independently. Therefore, the Government should:

1 Commission from management consultants or a merchant bank a review of the commercial prospects of each of BL's three vehicle manufacturing divisions - Austin Rover, Land Rover and Leyland Vehicles. This review should also recommend annual financial and performance targets and assess options for privatisation, including possible timing, market value and method of disposal.

2 Make clear its intention to wind up BL plc as of, say, 31 December, 1986, and vest its assets in the three vehicle divisions which would have separate boards, management teams and capital structure, and operate from 1 January, 1987 as entirely independent concerns. Subsidiary companies would be dealt with as appropriate.

3 Buy out remaining private shareholders, leaving the Secretary of State for Trade and Industry as sole shareholder.

4 Restructure the company's balance sheets to resemble those of private sector companies, though adjusting equity gearing to suit commercial reality.

5 Set specified financial and performance targets, with time limits appropriate for each company, for achieving sufficient profitability to allow for a return to private ownership. If these targets are not met, contingency plans should be prepared to invite bids for those parts which can be salvaged. In the last resort chronically unprofitable capacity may have to be closed.

Foreword by Sir Alfred Sherman, Chairman of Policy-Search

BL, an Exercise in Unreason

"The sleep of reason breeds monsters".
Goya

This report by Trevor Morse is a case-study in frustration. It is a case-study, because almost every feature of this sad saga can be found reproduced, mutatis mutandis, not only in other nationalised industries (which BL is in all but name) but wherever subsidies or protection are given to nominally private enterprises in order to maintain payrolls at higher levels than economic circumstances permit.

The case of BL cannot be posed and judged in economic and political terms alone. It has profound philosophical implications. It embodies a failure of ideas on a national scale, and in an age of intervention, if the ideas lack incisiveness and coherence, all material and institutional things will go wrong.

The BL episode raises several questions. How far can short term political considerations be allowed to overshadow foreseeable medium and long term effects of choices? How far is it ethically justifiable to draw on national wealth in order to shield groups of workers from the effects of their own irresponsibility and egoism?

How far can it be morally right to subsidise better-paid workers to the tune of thousands of pounds per head per year, necessarily at the expense of those less well off than themselves and often more deserving?

Is the belief that government expenditure on creating jobs can mitigate unemployment anything other than the embodiment of the fallacy of composition compounded by uncritical use of words, e.g. unemployment?

None of these questions is specific to BL, which is only one of the many monsters bred by what Goya named "the sleep of reason".

This is a study in frustration, first because a government which came to office determined to end BL's drain on the public purse found itself frustrated by circumstances seemingly beyond its control. It found its way barred by apparently impassable mine-fields sown by its predecessor: unlimited liability backed by a barrage of flesh-creeping prophecies of financial collapse and civil disorder were purse-strings tightened. The Government came up against an interlocking thicket of vested interests including a civil service consciously or otherwise committed to the perpetuation of its satrapies, suppliers who had become an extension of the public sector by other means, and backbenchers who found special interests more immediately attractive than the common good.

To what extent the government could have found ways of circumventing these obstacles is a tempting question, but it would involve a wide range of hypotheses which could distract attention from consideration of the background to actual choices now open to government in its dealings with BL and also with other importuners who, like the poor, are always with us.

Frustration with the outcome of BL is not confined only to the government, but is almost universal. After the expenditure of two and a half billion pounds of public money (at those days' prices, far more in current terms) none of the objectives which motivated those who created and nurtured BL from 1975 onwards have been achieved. The intended beneficiaries are doomed to bitter disappointment, more bitter than had hopes not been raised and nature been allowed to take its course in the first place.

BL's market share has fallen and seems certain to continue to fall. Whatever future the British car industry may have, no one relies any longer on BL to assure it.

BL's contribution to the balance of payments has declined. The fall is more than just a function of BL's declining market share and exports. In order to reduce its losses, it has turned abroad increasingly to meet its need for components, which was declining pari passu with sales. Et propter vitam vivendi perdered causas. It thereby progressively deserted the British suppliers, in whose name BL had been propped up in the first place, and who had marched so vociferously and effectively in the van of Sir Michael's army of supplicants, with their retinue of West Midlands Conservative MP's.

Employment, a major objective of the Benn rescue, has fallen, and will continue to fall.

In this decline, BL is a paradigm of all nationalised and supported industries. Support, however lavish, cannot halt their decline, but can only slow it down, at incommensurate cost which could have been dedicated to better things. It could even be demonstrated that subsidy and other protection only perpetuate and even exacerbate the very decline they are ostensibly designed to cure, by diminishing the need to obviate practices wholly or partly at its root. There are parts of the world which pay higher real wages than we do where unsubsidised coal and motor-cycle industries thrive and expand - to name but two cosseted branches which have declined here in the one case, failed completely in the other.

The roots of the government's present dilemmas reach down to BL's birth, not just back to Benn, but further back to when a series of mergers sponsored - or imposed - by the government of the day sought a way out of difficulties by adding good apples to rotten ones, in the quaint belief that it was the rotten ones which would thereby be cured. (Our new pragmatism seems to have left no room for folk wisdom.) In a sense, Benn's de facto nationalisation was the culmination of a process, begun years previously, of herding the lean cows together with the fat cows, in the apparent hope that the latter would eat the former.

This was the state of affairs which Sir Michael Edwardes inherited.

Like many nationalised industry chairmen, Sir Michael did well out of the British public's sporting instinct to give a chap a fair chance. With most nationalised industries, the incumbent or newcomer, provided he is reasonably good at communication, can obtain funds and breathing space, and Sir Michael showed himself more of a politician than either Sir Keith or Patrick Jenkin, against whom he was pitted. (To be quite fair, both gentlemen might object that this is not saying very much, and that they would wish to be remembered for qualities and contributions other than politicianship. But as every shop-steward knows, it is the relativities which count.)

Trevor Morse's study traces the fate of Sir Michael Edwardes' unfulfillable promises towards their inevitable abandonment, which could not be concealed for ever, even though many failures were left to emerge after his departure. His early decision to keep the group together rather than begin selling it off piecemeal determined the rest of his strategy and its outcome to this day.

No hindsight is needed in order to point out that Sir Michael's basic premise that profitability was a precondition for privatisation put the cart before the horse and was bound to lead to failure. Privatisation remains a sine qua non for the ending of losses because so long as there is a crock of gold at the end of the garden the spur to sink or swim is blunted. Were there no losses, there would be no urgency. Privatisation does not lack other rationales, but all others put together do not have the urgency of the obviation of losses which fall on the economy as a whole, weakening its struggle for solvency and expansion of employment. Since privatisation must precede profitability, it cannot ex hypothesi wait until every loss-maker has been turned round, or even made saleable except with vacant possession. It follows that piecemeal privatisation is the only possible alternative to continued loss-making and erosion.

De facto nationalisation, epitomised by the government's unlimited liability for BL's debts, assured the labour force, management, suppliers - some inadequate by world standards - and their labour force, that nemesis would be staved off for ever by the bottomless purse of Johnny public. With such a guarantee, why should any wish to leave their protected haven for the cold world outside where anything might happen at any time? So a new class of dependents was born into one of the most competitive and international industries in the world.

He justified his decision on the grounds that to sell off the profitable parts would make it even harder to support the unprofitable. That this disingenious argument was even treated seriously, let alone accepted, comes as a reminder of how wise Lord Rothschild was to include a logician in the CPRS, and how much we are paying for the flight from logic and intellectual rigour rationalised by the cult of pragmatism.

In the first place, insofar as subsidies are ever justified at all, they are public money which should be given in the light of day to clearly defined recipients for clearly defined purposes, and subject to monitoring regarding both use and effects. For BL to be able to shuffle subsidies from one firm to another within the group, for all the world like a find-the-lady operator in a fairground, is an open invitation to extend the bafflement and concealment of which auditors general and ministers have complained in vain.

The whole financial and economic picture has been obscured by lumping together the thin cows and the fat, or at least the not-so-thin.

Secondly, insofar as some parts of BL were actually profitable, their profits should have been used to service their debt - or, if you will, pay dividends to the government - leaving the government to decide how to subsidise the loss-making parts of BL. Or, insofar as saleable portions were not actually profitable, but only potentially so in the eyes of prospective buyers, their sale would have turned liabilities into assets.

Thirdly, the argument for nationalising BL in the first place, and giving it another billion plus in 1981, was that BL was so large that its total collapse would send shock-waves throughout the whole economy. It surely follows that were BL cut down in size, by floating parts safely into the private sector, any shock-waves caused by eventual liquidation would have become commensurately smaller and more easily absorbed.

Fourthly, a reforming government, however determined, is hard put to wrestle with a monster the size of BL, which will use any means to hand in order to ensure its survival and continued access to government funds, and capable of mobilising uspport from a wide range of sources. The smaller the residual BL, the less powerful its army of auxiliaries and mercenaries would have become, with correspondingly less political strength and power of manipulation.

Fifthly, BL has acted as a procrustean bed. It has funded the uneconomic or strike-happy units more generously than they deserved - in any sense of the word - while keeping the dynamic firms capable of healthy expansion on short commons, causing them to miss opportunities.

Sixthly, common identity has tended by the nature of things to push up demands for wages and conditions to those offered by the better, irrespective of deserts.

Lastly, were units sold off for whatever price they would fetch - and their asset value is often far higher than the capitalised value of their performance - this would leave the irreducible core to be seen for what it was, and tackled accordingly. It is difficult to understand the rationale of spending vast sums of public money in attracting a Japanese firm to a green field site, while maintaining these industrial pensioners in their demoralisation to engage in subsidised competition on the home market.

But here the sociology of nationalisation is decisive. Though sections of the labour force and management in plants and enterprises were surplus to requirement, others would have survived break up and withdrawal of subsidy. But the main board and its headquarters staff would have been seen to be wholly superfluous. Hence they fought the hardest to maintain a monolithic "unscrambleable" company, and there is ample anecdotal evidence of how they used every subterfuge to circumvent government instructions to sell off parts of their empire, without which they would have lost their role.

This brings us back to the philosophical implications, not least the use and misuse of words. The word "employment" is now used in quite a different sense from the meaning it formerly carried, and which afforded its moral overtones. Economists from Smith to Keynes took it for granted that employment connoted the use of labour as a factor of production and its remuneration accordingly. The Keynesian multiplier effect rests on this assumption no less than theories it set out to modify or supersede. Keynesian theory, no less than any other, falls to the ground if employment comes to mean any situation where staff are paid irrespective of their contribution, and wages and salaries are divorced from value created, however measured.

The national accounts, of pure Keynesian origin, treat wages and salareis as factors of production, whereas they treat payments made irrespective of an actual labour input into a final product, as transfer payments. Is it logically sound to use the term employment for two such disparate phenomena as value-creation and value-destruction?

The most accurate description of this new industrial welfariat would be hidden unemployed. Hidden unemployment invariably wastes complementary resources in addition to the outdoor relief which raises its recipient far above welfare levels accorded to overt unemployed, and thereby removes any spur to finding real productive employment.

Inasmuch as BL's contribution to the balance of payments is still cited in debate, one has the duty to ask what every dollar, or other foreign currency unit saved, costs. The answer comes to approximately a third higher than its formal exchange value. In other words, even on the extreme assumption that all vehicles produced by BL would be imported and that all its exports lost, were it to close down completely - both highly questionable assumptions - then its export and import saving would still be prohibitively expensive, and constitute de facto devaluation.

I referred earlier to the fallacy of composition, which takes a single phenomenon in isolation from its secondary effects and from the likely effect of its repetition. This is relevant to the claim that nationalisation - by any name - creates employment. It would be truer to say that it generates unemployment.

First, it places a burden on the economy, whether by additional taxation or high monopoly prices. This additional burden prices otherwise viable firms out of competition at home and abroad. In a perceptive aphorism coined during the mid-seventies, Sir Keith Joseph called the victims of this process the "unknown unemployed", and suggested erecting a monument to them like that to the unknown soldier. In the mid-eighties they still have their monument: BL.

Secondly, nationalised work-simulation provides a level of wages and conditions well above what a commercially viable employer could hope to provide and still stay in business. This shapes the thinking not only of union negotiators but also of men out of work. Who can blame them if they decide that pay and conditions provided by BL, BSC, British Shipbuilders, NBC, etc are fair? How could they be otherwise, when the Government decides them? Who can cavil, then, at their chosing to wait for a job at fair wages rather than take something inferior from the hands of private exploiters who patently lack the social conscience worn so proudly on their sleeves by memorable chairmen like Ezra, Ryder, Finniston and Villiers. (Their memory will be kept green by the scale of their deficits, if by nothing else.)

In this context, the history of a forerunner to BL'isation, Ford's move to Halewood under pressure from the great compassioneer, are relevant. An unpublished doctoral thesis by an economic geographer in Liverpool University showed that Halewood's overall effect on employment in Merseyside had been negative. Only ten per cent of the labour force had been taken from the register, the other ninety per cent from existing jobs. In many cases, skilled men took up semi-skilled work at Halewood because wages for semi-skilled, based on rates in London and the West Midlands, were so much higher than for skilled men in Merseyside. This exodus undermined hitherto viable firms, and created something of a labour shortage amid unemployment. Concomitantly, the effect on wage-expectations and labour relations throughout the region was calamitous. The cost of compassion fell on hapless Merseysiders and Ford alike.

The effects of nationalised industries by any name on wage demands and labour relations in the residual wealth-creating sector haunt real employers who have to balance their books. The employers' organisations await every pay-round in BL and other work-simulation centres with trepidation. Every generous settlement means lay-offs in the private sector, eroding the economy's tax-base and resource-base, giving yet another turn to the spiral of closures or lay-offs, redundancy payments and higher taxes to meet additional unemployment pay, higher burdens, more unemployment.

Nationalisation by any name has not only economic but also political and institutional side-effects. One lame duck gives more employment to civil servants than a hundred healthy firms. It creates a whole web of vested interests: sustainers; monitors; suppliers; customers; unions; compliant academics; etc. As Russell Lewis of "The Mail" put it succinctly: "Socialism makes Socialists". It is easy to underestimate the difficulties which beset a reforming government committed to disengagement. Will alone is insufficient. Much depends on its ability to find the particular thread which must be pulled to loosen the tangle instead of tightening it still further. For decades, the structure of government, politics and institutions has evolved to further the ratchetlike progress of increased involvement. New techniques suitable for the equal and opposite process still need to be worked out.

Though economics may be depicted by supply and demand curves and econometric formulas if you wish, economics remains human activity by flesh and blood people. Machiavelli's dictum that every society and its institutions reflect the character of the people holds good for economic life. Social historians of the future, who may view our times more dispassionately, will doubtless make great play of a typology of nationalised industry chairmen, whose personal style can be decisive.

Sir Michael Edwardes will rank high in their interest-scale as a man whose consummate political and communications skills, which sometimes bordered on theatre, did not necessarily rebound to BL's interests or ours. I remember how vigorously he was applauded at the CBI conference in late 1980, when he blamed the high pound for his misfortunes and North Sea Oil for the high pound. "Let them keep it in the ground", he declared to an ovation. It is a sad comment on the level of sophistication of our captains of industry that not one stopped to consider that either the pound's strength may not have come from oil - as subsequently came to be accepted - or that a quarter of NSO revenues were being spent to prop up BL. What should we make of his argument now that BL's market share has continued to fall along with the pound? And what lessons have we drawn from the chapter?

I mention the scope for social historians. But it strikes me that to do the episode full justice, the skills of a novelist are also required to trace in fine detail the interplay between personality and circumstances, between the pressure of vested interests and the temporary suspension of disbelief by decision-makers and opinion-formers, of hard-pressed ministers and MP's no less hard pressed by their agent and chairman, of those with axes to grind and those whose political culture places higher value on discretion than on valour. Novels by Thackeray and Trollope come to mind, Arnold Bennet, and perhaps Kingsley Amis, too.

Circumstances may not necessarily create personality types - here social psychologists differ - but circumstances patently give differential play to various types, greater scope to some, restricting that enjoyed by others. In the age of over-mighty chairmen of these great tax-eating corporations, we should do well not to allow the colums of figures and consideration of abstractions like productivity, labour forces and managerial prerogative to drive the psychological and spiritual dimensions from our field of vision.

London, April 1985.

Section 1 Has BL Kept Its Promises?

On 26 January 1981 Sir Keith Joseph, then Secretary of State for Industry, told the Commons that in approving BL's 1981 Corporate Plan the Government was making available a further tranche of financial assistance beyond that previously agreed under the Ryder Plan. This would amount to over £1.1 billion from 1981/2 to 1984/5 and would take the form of additional Government equity.(1)

Sir Keith Joseph subsequently explained to the Commons Select Committee on Industry and Trade that the Government's remarkable decision had been taken "on the balance of argument", and that BL "had given sufficient evidence of improved performance to justify the extra money".(2)

This was not strictly accurate - in fact BL's losses had jumped in 1979 and 1980 and its share of the domestic car market had slumped below 20 per cent. Less than a year previously, in May 1980, the Commons debate on BL's 1980 Corporate Plan had been conducted on the assumption that only £130 million of further Government aid would be necessary until 1983/4.

In reality the decision to finance what was in effect a second rescue was taken to avoid the social and economic consequences of allowing BL to go to the wall. Sir Keith had argued privately that this should be allowed to happen, but was opposed by his departmental officials and overruled by Cabinet and then required to justify Cabinet's decision to the House and its Select Committee.

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(1) House of Commons Official Report, 26 January, 1981, col 639-646.

(2) Third Report from the Industry and Trade Committee, Session 1980-81, HC 294, Finance for BL, Q. 1,2.

The decision was also a personal triumph for Sir Michael Edwardes. It represented an endorsement of Edwardes' recovery strategy for BL, which had evolved since his appointment in 1977 and which took shape in his 1979 Recovery Plan.

As modified and developed during 1980 and 1981 this strategy had as its key elements:

- the introduction of a new, more compact and competitive model range.
- the rationalisation of production facilities, involving plant closures and substantial shedding of labour.
- major investment in re-tooling remaining plants.
- a vigorous programme of cost-cutting and productivity increases.
- the disposal of peripheral businesses and concentration on central vehicle manufacturing operations.
- the development of collaborative projects with other manufacturers to share development and production costs.
- a reorganisation of BL's business structure and the creation of more autonomous trading groups.
- a management shake-up at all levels and the encouragement of a more assertive management style.
- a more aggressive approach towards trade unions and the introduction of new working practices.
- defending BL's dealer network in the UK, in Europe and in the USA as a vital element in protecting BL's status as a volume car producer.

In evidence to the Industry and Trade Committee Sir Michael Edwardes made it clear that the bulk of the new funding approved in January 1981 would be invested in introducing the new model range.(1)

Edwardes saw three phases in BL's anticipated recovery - first, breaking even on trading; secondly, achieving a rate of return on capital such that BL could fund its future development, and, finally, making profits sufficient to offer dividends to shareholders.(2)

Profitability forecasts

Sir Keith Joseph had emphasised that "prospects of profits"(3) and of BL's ultimate viability had played a part in the Government's decision to make new money available. BL's 1981 Corporate Plan envisaged that BL would achieve a return to profitability after 1982 and would aim:-

> "to attain a return on assets (Profit before Interest and Tax) of not less than 15 per cent in a five to ten year period".(4)

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(1) HC 294, Q. 113.

(2) HC 294, Q. 129.

(3) HC 294, Q, 60.

(4) Paragraph 36.

Sir Michael Edwardes amplified his medium-term forecast in January 1982 and declared that the company ought to break-even at the trading level in 1983 and at the profit before tax level in 1984.(1) No more up to date statement of the BL Board's estimate of future financial performance has been made public, though more specific forecasts of future profitability have been supplied in evidence to the Industry and Trade Select Committee but excised from the published minutes.

As Table 3.2 on page 27 shows, BL did indeed achieve a small trading profit in 1983, and first half results for 1984 showed improvements over the corresponding period in 1984. But BL's trading position deteriorated again in the second half (see Section 3) and it now appears unlikely that BL can proceed into the second phase of its recovery as Sir Michael Edwardes had anticipated or on the timescale he had envisaged. Already by April 1983 some slippage was being assumed when BL's Finance Director told the Select Committee that it would be "towards the end of the decade" before BL would achieve the forecast 15 per cent rate of return overall.(2)

If BL has run aground in its efforts to meet its overall recovery targets, its initial forecasts of the future profitability of individual business groups have gone even further awry. Thus the 1981 Corporate Plan stated:-

> "Land Rover and Unipart are projected to remain profitable throughout the period.(3) BL Cars . . . is expected to make substantial losses in 1981 and 1982 but to become profitable within five years. The Leyland Group results show a loss in 1981 and a modest profit thereafter."(4)

(1) Third Report from the Industry and Trade Committee, Session 1981-82, HC 194, BL Limited, Q. 26.

(2) Industry and Trade Committee, Session 1982-83, HC 353-i, BL plc, Q. 30.

(3) ie. 1981-85.

(4) paragraph 44.

As the company accounts presented in Section 3 reveal, the performance of both Land Rover and Leyland Vehicles fell far short of these expectations. A discussion of BL's reluctance to publicly reveal any indicators of its success or failure in achieving annual financial or cost targets appears in the next section. Later sections discuss BL's recent production and sales performance and its productivity and industrial relations record since 1980.

It is important to distinguish, however, between an analysis of BL's recent performance according to the commercial and business objectives set out in its recovery strategy, and its success in achieving those political objectives which have arisen out of BL's relationship with government, and in particular from its dependence on financial assistance from the state.

An analysis of the relationship between BL and government is presented in the next section, but it can be argued that BL has been dilatory in pushing ahead with objectives agreed between the Board and the Department of Industry (and more recently the Department of Trade and Industry).

Privatisation

The issue which has aroused the most intense political discontent has been the speed with which BL has sought to attract private capital into its operations and, more fundamentally, the extent to which the Board has complied with government pressure to return BL to private ownership.

In announcing results for the first half of 1982 the Board declared its desire to "seek further private sector funds over the next two years within BL's mainstream business". On 5 October, 1982 the Industry Secretary, Patrick Jenkin, told the Conservative Party Conference that he expected "substantial movement" within two years and had come to an informal agreement on this with the new Chairman-elect, Sir Austin Bide.(1) BL's 1983 Corporate Plan repeated this commitment.

(1) Reported in the Financial Times, 6 October, 1982.

And yet in May 1984 the Group Chief Executive, Cars, Ray Horrocks, and BL's Director of Finance, F L Fitzpatrick, were put under intense pressure from the Trade and Industry Select Committee to explain BL's apparent lack of progress in honouring its earlier undertaking.[1] Unfortunately the sections of their evidence which outlined BL's future plans to rectify the situation were deleted from the published document. Mr Horrocks did, however, reiterate the pledge made by Sir Austin Bide to the same Committee in April 1983 that BL did:-

> "not want another penny piece from the taxpayer if we can possibly avoid it. The right way to get money for a viable business is through the market".[2]

By December 1984, however, Mr Horrocks was telling the Conservative backbench trade and industry committee that BL could attract commercial funds to meet its anticipated investment requirements, and that its balance sheet would attract such funds, but that to borrow at high interest rates from the market would put the company at a disadvantage with European competitors such as Renault and Fiat who were receiving loans from the state on preferential terms. He is reported as having argued that only further government funding or a restructuring of BL's balance sheet would allow the company to move towards early privatisation.[3]

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(1) Third Report from the Trade and Industry Committee, Session 1983-84, HC 490, BL plc, Q. 43 ff.

(2) HC 353-i, Q. 41; HC 490, Q. 84-86.

(3) Reported in the Financial Times, 29 December, 1984.

The BL Board has also fought a rearguard action against selling off any significant parts of BL despite intense pressure from ministers. Sir Michael Edwardes and his successors have successfully frustrated all attempts to break up BL and sell it piecemeal. On 4 December, 1980 at the height of the internal Government debate on BL's 1981 Corporate Plan, Edwardes had written to Sir Keith Joseph offering to accede to a request that he stay on as Chairman after his term had expired in March 1981 if future funding were guaranteed and if BL were not compelled to agree to "any premature outright sale of our major business".[1]

Although peripheral businesses have been sold (raising £120 million between 1980 and 1983) offers for major assembly plants have been rebuffed. Offers for the MG marque and Abingdon plant and for the Rover marque and Solihull factory were rejected - though in retrospect both bids were extremely low in cash terms relative to the benefits on subsequent sales of retaining the MG marque on top-of-the-range Metro, Maestro and Montego variants, of retaining the Rover marque on collaborative ventures with Honda, and the importance to Land Rover's restructuring programme of the Solihull plant.

But, whatever the broader commercial justification for rejecting these offers, BL has consistently refused to bring forward specific proposals or a timetable for selling Unipart or Land Rover. Both were considered prime candidates (with Jaguar) for sale before the 1983 General Election but Edwardes took the view that the more lucrative parts of BL ought to be used as "attractive bargaining counters in any future deal involving the loss making cars division".[2]

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(1) Sir Michael Edwardes, Back from the Brink: An Apocalyptic Experience, 1983, page 236.

(2) Reported in the Financial Times, 13 July, 1981.

Edwardes successor, Sir Austin Bide, also reiterated that his strategy did "not include suddenly divesting the company of its profitable parts".[1]

BL's 1983 Corporate Plan showed some response to increasing Government frustration and declared that:-

> "BL's objectives are to be able to borrow funds at normal commercial terms on its own covenant and to obtain the investment of private sector funds in some of its mainstream businesses over the next two years as the first step towards an eventual return to private ownership".[2]

The tacit relegation of privatisation to the status of a secondary objective was reversed just before the General Election of June 1983, when in a written answer the Government unequivocally set out its intended policy for BL:-

1 To return all the constituent businesses, either together or separately, to the private sector as soon as practicable. If the return of any constituent business carries the risk of reduced viability of the remainder, the issue should be put to the Secretary of State with options.

2 Consistent with 1, to dispose of peripheral activities so as to concentrate on vehicle manufacture and sales.

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(1) Reported in the Daily Telegraph, January 1983.

(2) Paragraph 28.

3 To pursue in the corporate plan a specifically targeted programme of profitability improvement, within stated limits of public funding, so as to achieve a rate of return that would attract funds on normal commercial terms without government support.[1]

The Conservatives' election manifesto reiterated the commitment to return "substantial parts" of BL to the private sector. BL's 1984 Corporate Plan repeated the Government objectives laid out in May 1983 and announced the company's intention of floating Jaguar during 1984. This was carried out in July and raised £297 million, all of which was made available to the BL Board to fund further investment in line with the statement in the 1984 Corporate Plan that the privatisation of "parts of BL" would:-

> "strengthen the balance sheet and provide funds for carrying through the plans of the remaining businesses".[2]

It now appears that Unipart may be offered for sale later this year, but as yet there is no indication that any of the major vehicle manufacturing divisions are timetabled for early privatisation. Revised strategic objectives were published in February 1985, broadly along the lines of those issued in 1983, though stating that where the objective of returning "BL and its constituent businesses . . . to the private sector as soon as practical . . . cannot be achieved, the Board will review the future of that business".[3]

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(1) House of Commons, Official Report, 11 May, 1983, col. 317 w.

(2) Paragraph 33.

(3) House of Commons, Official Report, 14 February, 1985, col. 232 w.

It has also been made clear recently that no more government funds are to be made available to BL[1], and despite Ray Horrocks' reported comments in December it seems that BL can expect an uncharitable response to its 1985 Corporate Plan by Ministers who feel that it is now time for BL to stand on its own two feet.

(1) House of Commons, Official Report, 9 January, 1985, col. 446 w.

Section 2 BL and Government

Since 1975 successive governments have provided almost two and a half billion pounds of taxpayers' money for BL, over half of this since 1980 from a Tory Government ideologically hostile to the public sector and opposed to subsidising lame duck corporations. Table 2.1 gives a breakdown of this expenditure.

Table 2.1

GOVERNMENT FINANCIAL YEAR		£ MILLION
1975/6	Purchase of shares from private shareholders	46
	New equity under British Leyland Act 1975	200
1976/7	Loans (converted to equity March 1980)	100
1977/8	Loans (converted to equity March 1980)	50
1978/9	Equity	450
1979/80	Equity	150
1980/1	Equity	300
1981/2	Equity	620
1982/3	Equity (£370 million approved)	270
1983/4	Equity carried forward from 1982/3	100
	New funding promised February 1983	100
	Equity for finance of BL's dealer stocks	25
		2,411[1]

Source: Stephen Wilks, Industrial Policy and the Motor Industry, 1984, page 231.

(1) BL waived its right to draw £110 million in return for being permitted to retain the proceeds from the sale of Jaguar. It is no longer available.

Expressed another way, since 1980 each BL employee has received an average state subsidy of between two and six thousand pounds per annum, as Table 2.2 shows.

Table 2.2

YEAR	GOVERNMENT EQUITY PAID TO BL	AVERAGE WEEKLY NUMBER OF UK EMPLOYEES	AVERAGE ASSISTANCE PER UK EMPLOYEE
1980	£300 million	154,820	£2,222.39
1981	£620 million	134,990	£5,962.17
1982	£260 million	84,475	£3,077.83
1983	£200 million	81,261	£2,461.21

Source: House of Commons, Official Report, 19 January, 1984, c295w, and author's update.

Between 1976 and 1981 responsibility for monitoring BL's activities, and the effectiveness with which these vast sums were spent, lay technically with the National Enterprise Board (though the Department of Industry had taken over de facto responsibility from December 1979). The 1980 Industry Act, however, provided for the state's shareholding to be transferred to the Secretary of State for Industry. This took effect on 31 March, 1981, and at the same time a Memorandum of Understanding was set out stating the nature of the future relationship between the BL Board and the Secretary of State.(1)

(1) Published in the Twentieth Report from the Committee of Public Accounts, Session 1981-82, HC 407, Leyland Vehicles Ltd, Bathgate: Disposal of Tractor Assembly Line, pages 8-9.

The Memorandum established that BL would be expected to behave as far as possible as an independent company, operating according to commercial criteria and seeking an acceptable return on capital employed. The Secretary of State would not interfere in day-to-day management decisions, but expected to be kept informed of the company's progress and of its future plans and financial requirements.

In addition to the terms of the Memorandum, any single capital expenditure item over £25 million has to have the approval of the Secretary of State. The Government has also confirmed that it will continue to honour an agreement made in 1977 (known as the Varley-Marshall assurances) under which British Leyland would not be "left in a position where it would not be able to meet its obligations." The Government has undertaken to:-

> "honour the intention behind those statements and will ensure that the obligations of the group are met".(1)

In effect this represents a guarantee to creditors that BL's debts will be met in full in the event of the company's liquidation, as well as security for commercial loans negotiated by BL.

As conceived in 1980 and 1981 the role of the Department of Industry was to combine the functions of "banker and shareholder on behalf of the taxpayer",(2) with the right to change BL's management or to cut off financial support but otherwise to leave the management free to manage.

(1) House of Commons, Official Report, 31 March, 1981, col. 80w.

(2) Sir Keith Joseph, evidence to the Industry and Trade Committee, 18 February, 1981, HC 294, Q. 34.

In relation to the Department's other role as overall sponsor, through its Motor Vehicles Division, of the vehicle industry, the Memorandum stated that the Secretary of State would, "deal with BL on the same basis as with any other vehicle manufacturer".

The relationship between BL and the Department of Industry (and later the Department of Trade and Industry) was anomalous from the outset. As all parties concerned were quick to point out, BL was not a nationalised industry but a Companies Act company operating in a cut-throat and competitive commercial market. Nevertheless, enormous sums of public money were invested in BL and it was only natural that full accountability should be sought for the way in which these were being spent.

The formal monitoring process, as it came to exist after the transfer of shares to the Secretary of State, has been conducted at three main levels:

1 The submission by the Board (usually in about October) of a Corporate Plan, for the Secretary of State's consideration. This comprises a review of strategic issues and objectives covering the following five years, including likely funding requirements and broad areas of expenditure.

2 The submission of more detailed annual financial summaries covering anticipated budgets and targets for the forthcoming year.

3 Monthly meetings between senior BL executives and departmental officials (usually up to ten, including accountants on secondment to the department, economists and Treasury officials) at which progress reports similar to those presented to the BL Board are reviewed. These include funds flow statements for each business group and internal management reports of progress on major investment projects.

The criteria which the department uses in its monitoring procedures were described in a memorandum submitted by the Comptroller and Auditor General to the Public Accounts Committee in March 1983.

These include:

(a) to be sufficiently informed of the financial and operational plans and of the performance of BL to advise ministers concerning policy, financial strategy and industrial objectives for the Company;

(b) monitoring BL's progress towards its financial objectives;

(c) ensuring that BL's Corporate Plans and budgets are sound and conform with the agreed objectives;

(d) ensuring that BL operates in accordance with agreed plans and takes prompt action if necessary to restore performance to plan;

(e) operating effective systems of financial control over public funds advanced to BL.(1)

In evidence to, and reports from, the Public Accounts Committee and the Trade and Industry Committee the department itself, the Comptroller and Auditor General, senior BL managers and members of the respective Committees have expressed themselves broadly satisfied with the relationship between BL and government as laid down in the Memorandum of Understanding and monitored by departmental officials. Nevertheless, there have been areas where doubt has arisen, and from these it can be argued that the relationship has been unsatisfactory from the point of view of Parliament as a whole and the taxpayer whose interests its Members represent.

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(1) Third Report from the Committee of Public Accounts, Session 1983-84, HC 103, Department of Industry: Supervision and Monitoring of British Leyland, page 2.

In a report published in 1982 the Comptroller and Auditor General was asked by the Public Accounts Committee to investigate the circumstances surrounding BL's disposal in 1981 of its Bathgate tractor plant. BL denied (as they were legally entitled to do) the Comptroller and Auditor General access to their own records, and the Department of Industry, while making available its own files, declined to make representations to the company on his behalf.

In its conclusions the Committee expressed its surprise,

> "that the Department of Industry did not appreciate the clear advantage for Parliament and indeed for the Government and the company"[1]

that would have been gained by making the records available and concluded,

> "that this case illustrates the difficulties which inevitably arise when the Comptroller and Auditor General is unable to carry out a direct examination of the handling by public corporations of substantial sums of public money and public assets, and to provide assurance directly to Parliament".[2]

(1) Twentieth Report from the Committee of Public Accounts, Session 1981-82, HC 407, page xii.

(2) ibid. page xiii.

Subsequently the Comptroller and Auditor General made a further examination of the relationship between BL and the Department of Industry and expressed a number of reservations to which he drew the attention of the Public Accounts Committee. These included the fact that in February 1982 the Secretary of State had set BL a short-term financial target for that year,

> "which did not establish the date by which public funding of the company should cease, and included no target return on capital to take the place of the target return on its investment in BL previously set out for the NEB".[1]

On a similar point he noted that although the Department of Industry had examined BL's criteria for investment appraisal,

> "it had not established a minimum rate of return to be achieved by new investment either individually or as a whole, and arrangements for back checks on returns actually achieved from past investments were not comprehensive".[2]

(1) HC 103, pages 4-5.

(2) ibid. page 5.

The Comptroller and Auditor General also noted that the department does not require BL to <u>publish</u> performance indicators in its annual report and accounts, though he accepted that some indicators were published in BL's annual performance review presented to Parliament, and that the department and BL discussed more comprehensive indicators during regular monitoring meetings. In oral evidence the Permanent Secretary merely said that publishing more indicators "is a matter to which I should be happy to give consideration and discuss with the company".[1] That was in March 1983. Two years later it is no easier for Parliament or the taxpayer to assess BL's success in achieving its annual financial targets or cost-cutting objectives.

Thus where BL supplies forecasts or indicators to the department, these are regarded as commercially sensitive and are not disclosed. The published version of BL's annual review and Corporate Plan reveals little beyond anodyne generalities.

BL's annual report and accounts give almost no indication as to the relative performance of the company's trading groups or their underlying profitability. They give no information on their asset structure, utilisation of funds or inherent viability as a guide to potential investors or buyers. Audited accounts are now available at Companies House for Austin Rover, Unipart and Land Rover from 1982 onwards, and for Leyland Vehicles for earlier years, but these have not previously been published. Those now available are reproduced in Section 3.

(1) Ibid. page 11.

Not all the blame for the defects in the relationship can be attached to BL, however. The Memorandum of Understanding is a masterpiece of vagueness and the Public Accounts Committee has twice urged its partial re-drafting. Although the Government has a clear policy of privatising parts of BL as soon as possible, no clear timetable appears to have been laid down, and neither does there appear to be any machinery within the monitoring process for compelling the Board to frame one and adhere to it. It is surprising that a clear framework was not attached as a sine qua non to the approval of the 1981 Corporate Plan, or subsequent Plans, in view of the known frustration caused amongst ministers and Tory backbenchers by the Board's apparent prevarication.

It is also surprising that no timetable has been urged on BL for making a decision on the long-term viability of individual parts of its business. The 1982 Corporate Plan stated the company's intention of,

> "turning round or discontinuing those parts of the business which are now unprofitable",[1]

in order to achieve its financial objectives.

In the Report of the Directors' attached to BL's 1983 report and accounts the Board promised,

> "to monitor the progress of the company's constituent businesses",

and if it,

> "appears impossible to bring about recovery within the time scale envisaged the Board will reconsider the future of relevant businesses".[2]

(1) Paragraph 36.

(2) Page 8.

In evidence to the Industry and Trade Committee in April 1983 Sir Austin Bide would not concede that at that time parts of the business were "irrecoverable" and "by some definition non-viable", though he could not guarantee to,

> "turn absolutely everything into a state of viability".[1]

It is worth remarking that apparent disagreements between government and BL's management over the speed at which BL can realistically be returned to private ownership reflect genuinely opposing interpretations of how best to turn around the whole of the business. Sir Michael Edwardes, in resisting pressure to sell off Unipart and Land Rover in 1981 and 1982, took the view that to do so "will impact very unfavourably on our cash flow and we will need more funds from somewhere".[2] Uppermost in the Board's considerations was the fear that to sell the profitable parts of BL prematurely would leave an unprofitable rump doomed to closure.

Ministers and their backbench supporters have taken the opposite line - that to sell profitable operations would provide a cash injection offering remaing parts of the business every prospect of viability , as well as reducing the company's borrowings and releasing the taxpayer from the threat of further calls for subsidy.

The apparent inability of the Conservative Government to impose its political will over privatisation in part reflects the anomalous relationship between BL and the Department of Industry, particularly the lack of machinery for making the Government's political aims a reality. However, it also derives from the wider political issues at stake and the way in which these have at times come to circumvent the monitoring procedures designed to keep BL on course.

(1) HC 353-i, Q. 45, 46.

(2) HC 194, Q. 63.

At the end of 1980 and the beginning of 1981 Ministers had no contingency plans for BL, and when it came to deciding the company's fate only two options were available - the sanctioning of further massive subsidies or allowing BL to go down, with the social and economic repercussions which would have resulted.

This was a situation which Sir Michael Edwardes had skilfully engineered. Already by 1981 political decisions about BL had come to be influenced by factors outside the formal monitoring machinery.

As Stephen Wilks has pointed out a network of contacts between BL and the Industry Department already existed at an informal level, allowing set monitoring procedures to be by-passed.[1] From August 1979 onwards a Department of Industry principal was seconded to act as Sir Michael Edwardes' personal assistant. Edwardes described in his memoirs how this became a highly expedient arrangement whereby,

> "information could be exchanged or draft letters cleared informally without establishing precedents or commitments".[2]

Such procedures became especially valuable when relations between BL and the Industry Secretary, Patrick Jenkin, became strained during 1981 and 1982.

(1) Stephen Wilks, Industrial Policy and the Motor Industry, 1984, page 227.

(2) Back from the Brink, page 218.

The department's capacity to adequately monitor BL's activities and take appropriate decisions on its annual Corporate Plan was further compromised by the way in which the relationship between BL and government came to be conducted through channels outside the Industry Department's control. Edwardes' charismatic and volatile personality made him a favourite of the media, and he used his appeal to project both himself and BL on to the national political stage. BL's Public Affairs department was expanded and the effect of the company's high media profile was to make it, according to Wilks "at the political level a difficult creature to manipulate".[1]

Partly for this reason, and also because the Prime Minister and senior Cabinet colleagues held such strong views on the fortunes of the company, almost every major decision on BL came to be taken in No. 10. Thus, issues such as approval of BL's Corporate Plan, and wider considerations on the survival or otherwise of the company were taken out of the department's hands and became elevated to the status of traumatic political events, a phenomenon encouraged by Edwardes.

Wilks argues that the Corporate Plan became, in Edwardes' hands,

> "virtually non-negotiable. Edwardes maintained that he required unequivocal backing and the Department of Industry had neither the resources nor the inclination to attempt to rewrite the plan. It was take it or leave it - support the plan or liquidate the company".[2]

(1) op. cit. page 225.

(2) ibid. page 226.

Wilks draws the conclusion that the structure of the relationship between BL and the Department of Industry, and the way in which approval of the Corporate Plan was sought, came to resemble an "annual planning cycle" analagous to the planning agreements drawn up between the last Labour administration and Chrysler UK.[1]

By carefully calculated brinkmanship Edwardes would play off Government and workforce against each other, submitting the Corporate Plan at the same time as the company's annual pay round negotitations and the Treasury's review of the following year's public spending. This became, according to Wilks,

> "a dangerously unpredictable process in which BL was marketing itself on two fronts - selling its cars to the public and its plans to the government".[2]

Thus, during the Edwardes era not only was the monitoring process defective in that it did not ensure an effective balance between commercial and political considerations and included no machinery for keeping BL on course, but it was in any case being out-flanked by other actions and procedures outside the department's control.

Edwardes' successors have employed less overt political leverage on government in seeking approval for BL's annual corporate plans, but by more subtle methods have managed to frustrate efforts by ministers to force the pace on privatisation.

(1) ibid. page 228.

(2) ibid. page 229.

Section 3 BL Performance 1981-84: Financial Information

This section provides the fullest available information on the recent financial performance of BL plc and its principal trading groups. Comparison of results for Austin Rover, Unipart and Land Rover UK for 1982 and 1983 with earlier years is difficult in view of a reorganisation of BL's trading groups effective from January 1982. Details of changes are given in each relevant section, but broadly BL is now divided into two distinct trading groups:-

Cars Group, which includes Austin Rover Group, BL Technology and Unipart Group;

and Land Rover-Leyland Group, which includes Leyland Vehicles, Land Rover UK and Land Rover-Leyland International Holdings.

As mentioned in Section 1, BL had set itself the target of breaking even on trading in 1983 and at the profit before tax level in 1984, with the longer term objective of achieving a rate of return on assets of at least 15 per cent on profit before interest and tax within five to ten years from 1981.

BL did indeed achieve a small trading profit in 1983 but interim results for 1984 show pre-tax losses of £11.7 million (see Table 3.1). However, a change in depreciation policy reduced provision by £29 million and Jaguar contributed profits of nearly £53 million. Without Jaguar and under the old depreciatiion convention BL would have returned pre-tax losses of around £93 million.[1]

(1) Derived from BL's Interim Results, 1984.

It is as yet too early to assess the likely impact on BL's long term financial position of the sale of Jaguar. Last year the Trade and Industry Committee expressed concern that:-

> "the amputation of the most healthy part of the company is bound to make it harder for the rest of BL to achieve viability in the next few years".[1]

In evidence senior BL executives had been more optimistic and pointed out that the sale would not only produce a cash injection but would reduce overall borrowings and interest charges.

It is current Board policy that BL plc should be considered as a holding company and that all business units must ultimately be viable in their own right.

(1) HC 490, p v.

Table 3.1 - BL PLC

Interim Statement of Results for the year to 31 December 1984

	1984
	£ million
TURNOVER	
UK	1,987
Overseas	1,415
	3,402
Of which direct exports from UK	827
OPERATING LOSS	11.7
Interest payable less interest receivable	61.6
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION	73.3
Taxation on ordinary activities	7.7
LOSS ON ORDINARY ACTIVITIES AFTER TAXATION	81.0
Minority share of profits of subsidiaries	1.8
LOSS BEFORE EXTRAORDINARY ITEMS	82.8
Extraordinary profit	163.4
PROFIT AFTER EXTRAORDINARY ITEMS	80.6[1]

1 This profit figure takes into account net proceeds of £186.1 million from the sale of Jaguar.

Table 3.2 - BL PLC

Consolidated Profit and Loss Account for the years ended 31 December 1981, 1982 & 1983

	1983	1982	1981
	£ million	£ million	£ million
TURNOVER	3,420.7	3,071.9	2,868.7
OPERATING PROFIT (1981, 1982 loss)	4.1	125.8	244.6
Interest payable less interest receivable	71.2	96.9	88.3
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION	67.1	222.7	339.2
Taxation on ordinary activities	7.2	6.8	5.8
LOSS ON ORDINARY ACTIVITIES AFTER TAXATION	74.3	229.5	339.2
Minority share of profits of subsidiaries	3.8	4.6	5.8
LOSS BEFORE EXTRAORDINARY ITEMS	78.1	234.1	345.0
Extraordinary losses	73.4	58.8	152.0
LOSS AFTER EXTRAORDINARY ITEMS	151.5	292.9	497.0
ACCUMULATED DEFICIT AT BEGINNING OF YEAR	1,543.7	1,250.8	753.8
LOSS AFTER EXTRAORDINARY ITEMS	151.5	292.9	497.0
ACCUMULATED DEFICIT AT END OF YEAR	1,695.2	1,543.7	1,250.8
Weekly average number of employees	103,216	107,763	126,267
Of which UK employees	81,261	84,475	103,989

SOURCE: BL Annual Report & Accounts

Table 3.3 - BL PLC

Consolidated Balance Sheet as at 31 December 1982 & 1983

	1983	1982
	£ million	£ million
FIXED ASSETS		
Tangible Assets	1,006.8	957.5
Investments - in related companies'	7.8	7.1
	1,014.6	964.6
CURRENT ASSETS		
Stocks	813.8	864.3
Debtors	392.1	432.0
Investments - short term deposits	246.2	5.5
Cash at bank and in hand	38.1	38.8
	1,490.2	1,340.6
CREDITORS - amounts falling due within one year		
Short term borrowings	(314.8)	(252.7)
Other	(717.8)	(776.0)
NET CURRENT ASSETS	457.6	311.9
TOTAL ASSETS LESS CURRENT LIABILITIES	1,472.2	1,276.5
CREDITORS - amounts falling due after more than one year	(651.6)	(561.4)
PROVISIONS FOR LIABILITIES AND CHARGES	(102.3)	(43.3)
	718.3	671.8
CAPITAL AND RESERVES		
Called up share capital	2,139.5	1,958.1
Share premium account	113.3	96.7
Other reserves	118.7	118.7
Profit and loss account	(1,695.2)	(1,543.7)
	676.3	629.8
MINORITY INTERESTS IN SUBSIDIARIES	42.0	42.0
	718.3	671.8

NOTE: 1981 information is not supplied as the basis on which the balance sheet is presented was changed in the 1983 accounts.

SOURCE: BL Annual Report and Accounts

Table 3.4 - BL PLC

Consolidated Source and Application of Funds for years ended 31 December 1983, 1982 & 1981

	1983	1982	1981
	£ million	£ million	£ million
ILIZATION OF FUNDS			
t operational inflow/(outflow)	37.4	(133.7)	(350.9)
ss on ordinary activities before taxation	(67.1)	(222.7)	(332.9)
xtraordinary losses	(73.4)	(58.8)	(152.0)
epreciation and amortisation	177.9	147.8	134.0
ecrease in working capital	99.7	18.4	124.5
tocks less deposits - decrease	50.5	6.7	75.0
btors and bills receivable - decrease/(increase)	39.9	(91.0)	92.6
reditors and provisions - increase	9.3	102.7	(43.1)
apital Expenditure	(247.7)	(229.9)	(200.8)
axation	(7.2)	(5.7)	(3.2)
ther - principally disposal of fixed assets	16.0	10.1	48.3
	(101.8)	(340.8)	(382.1)
INANCED BY:			
et proceeds of share issues	198.0	257.4	514.7
ncrease in			
Loan capital and term loans	48.0	207.3	(15.7)
Finance leasing liabilities - long term	37.2	42.3	17.2
ecrease in			
Bills payable to banks - long term (1982 increase)	(3.5)	4.7	(1.2)
Net short term borrowings	(177.9)	(170.9)	(132.9)
	101.8	340.8	382.1

SOURCE: BL Annual Report and Accounts

Austin Rover Group Ltd

Austin Rover has traded since January 1982. It was formerly part of BL cars which also included Land Rover, Jaguar and Unipart.

The company made a small trading profit in 1983, and a small profit of around £300,000 in the first half of 1984. However, sales slipped badly in the second half and Austin Rover ended with a trading loss of £26 million for the year(1) on a turnover of £1.81 billion(2), only marginally up on 1983's £1.8 billion.

The accounts show some tightening up of working capital management, and the balance sheet looks good with its strong equity gearing ratio.

There are some snags, however. Table 3.6 shows that the company is backed by a £1.2 billion interest free loan from BL plc, callable at one month's notice. If this was a commercial loan Austin Rover would have paid perhaps around £120 million interest in 1983, its total interest charge would have been nearer £140 million and pre-tax losses would have been over £130 million.

(1) BL Interim Results, 1984.

(2) Reported in the Financial Times, 12 January, 1985.

Table 3.5 - Austin Rover Group Ltd

Consolidated Profit and Loss Account for years ended 31 December 1982 and 1983

	1983 £ million	1982 £ million
TURNOVER	1,799.4	1,582.3
OPERATING PROFIT (1982 loss)	2.7	105.9
Interest payable less interest receivable	19.0	28.3
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION	16.3	134.2
Taxation recovered (1982 charge)	8.9	0.2
LOSS ON ORDINARY ACTIVITIES AFTER TAXATION	7.4	134.4
Minority share of profits of subsidiaries	1.7	2.2
LOSS BEFORE EXTRAORDINARY ITEMS	9.1	136.6
Extraordinary losses	0.7	37.8
LOSS AFTER EXTRAORDINARY ITEMS	9.8	174.4
ACCUMULATED DEFICIT BROUGHT FORWARD	926.2	751.8
LOSS AFTER EXTRAORDINARY ITEMS	9.8	174.4
ACCUMULATED DEFICIT AT END OF YEAR	936.0	926.2
Weekly average number of employees	41,136	43,717

SOURCE: Company Accounts

Table 3.6 - Austin Rover Group Ltd

Consolidated Balance Sheet as at 31 December 1983 & 1982

	1983	1982
	£ million	£ million
FIXED ASSETS		
Tangible Assets	434.4	404.4
Investments - in related companies	0.9	0.9
	435.3	405.3
CURRENT ASSETS		
Stocks	322.6	328.0
Debtors	284.4	488.6
Cash at bank and in hand	48.5	22.2
	655.5	838.8
CREDITORS - amounts falling due within one year		
Short term borrowings	(134.8)	(103.5)
Other	(518.7)	(810.9)
NET CURRENT ASSETS	2.0	(75.6)
TOTAL ASSETS LESS CURRENT LIABILITIES	437.3	329.7
CREDITORS - amounts falling due after more than one year		
Finance leasing liabilities	74.0	56.3
Bank and other loans	6.6	8.1
PROVISION FOR LIABILITIES AND CHARGES	17.5	33.8
	98.1	98.2
CAPITAL AND RESERVES		
Called up share capital	58.0	58.0
Share premium account	2.3	2.3
Profit and loss account	(936.0)	(926.2)
	(875.7)	(865.9)
HOLDING COMPANY LOANS	1,196.2	1,079.0
MINORITY INTERESTS IN SUBSIDIARIES	18.7	18.4
	437.3	329.7

SOURCE: Company Accounts

Table 3.7 - Austin Rover Group Ltd

Consolidated Source and Application of Funds for years ended 31 December 1983 & 1982

	1983	1982
	£ million	£ million
UTILIZATION OF FUNDS		
Net operational inflow/(outflow)	70.0	(103.0)
Loss on ordinary activities before taxation	(16.3)	(135.6)
Extraordinary losses	(0.7)	(39.5)
Depreciation and amortisation	87.0	72.1
Increase in working capital	(98.9)	(153.1)
Stock less deposits - decrease	5.4	181.8
Debtors decrease/(increase)	204.2	39.5
Creditors and provisions - (decrease)	(308.5)	(52.0)
Subsidiaries/fellow subsidiaries - (increase)		(322.4)
Capital Expenditure	(127.7)	(119.4)
Taxation recovered	8.9	
Other - including fixed asset disposals	9.3	175.0
	(138.4)	(200.5)
FINANCED BY:		
Holding company loans	117.2	243.8
Finance leasing liabilities - long term	17.7	11.0
Bank and other long term loans	(1.5)	(0.5)
Cash bank and other short term deposits	(26.3)	
Net short term borrowings	31.3	(53.8)
	138.4	200.5

SOURCE: Company Accounts

Unipart Group Ltd

Separate accounts for Unipart are only available from 1982 onwards.

As already mentioned in Section 1, Unipart has been viewed for several years as a prime candidate for early privatisation. A value of £100-150 million has been put on the company, and the enclosed accounts show this not to be unreasonable, though perhaps £100-135 million might be closer to the mark.

The accounts reflect John Neill's strong management and show an efficient use of working capital, though the static turnover is a little worrying, and Unipart's operating profit fell to £14 million in 1984 - though changes in contractual arrangements with other BL companies affected profit margins. Unipart's operations were also realigned in 1984 to concentrate activity more closely on its mainstream business.(1)

Unipart has recently looked to strengthen its balance sheet by acquiring other companies in the components industry, and in August 1984 it paid £15 million for Edmunds Walker Holdings. It is likely that this acquisition will further strengthen the company's operations and increase its market value.

It now seems that Unipart will be offered for sale later this year, though as yet no information on timing or method of disposal has been made public.

(1) BL Interim Results, 1984.

Table 3.8 - Unipart Group Limited

Consolidated Profit and Loss Account for the years ended 31 December 1982 & 1983

	1983	1982
	£ thousand	£ thousand
TURNOVER	346,052	341,959
OPERATING PROFIT	17,410	13,623
Interest payable less interest receivable	349	5,200
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	17,061	8,423
Taxation on profit on ordinary activities	-	-
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION	17,061	8,423
Extraordinary items	-	6,908
PROFIT FOR THE FINANCIAL YEAR	17,061	1,515
RETAINED PROFITS		
Parent Company	17,061	1,515
Subsidiary Company	-	-
	17,061	1,515
STATEMENT OF RETAINED PROFITS/RESERVES		
Accumulated reserves at beginning of year	1,505	(10)
Retained profit for the year	17,061	1,515
ACCUMULATED RESERVES AT END OF YEAR	18,566	1,505
Weekly average number of employees	4,737	5,514

SOURCE: Company Accounts

Table 3.9 - Unipart Group Limited

Consolidated Balance Sheet as at 31 December 1982 & 1983

	1983	1982
	£ thousand	£ thousand
FIXED ASSETS		
Tangible assets	32,757	30,902
	32,757	30,902
CURRENT ASSETS		
Stocks	96,322	84,020
Debtors	84,085	119,028
Cash at bank and in hand	6,952	10,287
	187,359	213,335
CREDITORS - amounts falling due within one year	(198,706)	(240,822)
NET CURRENT LIABILITIES	(11,347)	(27,487)
TOTAL ASSETS LESS CURRENT LIABILITIES	21,410	3,415
CREDITORS - amounts falling due after more than one year	(2,353)	(1,411)
ACCRUALS AND DEFERRED INCOME	(481)	(489)
	18,576	1,515
CAPITAL AND RESERVES		
Called up share capital	10	10
Reserves	18,566	1,505
	18,576	1,515

SOURCE: Company Accounts

Table 3.10 - Unipart Group Limited

Consolidated Source and Application of Funds for the years ended 31 December 1982 & 1983

	1983	1982
	£ thousand	£ thousand
UTILIZATION OF FUNDS		
Net operational flow		
Profit on ordinary activities before taxation	17,061	8,423
Extraordinary losses	-	(6,908)
Depreciation	6,648	5,811
Development grant credit	(182)	(145)
	23,527	7,181
(Increase) in working capital		
Stocks - (increase)	(12,302)	(84,020)
Debtors and bills receivable - decrease/(increase)	603	(47,279)
Group Company Indebtedness - (decrease)/increase	(21,396)	7,033
Short term creditors - increase	12,352	36,057
	(20,743)	(88,209)
Capital Expenditure Net	(8,503)	(36,713)
Development grants received, less repaid	174	634
	(5,545)	(117,107)
FINANCED BY:-		
Parent company loan	4,900	110,000
Finance leasing liabilities - long term	942	1,411
Net short term borrowings	(297)	5,696
	5,545	117,107

NOTE:
Unipart Group Limited and its subsidiary commenced trading on 1 January 1982 and thus the consolidated source and application of funds for the year ended 31 December 1982 includes the acquisition of their assets at 1 January 1982.

SOURCE: Company Accounts

Land Rover UK Ltd

Land Rover UK Ltd began trading on 1 January, 1982, when the assets and liabilities of Land Rover and Freight Rover were transferred from BL Cars to Land Rover Group, a holding company for Land Rover UK Ltd.

Land Rover UK has three wholly-owned subsidiaries - Land Rover, Freight Rover and Land Rover Parts and Equipment. Separate accounts are not available, but it is known that Freight Rover traded profitably in 1983 for the first time in several years[(1)] and improved its performance in 1984.

Land Rover has also moved into profit in 1984 and overall Land Rover UK made a small operating profit of £2 million before tax and interest.[(2)] The continuing decline in Land Rover's export markets leaves a question mark over the division's future profitability. A major restructuring programme is currently in progress and is not due to be completed until 1986, and this makes any estimate of Land Rover's potential profitability highly speculative at present, though as the analysis in the next section explains, there may be some cause for optimism.

(1) Land Rover UK company accounts, 1983, Report of the Directors.

(2) BL Interim Results, 1984.

Table 3.11 - Land Rover UK Ltd

Profit and Loss Account for the years ended 31 December 1983 & 1982

	1983 £ million	1982 £ million
TURNOVER	371.8	419.3
OPERATING LOSS	14.5	1.8
Investment income receivable	-	(0.2)
Interest payable less interest receivable	5.4	3.8
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION	19.9	5.4
Tax on profit on ordinary activities	0.1	0.2
LOSS ON ORDINARY ACTIVITIES AFTER TAXATION	20.0	5.6
Extraordinary items less taxation	24.4	3.2
LOSS AFTER EXTRAORDINARY ITEMS	44.4	8.8
ACCUMULATED DEFICIT AT BEGINNING OF YEAR	8.8	-
Loss after extraordinary items	44.4	8.8
ACCUMULATED DEFICIT AT END OF YEAR	53.2	8.8
Weekly average number of employees	11,026	12,043

SOURCE: Company Accounts

Table 3.12 - Land Rover UK Ltd

Balance Sheet as at 31 December 1983 & 1982

	1983		1982	
	£ million	£ million	£ million	£ million
FIXED ASSETS				
Tangible assets	136.5		147.4	
Investments	-	136.5	-	147.4
CURRENT ASSETS				
Stocks	87.3		71.1	
Debtors	75.9		351.2	
Cash at bank and in hand	4.9	168.1	0.1	422.4
CREDITORS - amounts falling due within one year		(161.6)		(403.8)
NET CURRENT ASSETS		6.5		18.6
TOTAL ASSETS LESS CURRENT LIABILITIES		143.0		166.0
CREDITORS - amounts falling due after one year				
Interest free loan from Land Rover-Leyland Ltd	145.0		145.0	
Other creditors	27.0	172.0	28.9	173.9
PROVISION FOR LIABILITIES AND CHARGES		24.2		0.9
CAPITAL AND RESERVES				
Called up share capital	-		-	
Profit and loss account	(53.2)	(53.2)	(8.8)	(8.8)
		143.0		166.0

SOURCE: Company Accounts

Table 3.13 - Land Rover UK Ltd

Source and Application of Funds for the years ended 31 December 1982 & 1983

	1983	1982
	£ million	£ million
UTILIZATION OF FUNDS		
Net operational (outflow)/inflow	(14.7)	13.4
Loss on ordinary activities before taxation	(19.9)	(5.4)
Extraordinary items	(24.4)	(3.2)
Depreciation and amortisation	29.6	22.0
Decrease in working capital	45.1	103.6
Stocks - (increase)	(16.2)	(71.1)
Debtors - decrease/(increase)	275.3	(351.2)
Creditors and provisions - (decrease)/increase	(214.0)	525.9
Capital Expenditure	(21.8)	(173.8)
Transfers at 1 January 1982	-	(134.0)
Other additions	(21.8)	(39.8)
Taxation	(0.1)	(0.2)
Other - disposals of fixed assets and provisions on closures	3.1	4.4
	11.6	(52.6)
FINANCED BY:-		
Finance leasing liabilities - long term - (decrease)/increase	(2.0)	28.6
Net short term borrowings - (decrease)/increase	(9.6)	24.0
	(11.6)	52.6

SOURCE: Company Accounts

Leyland Vehicles Ltd

Leyland Vehicles incorporates Leyland Trucks, Leyland Bus and Leyland Parts. It traded as a separately audited business group before 1982 and therefore accounts for 1981 are provided. Accounts for the three constituent groups are not available, but Leyland Parts has traded profitably for some years and the bus division returned to trading profit in 1983[1], though it suffered a "sharp decline" in 1984 according to BL's interim results.

Leyland Vehicles cut its losses in 1984 to £61 million from £70 million in 1983, but the accounts for 1981 to 1983 show that the company appears irrecoverable in strictly commercial terms. Its trading losses exceed provision for depreciation and amortisation, liabilities exceed assets and the company is in general unable to support its basic trading activities.

In May 1984 David Andrews, Group Chief Executive, Land Rover-Leyland, estimated that on the truck business it would be:-

> "two or three years before we can be optimistic and say we can get back into profit".[2]

More recently it has been reported that the company does not expect to become profitable until 1988.[3] Leyland Trucks reduced its losses significantly in 1984 according to BL's interim results.

As the next section discusses there is no prospect of a miraculous recovery in either the UK truck market or Leyland's traditional export markets and the prospects for the division's future profitability look exceptionally bleak, despite further rationalisation measures announced in May 1984.

(1) Company accounts, 1983, Report of the Directors.

(2) HC 490, Q. 121.

(3) Management Today, December 1984, page 66.

Table 3.14 - Leyland Vehicles Ltd

Consolidated Profit and Loss Account for the years ended 31 December 1983, 1982 & 1981

	1983 £ million	1982 £ million	1981 £ million
TURNOVER	433.5	420.8	428.8
OPERATING LOSS	69.6	58.9	80.5
Interest payable less interest receivable	28.5	15.2	10.3
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION	98.1	74.1	90.8
Taxation on ordinary activities	-	0.1	0.2
LOSS ON ORDINARY ACTIVITIES AFTER TAXATION	98.1	74.2	91.0
Extraordinary losses	45.5	0.3	34.5
LOSS AFTER EXTRAORDINARY ITEMS	143.6	74.5	125.5
ACCUMULATED DEFICIT AT BEGINNING OF YEAR	300.1	225.6	100.1
Loss after extraordinary items	143.6	74.5	125.5
Pre acquisition reserves acquired during the year	(1.0)	-	-
ACCUMULATED DEFICIT AT END OF YEAR	442.7	300.1	225.6
Weekly average number of employees	15,821	17,632	18,973

SOURCE: Company Accounts

Table 3.15 - Leyland Vehicles Ltd

Consolidated Balance Sheet as at 31 December 1982 & 1983

	1983 £ million	1982 £ million
FIXED ASSETS		
Tangible assets	156.5	156.9
CURRENT ASSETS		
Stocks	154.4	168.7
Debtors	68.1	102.3
Cash at bank and in hand	1.3	2.1
	223.8	273.1
CREDITORS - amounts falling due within one year		
Short term borrowings	10.2	12.3
Other	378.6	327.2
NET CURRENT LIABILITIES	(165.0)	(66.4)
TOTAL ASSETS LESS CURRENT LIABILITIES	(8.5)	90.5
CREDITORS - amounts falling due after more than one year		
Interest free loans from group companies	308.0	300.0
Other creditors	15.1	15.5
PROVISIONS FOR LIABILITIES AND CHARGES	46.7	10.7
CAPITAL AND RESERVES	(378.3)	(235.7)
Called up share capital	64.4	64.4
Profit and loss account	(442.7)	(300.1)
	(8.5)	90.5

NOTE:

1981 information is not supplies as the basis on which the balance sheet is presented was changed in the 1983 accounts.

SOURCE: Company Accounts.

Table 3.16 - Leyland Vehicles Ltd

Consolidated Source and Application of Funds for the years ended 31 December 1981, 1982 & 1983

	1983 £ million	1982 £ million	1981 £ million
UTILIZATION OF FUNDS			
Net operational outflow	(116.1)	(46.5)	(99.5)
Loss on ordinary activities before taxation	(98.1)	(74.1)	(90.8)
Extraordinary losses	(45.5)	(0.3)	(34.5)
Depreciation and amortisation	27.5	27.9	25.8
Decrease/(increase) in working capital	74.2	(24.8)	76.7
Stocks - decrease/(increase)	14.3	(6.8)	36.8
Debtors & bills receivable - decrease/(increase)	31.1	(15.6)	24.2
Creditors and provisions - (decrease)/increase	22.3	(8.6)	15.7
Subsidiaries/fellow subsidiaries - decrease	6.5	6.2	-
Capital Expenditure	(30.4)	(29.5)	(18.3)
Taxation	-	(0.1)	(0.2)
Trade investment	-	3.8	1.9
Other - principally disposals of fixed assets	4.3	3.2	3.9
	(68.0)	(93.9)	(35.5)
FINANCED BY:-			
Group Companies	69.4	108.4	13.2
Loan capital and term loans	(0.1)	(2.6)	5.0
Finance leasing liabilities - long term	-	0.2	5.6
Net short term borrowings	(1.3)	(12.1)	11.7
	68.0	93.9	35.5

SOURCE: Company Accounts

Section 4 BL Performance 1980-84: Production and Sales

CARS

Production

Since 1980 BL Cars and its successor Austin Rover have introduced an entirely new product range. Metro was launched in October 1980 and is due to be re-skinned next year. The Triumph Acclaim, a re-engineered Honda Ballade produced under licence as a market stop-gap, was introduced in October 1981 and discontinued in mid 1984. Maestro appeared in March 1983, Montego in April 1984, and the Rover 200 series (again substantially a Honda derivative) in June 1984. The range is due to be completed by the introduction, sometime in 1986, of a new executive Rover, currently code-named XX and representing the first fruits of genuine design collaboration with Honda.

Integral to BL's efforts to generate its 'product-led' recovery has been the concentration of volume production at Longbridge and Cowley. Both plants have been completely re-tooled at a cost of over £500 million with the installation of advanced manufacturing systems and industrial robots, placing the two factories at the forefront of car manufacturing technology. Austin Rover has spent £147 million on re-tooling Cowley to produce Maestro and Montego, including £31 million on robots alone. Austin Rover planned to have installed 116 robots at Cowley, including 92 in the body plant, by the time Montego was in production last year.(1) A further £21 million has been spent in re-equipping the Swindon body plant, linking its production, design and testing facilities to a master data base housed at Canley, Coventry.

(1) Reported in the Financial Times, 1 March, 1983.

Austin Rover's objective is not only to operate robot-run assembly lines but to possess a fully self-contained "total technology strategy"(1) linking design, toolmaking and computer integrated assembly via a central data base, which holds all available data on each model and is available to designers, engineers and product managers at each of the company's plants.

Table 4.1 - UK Car Production for domestic and export markets 1980-84: BL and Main Competitors

	1984	1983	1982	1981	1980
Austin Rover	371,427	433,183	369,839		
Land Rover[1]	11,897	12,181	13,235		
Total BL	383,324	473,341[2]	405,116[2]	413,440[2]	395,820[2]
Ford	273,767	318,674	306,635	342,171	342,767
GM/Vauxhall	117,114	126,524	112,669	69,932	55,002
Talbot	95,122	120,503	56,235	117,439	125,314
TOTAL UK	908,906	1,044,597	887,679	954,650	923,744

1 Range Rover production.
2 Includes Jaguar/Daimler production.

Source: SMMT

(1) Andrew Barr, Managing Director, Operations, Austin Rover, quoted in the Financial Times, 13 February, 1984.

But as Table 4.1 shows, despite Austin Rover's adoption of new technology, its production levels have remained consistently below target and below installed capacity. In April 1983 Ray Horrocks told the Industry and Trade Committee that total available car manufacturing capacity (assuming two-shift working) was between 600 and 700,000 units a year, with capacity for another 100,000 due to come on stream when new ranges were introduced.[1] As Table 4.1 shows, however, some 200 to 250,000 units of BL's car manufacturing capacity was not utilised in 1983. The figures for 1984 show a further drop in production.

It has recently been reported that BL's 1985 Corporate Plan estimates that Austin Rover would need to operate under current conditions at an annual production level of around 650,000 cars a year in order to generate sufficient internal revenue to finance the development of new models without further external assistance, and to guarantee the return of the company to private ownership by 1989.[2]

Austin Rover is still making efforts to increase productivity and cut its cost base, but a production target of 650,000 cars a year seems over-optimistic at present. The company is thought to be aiming nearer 500,000 this year.[3]

It has emerged recently that Austin Rover plans to introduce up to five new models in the next four years and that the company now has the capacity to cut developmnet lead times from around six years to four.[4]

(1) HC 353-i, Q. 61, 92.

(2) Reported in the Financial Times, 12 January, 1985.

(3) Reported in the Financial Times, 12 January, 1985.

(4) Reported in the Sunday Mercury, 2 September, 1984.

Collaborative ventures have become increasingly important since 1980 in keeping development and investment costs down, and look likely to remain crucial to the introduction of new models. In March 1981 Sir Michael Edwardes posed a series of rhetorical questions:-

> "Can BL in our present size and shape survive the next ten or 20 years? Has it enough R and D resources and so forth? The answer is 'No'. Can any competitor of our size and shape survive, and some are very profitable today? The answer is 'No'. Can we, however, become quite profitable and survive with comprehensive collaboration with others? The answer is decidedly: 'Yes'. There is no doubt about it."[1]

The arrangement under which Austin Rover produced the Triumph Acclaim and, to a lesser extent, the new Rover 200 series placed significant reliance on Honda design-work and bought-in engines and transmissions (though the new 216 model uses an Austin Rover "S"). The projected XX executive car is being developed jointly from the ground up and costs associated with its design and development are being halved.

There have, however, been problems in important areas of the car's development stage, particularly with the Honda power-train for the larger 2.6 litre version[2], and these have led to a series of postponements to the proposed launch date. XX was initially due to be introduced in the autumn of 1985, but will now be delayed until at least the early summer of 1986.

(1) HC 294, Q. 157.

(2) Reported in the Financial Times, 14 January, 1985.

It seems clear that collaboration is essential if Austin Rover is to have any chance of remaining in the volume car business as it intends, though the company's survival depends at least equally on its ability to sell its new models and recapture lost market share.

Sales

Perhaps the most ominous development for Austin Rover in recent years has been the increasing share of the domestic market taken by imports and tied imports. Total import penetration stood at 57.6 per cent last year, up from 56.9 per cent in 1983 and just below the 1982 peak of 57.7 per cent. Over a third of this is in the form of tied imports and kits brought in by Ford, GM and Peugot/Talbot. There seems at present little likelihood that this trend can be reversed to any significant degree in the immediate future.

Table 4.2 shows the recent sales performance of BL and its major competitors. Comparison with UK production figures in Table 4.1 shows how Vauxhall in particular has relied on tied imports to support its assault on the domestic market.

Table 4.2 - UK Car Sales 1981-84: BL and Main Competitors

New Registrations (000's) (Market Share)	1984	1983	1982	1981
BL	312,054[1] (17.84)	325,656[1] (18.18)	277,260[2] (17.83)	285,071[2] (19.20)
Ford[3]	486,971 (27.83)	518,048 (28.91)	474,192 (30.49)	459,365 (30.94)
GM/Vauxhall[3]	282,835 (16.17)	262,141 (14.63)	181,737 (11.69)	127,141 (8.56)
Peugot/Talbot[3]	70,519 (4.03)	79,495 (4.44)	75,785 (4.87)	85,853 (5.78)
TOTAL UK new registrations	1,749,650	1,791,699	1,555,027	1,484,713

Source: SMMT

Notes: 1 Includes Range Rovers. Market share for Austin Rover alone is as follows:- 1981 18.67
1982 17.24
1983 18.01
1984 17.66
(Source: Financial Times, 12 January, 1985)

2 Also includes Jaguar.

3 Includes tied imports and kits.

After a revival in 1983 BL's sales slipped in 1984. The inexorable rise in GM sales, thanks chiefly to the success of the Vauxhall Cavalier and, to a lesser extent, the Nova and Astra, presents a serious threat for Austin Rover. Ford's Sierra range has not captured the same share of the market held by its predecessor the Cortina but it nevertheless remains a steady seller, particularly in the all-important fleet market, where Austin Rover's new Montego is currently held in third place behind the Cavalier and Sierra.

Despite widespread critical acclaim, the Montego has been slow to penetrate the fleet market, though there are signs of awakening interest amongst large fleet purchasers. Nearly 35,000 Montegos were sold between its launch in April 1984 and the end of the year, but it is generally recognised that it will have to sell much better in 1985 if Austin Rover's immediate prospects are to improve. At the time of the Montego's launch Austin Rover were looking to eventually produce 120,000 a year.

Metro and Maestro sold well in 1984 (sales of 117,000 and 83,000 respectively) but could not topple the Ford Escort (157,000), Vauxhall Cavalier (132,000) and Ford Fiesta (126,000), though in the previous two years the Metro had outsold the Ford Fiesta.

Ford ran a very aggressive dealer incentive campaign during 1984, and perhaps most worrying for Austin Rover is the current battle for market share between Ford and Vauxhall led by massive press and television advertising campaigns and backed up by promotional activities and aggressive discounting.

Austin Rover has been offering discounts to fleet buyers, but not on the scale offered by Ford and GM, both of whom are backed by record profits from US operations, and there is a danger that Maestro and Montego could be gunned down in the crossfire in any protracted discounting war.

Austin Rover's difficulties have been compounded by industrial relations problems at crucial periods. The launch of Maestro in March 1983 was almost immediately followed by the 'washing-up' strike at Cowley, and Montego's introduction in April 1984 was followed by a spate of wildcat stoppages at Cowley and a strike at Longbridge. These disputes are considered by the company to be largely responsible for Austin Rover's poor sales performance in the key month of August last year. One executive complained:-

> "Short of stock and going into the peak selling month, how could we afford to offer our dealers incentives available to the competition."(1)

The November pay strike also starved Austin Rover of new Montego and Maestro variants and held up a drive for European markets. Over 30,000 vehicles were lost and BL's December market share fell to only 11.8 per cent.

In January and February this year BL improved its market share to an average of 18.9 per cent, but this has followed the introduction of more generous dealer incentives, increased discounts and more aggressive promotions. Dealers have been set the target of achieving a 22 per cent market share for 1985 though it is believed that total sales of around 435,000 (implying at least a 19 per cent domestic share) would allow Austin Rover to break even on trading.(2)

This target might perhaps be achieved if Austin Rover can improve its penetration of export markets. In 1984 foreign sales totalled about 80,000 cars, and its target for 1985 is thought to be about 110,000.(3)

The company is looking for an expansion in exports, particularly in Europe, but here also it is in danger of being muscled out by Ford, GM and other competitors. All major European markets have far lower import penetration than in the UK and in none does BL rank as a significant importer. Table 4.3 shows BL's car sales in important EEC markets.

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(1) Reported in the Financial Times, 12 January, 1985.

(2) Reported in the Financial Times, 12 & 17 January, 1985.

(3) Reported in the Financial Times, 9 January, 1985.

Table 4.3 - BL Sales in Principal EEC Markets, 1980-83

SALES (Market Share)	Belgium	France	W Germany	Italy	Netherlands
1983	1,059 (1.7)	30,651 (1.5)	5,772 (0.2)	27,093 (1.7)	7,976 (1.7)
1982	5,629 (1.6)	33,199 (1.6)	6,712 (0.3)	29,075 (1.7)	6,321 (1.6)
1981	4,842 (1.3)	24,048 (1.3)	6,343 (0.3)	23,087 (1.3)	6,416 (1.7)
1980	5,305 (1.3)	20,625 (1.1)	4,013 (0.2)	12,100 (0.8)	7,346 (1.6)

Source: SMMT

The European new car market shrank in 1984 to 10.18 million from 10.50 million in the previous year, and Austin Rover's average share dropped from 4 to 3.9 per cent. Most major European manufacturers made substantial losses between 1980 and 1984 and in the same five years the industry as a whole returned a collective deficit. In 1984 this may have been as high as £650 million.(1)

It is estimated that there is an annual production capacity of around 12.5 million cars in Europe currently, compared with demand of just over 10 million. The persistence of this over capacity is likely to result in continuing cut-throat competition and unprofitability, and whatever the quality of its product range, Austin Rover is unlikely to be able to capture market share against competition from the likes of Ford and GM who are prepared to use record profits from their US operations to buy or maintain market share in Europe.

(1) Reported in the Sunday Times, 13 January, 1985.

Austin Rover has also argued that its competitive position is hampered by the financial assistance offered to a number of European domestic producers by their governments to help offset losses and implement investment plans. The Italian government has helped Alfa Romeo and the French government has aided Renault and, to a lesser extent, Peugot. Inter-group loans from GM to its West German Opel subsidiary fulfil a similar function (though interestingly Ford UK was until recently providing cash for its UK parent company).

On the other side of the equation, however, recent movements in exchange rates are likely to assist Austin Rover's competitiveness in foreign markets. The decline of Sterling against the Franc and Deutschmark may open up the important French and West German markets. Until 1983 BL argued that a strong pound hindered their export prospects. But since the first quarter of 1984 the pound has fallen against all major currencies and its non-Dollar trade-weighted index fell by nearly 10 per cent between August 1984 and February 1985. This ought to offer an unrivalled opportunity to boost exports in Europe.

However, Austin Rover's prospects in the US market look unpromising in the short-term, despite the strength of the Dollar against Sterling. Austin Rover has no competitive products on offer, and the Rover XX which the company sees as a likely market penetrator in the US will not be available in the export market until 1987. The Reagan administration is to end 'voluntary restraints' on Japanese imports from April 1985 and in the increasingly competitive market which will ensue there are unlikely to be any pickings for Austin Rover.

COMMERCIAL VEHICLES

Production

Table 4.4 presents comparative output figures for BL and its main competitors since 1980. The commercial vehicle category comprises car-derived van, four-wheel-drive vehicles, light and medium vans, trucks, buses and coaches.

Table 4.4 - UK Commercial Vehicle Production 1980-84: BL and Main Competitors

	1984	1983	1982	1981	1980
Austin Rover		25,147	20,995	14,802	31,908
Land Rover		30,093	39,903	41,060	51,378
Freight Rover		18,152	13,767	10,594	23,393
Leyland Vehicles[1]		12,810	14,260	16,852	22,953
Total BL	72,518	86,202	88,925	83,308	129,632
Ford	94,211	96,843	115,637	85,324	138,373
GM/Bedford	47,007	51,478	51,733	48,311	96,424
Talbot/Dodge			6,395	8,457	16,334
Total UK	224,825	244,514	268,798	229,555	389,170

1 Leyland Trucks and Leyland Bus.
Source: SMMT

These figures show that UK production has slumped since 1980, reflecting a depressed world market in most CV sectors and increasing competition in both domestic and export markets. The UK market as a whole has held up reasonably well, but in some sectors it has been depressed for several years and the steady fall in BL's production reflects rationalisation of plant capacity and the collapse of export markets for Land Rovers and trucks in some Third World countries.

As with its car operations BL had surplus CV production capacity in 1983, according to Ray Horrocks and the Chief Executive of Land Rover-Leyland, David Andrews. Horrocks told the Industry and Trade Committee that Austin Rover could produce some 100,000 car-derived vans annually[(1)], while Andrews stated that Land Rover Group could produce 100,000 vehicles, and Leyland Vehicles 25,000 trucks and 3,000 buses and coaches annually.[(2)] Andrews told the same Committee a year later that the bus division was running at between 55 and 60 per cent capacity.[(3)]

Actual output figures in Table 4.4 indicate that all BL's CV plants have substantial over-capacity despite closures and rationalisation since the late 1970's, and both Land Rover and Leyland Vehicles have announced further restructuring programmes in the last eighteen months.

Land Rover is currently in the middle of a major restructuring programme, which is due to be completed in 1986. The company has bought the former Rover plant at Solihull and is concentrating its activities around the main plant and seven satellite sites. The programme is costing some £200 million and is aimed at producing what Land Rover's managing director has described as a "single, integrated, modern facility".[(4)]

(1) HC 353-i, Q. 61.

(2) HC 353-i, Q. 65.

(3) HC 490, Q. 144-146.

(4) Quoted in the Financial Times, 12 November, 1983.

The company has also been up-grading its ageing product range. A modified basic Land Rover, the One Ten, was introduced in March 1983, and a new short-wheelbase model, the Land Rover Ninety, appeared in June 1984. Where possible key components such as brakes, axles, suspension and gearbox are being standardised in the new models. Concentration of production on one site will reduce the cost of transporting components and cut total overheads by about £14 million a year.[1] Land Rover appears to be belatedly responding to the need to develop new products in its attempts to match its competitors, relying on its models' traditional reputation for quality, durability and versatility.

Land Rover's subsidiary company Freight Rover has also streamlined its production capacity and introduced new models. A new wide-bodied 3.5 tonne Sherpa van was introduced in 1984 and the division's management has been looking at the possibility of introducing larger vans in the 4.5 to 5 tonne range.

As Table 4.4 shows Sherpa production rose considerably between 1981 and 1983.

Leyland Trucks announced further cut-backs in capacity in May 1984 beyond those already implemented between 1979 and 1981 and subsequently under its 1982 "radical plan". Production at the Bathgate plant is being phased out and the factory will close in 1986. The division is currently looking to concentrate axle manufacture at its Albion plant in Glasgow, and vehicle assembly at Leyland itself and Watford's Scammell plant.[2]

Since 1978 Leyland Trucks has cut its capacity by 55 per cent and its workforce by 60 per cent to around 12,000.

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(1) Reported in the Financial Times, 12 November, 1983.

(2) HC 490, Q. 122.

In the last five years the company has introduced, at a cost of £60 million, five new models covering the six to forty-tonne categories, bracketed as the T45 range and marketed as the company's "Trucks for Europe". A new light truck, the Roadrunner, completes the range and was launched in October 1984. It is aimed particularly at small fleet operators with under five vehicles.

Leyland now possesses a new technical centre, costing £22 million, but in developing its model range the company is looking to buy in most of its engines and all transmission units. The company pulled out of a joint venture with Cummins, the US diesel engine manufacturer, to produce a new engine at Bathgate.

In other areas of its development and manufacturing operations Leyland Trucks has made significant technical advances, but it will only be able to finance future investment, even for its remaining slimmed-down operations, if sales improve radically.

Leyland Bus has also cut back its production capacity in response to shrinking markets, and has begun to diversify its product range. It has developed a rail-born coach, the Rail Bus, in conjunction with British Rail Engineering, and the range is being expanded to compete in both UK and overseas markets.

The division has also concluded a deal with the Gillig Corporation of San Francisco for the assembly and marketing of Leyland's double-deck buses in California.

Sales

Table 4.5 - New UK Commercial Vehicle Registrations 1980-84: BL and Main Competitors

New Registrations (market share)	1984	1983	1982	1981	1980
Austin Rover	18,442	25,256)			
Land Rover	6,757	6,768)	34,006	32,105	46,254
Freight Rover	14,645	14,204)			
Leyland Trucks	7,735	7,476	6,062	7,183	10,616
Leyland Bus	1,488	1,801	1,844	2,332	3,059
Total BL	49,397 (18.36)	55,505 (20.72)	41,912 (18.14)	41,620 (19.11)	59,929 (22.03)
Ford[1]	83,211 (30.93)	86,546 (32.31)	84,161 (36.43)	65,443 (30.05)	87,947 (32.33)
GM[1]	39,220 (14.58)	36,672 (13.69)	31,734 (13.74)	30,543 (14.02)	40,176 (14.77)
Peugot/Talbot	10,361 (3.85)	9,154 (3.42)	N/A	N/A	
Total UK	269,003	267,839	231,010	217,812	272,010

1 Includes sales of buses and coaches.
Source: SMMT

Table 4.5 shows how BL's overall commercial vehicle operations have held market share relatively well, but these averages conceal wide variations.

For example, the UK market for buses and coaches has nearly halved since 1980, from 5,301 in that year to 2,928 in 1983. Leyland Bus' sales fell correspondingly, and by closing plants and shedding labour the division has maintained market share, but on a 50 per cent lower sales base.

The division is concerned at the potential effects of legislation de-regulating bus and coach services in the UK. It has argued that the phasing out of subsidies to local authority operators has already contributed to the decline in the domestic market, and that de-regulation will encourage more small operators who may rely on second-hand vehicles and make less generous provision for depreciation and renewal. Leyland Bus is looking to exports and product diversification to counteract any further shrinkage in the UK market.

The truck market remains depressed and many European manufacturers suffered in the highly competitive environment which existed after the recession bit in 1980. Over-capacity led to cut-throat pricing and Leyland Trucks' share of the domestic market fell from 19.3 per cent in 1978 (it had been 30 per cent in 1973) to 17.3 per cent in 1980 and 13.4 per cent in 1982. It rose again to 14.9 per cent in 1983 but fell again to 14.6 per cent last year. At the same time, foreign manufacturers such as Volvo and Scania have been looking to make in-roads in the UK market, while the position of Ford and GM remains strong.

Leyland is depending very heavily on the success of Roadrunner to recapture lost market share. The company hopes to sell 3,000 this year. Initial orders were encouraging - by November 1984 orders worth £25 million had been received.(1) However, there is little sign that the domestic truck market is on the threshold of a major recovery and even with its new product range the company's future is in grave doubt. With under 8,000 sales last year Leyland is nowhere near approaching the volume base which it would need to become profitable.

(1) House of Lords Official Report, 6 December, 1984, c1452-3w.

Leyland's overseas markets have also suffered. The African market has all but collapsed as previously large importers like Nigeria plunged into economic crisis. Leyland's truck exports halved from 6,000 units in 1982 to 3,000 in 1983. Markets in Europe and the Near East have also shrunk but sales to the Far East, particularly Hong Kong, Singapore and Thailand, have held up well.

Even on optimistic forecasts Leyland did not expect to exceed 12,000 trucks sold in 1984, and as the company's managing director is quoted as saying,

"we can't make money on 12,000 trucks."(1)

The company estimate it would need to increase this volume by 50 per cent to stand any chance of returning to profit by 1988. Given the current state of the truck market this looks a very tall order.

Land Rover's sales have also suffered from the collapse of several of its Third World markets. For example, in 1981 it exported nearly 6,000 vehicles to Nigeria. In 1982 this fell to under 1,000 and in 1983 to only 300. Likewise Land Rover sold 3,500 units to Libya in 1982. Last year it sold none. Total exports fell from 31,000 in 1982 to 19,000 in 1983. The company is currently looking for new markets in Europe and elsewhere - for example, in India and China - but these will not quickly replace lost export volume.

The principal worldwide threat to Land Rover's sales has come from Japanese manufacturers, who have doubled their share of the world market in a decade and who now manufacture half of all 4x4 vehicles sold. The major threat to Land Rover sales has come from the Toyota Land Cruiser and the Nissan Patrol.

(1) Reported in Management Today, December 1984.

Exporting is likely to remain vital to Land Rover's sales prospects. The domestic market represents only 20 per cent of the company's total business. Land Rover's UK sales rose slightly in 1983 and remained static last year but the company's total sales fell from nearly 41,000 in 1982 to 28,000 in 1983 as a consequence of lost export volume.

Nevertheless, Land Rover's future looks reasonably encouraging. The restructuring programme will streamline production and help cut costs. The company's products have a worldwide reputation with which its Japanese and other competitors cannot compete. Land Rover receives regular orders for military vehicles from foreign governments and in the private buyer market its products are pitched at the quality end where high profit margins can be achieved.

Freight Rover's UK sales rose slightly from 14,204 in 1983 to 14,645 in 1984, and the division is currently profitable having pulled back from near-collapse in 1981.

Freight Rover's sales have been boosted by three major orders from British Telecom since 1983, the last of which was announced in January this year and was for a further 2,350 vehicles with a showroom value of £14 million. British Telecom will have over 6,000 Sherpa vans in its fleets when deliveries are completed.

Freight Rover's exports declined from 1,600 in 1982 to 1,500 in 1983, but this slight fall was more than offset by improved domestic sales.

In the car-derived van sector 1984 was a poor year for Austin Rover. The company blames industrial disputes for some lost sales, though potential customers were also inhibited by having to wait for the new Maestro van to replace the obsolescent Ital van. The Maestro van has already begun to prove attractive and in January this year British Telecom placed an order for 3,000 with a showroom value of almost £14 million. British Telecom also has the option of ordering a further 1,500.

Austin Rover soon hopes to compete in the increasingly important diesel van market. It is currently engaged in a joint project with Perkins to develop a direct-injection engine which it claims will be more efficient than existing diesels.

Austin Rover exports vans to Europe in some quantity, but BL's share of the total European market fell from 9.1 per cent in 1979 to 6.1 per cent in 1983 in a market which grew from 348,000 to 436,000.(1)

(1) Reported in the Financial Times, 9 July, 1984.

Section 5 BL Performance 1980-84: Productivity, Pay and Industrial Relations

Since the late 1960s the motor industry has become synonomous with bad industrial relations. Car assembly workers have become to be considered amongst the best paid and most militant groups in British manufacturing industry.

At British Leyland multi-unionism, fragmented wage bargaining machinery and concessions by management encouraged the growth of a rigid structure of working practices and increased vulnerability to industrial action.

Sir Michael Edwardes' recovery strategy included amongst its central objectives the need to increase productivity and reduce costs across the board. The means by which this was to be achieved included clsoing plants, cutting the workforce and pushing through reforms in working practices. Edwardes' strategy for achieving these objectives required reasserting the prerogative of management to manage and confronting the powerful trade unions within BL.

In October 1979 BL presented a 92 page document on proposed changes to working practices in its car plants, abrogating unilaterally the 'mutuality' agreement negotiated in 1971 by which management sought the agreement of shopstewards to changes in manning levels, track speeds, work assignment and other practices.

In April 1980 an abbreviated form of this document, known as the 'blue newspaper', was presented as a fait accompli. The management's position had been strengthened in the intervening monghts by the defeat of strikes precipitated by the Edwardes' Recovery Plan and the sacking of the Longbridge convenor, Derek Robinson.

The imposition of the terms of the 'blue newspaper' provoked a further strike, but management made clear its intention to tought it out and appeared to be gambling that disruption caused by its unilateral action would be short-lived.

It is clear that the management's assumption has not been wholly justified (see below pages 67 ff.) but the changes soon brought visible improvements in productivity.

Productivity

The reform of working practices, coupled with radical restructuring and the introduction of new technology, quickly increased productivity in BL's assembly operations. In 1980 output was 5.06 vehicles per man/year, well below comparable levels for BL's major competitors. In 1981 this rose to 7.45. These figures include Jaguar production, which because of its specialised techniques brought the average down. Figures for Austin Rover alone show that productivity rose from 10.2 cars per man/year in 1982 to 12.1 in 1983.(1) It now stands at around 14, with further improvements anticipated.

On an individual plant basis productivity gains have been even more astounding. It was reported in February 1982 that output at Longbridge was the equivalent of 42 cars per man/year, 36 per cent higher than a year previously.(2) A survey published in February 1984 estimated that productivity had risen to 55 cars per man/year, making the plant more efficient than any other major European assembly plant (by comparison Talbot's Ryton works produced 37 cars per man/year and Ford's Halewood plant 26).(3)

Austin Rover now claims with some justification that its plants are as efficient as those of tis Japanese competitors. Comparable figures for productivity trends in Land Rover and Leyland Vehicles are harder to piece together. BL does not provide a complete or consistent series of indicators to allow year on year comparison. For example, its review of 1983 gives an average output per man/year figure for the entire Land Rover-Leyland group.

(1) All figures from BL annual performance reviews.

(2) Reported in the Sunday Times, 21 March, 1982.

(3) Reported in The Engineer, 9 February, 1984.

However, by combining what figures are available for earlier years with rough calculations from recent production and manning levels the approximate position can be estimated. This reveals that despite plant closures and de-manning, productivity at both Land Rover and Leyland has remained static or fallen. Output per man/year figures are as follows:-

	1983	1982	1981	1980
Land Rover[1]	5.48	5.56	4.86	5.52
Leyland Vehicles	0.81	0.81	0.89	0.99

1 Land Rover, Range Rover and Sherpa production.

Industrial Disputes

BL is also reluctant to publish detailed information on the effects of industrial disputes on its operations. Company records show that between 1977 and 1982 the number of vehicles lost annually fell each year. In 1977 over a quarter of a million vehicles were lost. In 1982 the fugure was under 10,000.

BL now expresses its industrial relations record in terms of the number of manhours lost as a percentage of total available hours. The figures show the following trend:-

1983	1982	1981	1980
2.0	1.6	0.5	1.4

Manhours lost in 1982 were chiefly the result of a bitter strike at Leyland Vehicles over restructuring plans, and the 1983 figures derived largely from the 'washing-up' dispute at Cowley. The Cowley strike caused the loss of cars with a showroom value of £120 million, and a loss in revenue to the company of some £70-80 million.(1) Management blamed the unions, but a number of independent commentators argued that the company had aggravated the dispute by taking too far its assertive approach towards the unions.

(1) HC 353-i, Q. 24, 27.

The 'washing-up' dispute showed above all that the management had been wrong to assume that pushing through changes in working practices and workplace industrial relations would result in a once-for-all confrontation followed by a period of compliance from the labour force.

Both sides now recognise that substantial reforms in workplace organisation are needed to fill the vacuum left by the erosion of shop steward authority, and to restore discipline and authority on the shop floor. The current unsatisfactory situation has arisen as a direct result of the de-skilling and fragmentation of workplace organisation which followed the introduction of new technology and the assault by management on entrenched working practices. In March 1982 new procedural agreements were put into force aimed at improving communications between management and workforce. The seven TGWU and five AUEW full-time convenors at Cowley were put back on production. Each union was permitted only one convenor. Steward constituencies, previously small in comparison with manual workforces in other industries, grew larger and some workers were left unrepresented.

Ironically, by undermining or breaking the authority of shop stewards, Austin Rover's management has opened the way for increasing unofficial action. 1984 was a bad year for wildcat stoppages at Cowley and Longbridge. Though these may not appear serious in terms of percentages of man hours lost, stoppages of this kind can have a disproportionate effect on production continuity. By mid September there had been 130 wildcat strikes at Cowley, 30 in the preceeding three weeks alone.[1]

(1) Reported in the Financial Times, 15 September, 1984.

Resentment at what has come to be considered management by diktat has continued to build up at both Cowley and Longbridge, and 1984 ended with a major strike over the new pay round. The company is now seeking damages from the eight unions represented in Austin Rover under the 1984 Trade Union Act, but the position is confused because two of the major unions repudiated the strike. Whatever the outcome of the legal proceedings pending, damage has been done to Austin Rover's production at crucial times when it has been looking to boost sales of its new models and make an impact in foreign markets.

It is important for Austin Rover to supplement its efforts to bring the unions to heel by use of the new legislation with attempts to find appropriate procedures through which union representatives can curb unofficial action and deliver negotiated agreements.

Pay

The 1984 Austin Rover strike was the first major stoppage over pay since 1981. Increases in basic rates have been kept close to the rate of inflation, although consolidation of some bonus payments and opportunities for increased bonus earnings have raised average earnings well above percentage increases in grade rates. According to BL figures gross earnings rose by 77 per cent between 1977 and 1982.

Since 1982 annual wage negotiations have been conducted separately for the main vehicle divisions. The details of increases agreed are as follows:-

Austin Rover

Commencement date	Nov 1981[1]	Nov 1982[2]	Nov 1983	Nov 1984[3]
Increase in grade rates	3.8	5.0*	5.6*	5.1**

* plus £3.75 p.w. bonus consolidation. Bonus ceiling £30 p.w.
** plus £5.25 p.w. bonus consolidation. Bonus ceiling £30 p.w.

1 BL Cars (includes Jaguar and Land Rover)
2 Two year settlement.
3 Two year settlement. 5.0 per cent increase in rates from November 1985.

Land Rover

Commencement date	Oct 1982	Jan 1984	Jan[1] 1985
Increase in grade rates	5.8*	3.0	4.5**

* plus £5.25 p.w. bonus consolidation. Bonus ceiling £30 p.w.
** plus £5.00 p.w. bonus consolidation. Bonus ceiling £30 p.w.

1 Two year settlement. 5.0 per cent increase in rates plus £5.00 p.w. bonus consolidation from January 1986.

Leyland Vehicles

Commencement date	Sept 1981	Sept 1982	Sept 1983	Sept 1984
Increase in grade rates	4.0*	5.0**	2.5***	5.0****

* Bonus revised.
** Plus consolidated bonus revised.
*** Plus £5.33 p.w. bonus consolidation. Bonus ceiling £20.64 p.w.
**** Plus £5.67 p.w. bonus consolidation. Bonus ceiling reduced to £14.00 p.w.

Source: Incomes Data Services

The calculation of actual increase in earnings is less easy. Austin Rover estimates earnings to have risen by 15 per cent in the two years to November 1984. The average bonus payment in October 1984 was £19.37 per week. For Land Rover employees it was £12.39 per week.

Fluctuations in bonus payments were a major grievance in the 1984 Austin Rover pay negotiations. There was also a feeling that the company's success in 1983 entitled the workforce to a more generous settlement. In the event the final settlement increased grade rates by only about the same level as in 1982 and 1983, roughly in line with comparable settlements at Talbot and Vauxhall, and slightly less than that at Ford, where a 7 per cent increase in grade rates has been negotiated.

Section 6 BL and the Domestic Component Industry

As outlined in Section 1, one of the crucial arguments deployed in government discussion of BL's 1981 Corporate Plan was the effect which the demise of substantial parts of the company would have on short-term Exchequer costs, manufacturing output and employment amongst BL's suppliers. The Economist reported that Treasury estimates of the cost of liquidation ran as high as £3 billion.(1)

This was probably an exaggeration, but crucial to the calculations were estimates of how many jobs in component manufacturers and other suppliers depended on BL. Here there was (and remains) considerable dispute. The Department of Industry estimated that the ratio of jobs in dependent companies to employees in BL was 1:1.(2) Sir Michael Edwardes put the figure at nearer 2:1(3) and some estimates went as high as 3:1.

The Department of Industry submitted a memorandum to the Industry and Trade Committee explaining its methodology and its own estimates of the overall employment consequences of BL's closure, but this was not published. But it is clear that with 120,000 UK employees at the end of 1980, and a worldwide turnover of nearly £2.9 billion, BL was a major employer by any standards and that a substantial segment of the component industry was dependent on orders from BL. Total employment in SIC 35, covering the manufacture of vehicles, engines, bodies, caravans, trailers and metal components, was 412,000 in June 1980. This did not include employment in plastics, electronics, rubber or glass suppliers. It is not surprising therefore that Industry Department officials and a majority of the Cabinet shrank from the decision to allow BL to go down.

(1) 31 January, 1981.

(2) House of Commons Official Report, 4 March, 1981, col 141w.

(3) HC 294, Q. 175.

Five years later BL remains a major employer in the manufacturing sector, and Austin Rover places over £1 billion worth of orders with domestic component suppliers which rely on BL for a proportion of their business.

However, in the intervening years several inter-related developments have eroded the closeness of that dependence and precipitated structural changes within the industry. These include:-

1 BL's policy of purchasing more components abroad in its search for competitiveness on price, quality and technology.

2 A shrinking of the UK components market generally, as imported vehicles and tied imports take greater market share and UK-based multinationals buy in more foreign-made components for their domestic operations. Linked to this is the increased competition in the replacement parts market from vehicle manufacturers' own subsidiaries.

3 A diversification of operations by larger component manufacturers, both geographically and in product development, chiefly in response to UK market trends.

4 The loss of many smaller companies and major rationalisation by most of the larger manufacturers, who are now better equipped to operate in wider markets.

Reviewing these trends in turn:-

1 In April 1981 Sir Michael Edwardes told the Industry and Trade Committee that BL's purchasing of bought-in components was 95 per cent "British-based"(1), but that the company was increasingly looking abroad in its efforts to contain costs. By early 1983 it was reported that Austin Rover was already placing 15 per cent of its component orders abroad.(2)

(1) HC 294, Q. 177.

(2) Reported in The Times, 5 January, 1983.

In May 1984 Ray Horrocks told the Trade and Industry Committee that on a weighted average basis across all car production BL was running 93 per cent EEC content and 87 per cent "UK pure content", but that this was falling.[1] Horrocks had admitted a year earlier that it was possible to claim at least 60 per cent UK content at factory gate prices without purchasing any UK-made components, since the local content definition includes direct and some indirect overheads, including advertising, catering, energy costs, etc. In fact the margin within which domestic component manufacturers were competing was only about 20 to 30 per cent of the factory gate price per vehicle.[2]

Austin Rover has continued to warn that it may have to reduce this margin still further and increase its purchase of foreign components, though it has made clear its intention to buy British where it makes commercial sense to do so. This reflects some degree of discrete pressure from the Government, and the company has over the last two years entered into a number of two and three year contracts with UK suppliers. From the company's point of view this has not been a wholly successful move, and early last year Harold Musgrove issued an uncompromising warning to Austin Rover's suppliers. He said that he could buy certain components 15 to 20 per cent cheaper in Europe and that Austin Rover,

> "had no intention of jeopardising our long-term viability by accepting unjustifiably high prices or inadequate quality from our suppliers".[3]

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(1) HC 490, Q. 111.

(2) HC 353-i, Q. 75 and 76.

(3) Reported in the Daily Telegraph, 28 March, 1984.

At the same time, other reports within Austin Rover suggested that very few of those suppliers with whom the company had negotiated long-term contracts were performing satisfactorily, and that the proportion of orders placed abroad might have to rise from 15 per cent to 45 per cent.[1]

Austin Rover has recently challenged its domestic suppliers to produce more competitive products and to try and win back orders from abroad, but it seems likely that it will have to look abroad still further as it seeks to trim costs and seek optimum quality in order to compete in the cut-throat volume car market.

In its commercial vehicle manufacturing BL has retained a higher UK content. In 1983 ths was 96 to 97 per cent in trucks and buses and 90 to 91 per cent in Land Rover products.[2] However, the trend towards examining foreign suppliers' products and prices is also evident in commercial vehicle manufacture and BL expected its UK sourcing to decline by about 1 per cent across all CV assembly in 1984 as against 1983.[3]

For suppliers of CV components the most damaging development has been the overall decline in vehicle assembly in the UK and the depressed state of world markets in certain sectors, notably trucks and buses.

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(1) Reported in the Financial Times, 19 March, 1984.

(2) HC 353-i, Q. 82.

(3) HC 490, Q. 119.

2 Austin Rover's increasing use of foreign components is not only a function of price, quality and delivery. It also reflects falling technological standards amongst domestic suppliers. As Ray Horrocks told the Trade and Industry Committee in May 1984,

> "some UK manufacturers are not able to afford to keep up".(1)

This falling technology base derives chiefly from a general shrinking of the UK components market. Harold Musgrove explained in March 1984 that,

> "the volume base for components has moved out of Britain".(2)

Without this volume base manufacturers have beeen increasingly unable to fund expensive research and development or investment programmes. Census of production data show that betweeen 1979 and 1982 total capital expenditure in the motor vehicle parts sector (which excludes electrical, plastics, glass and rubber suppliers) fell from £209.5 million to £63.1 million, and, despite a fall in employment by 50 per cent, over the same period net capital expenditure per head dropped from £1,335 in 1979 to £585 in 1982.(3)

As a greater share of the car market has been taken by imports and tied imports domestic manufacturers have used their bargaining leverage to hold down component prices. Austin Rover has managed to keep its bought-in component prices almost constant in cash terms since 1980.

(1) HC 490, Q. 118.

(2) Reported in the Daily Telegraph, 28 March, 1984.

(3) Business Monitor, PA 353, Motor Vehicle Parts.

Ford and GM have begun to respond to political pressure to manufacture more cars in the UK and rely less on tied imports, but this has not interrupted a trend towards greater foreign sourcing of components used in their domestic manufacturing operations. Professor Dan Jones has recently claimed that the UK content of GM cars sold in Britain fell from 89 per cent in 1973 to 26 per cent in 1983. In the same period the UK content of Ford's UK production fell from 86 per cent to 43 per cent, and of Talbot's from 97 per cent to 37 per cent. On the same basis the UK content of Austin Rover's output fell from 100 per cent to 92 per cent.

Overall Professor Jones concluded that the domestic component market had fallen by 60 per cent in a decade,

> "a devastating blow, which has eroded their competitiveness and ability to export".(1)

Balance of trade statistics show how quickly imports of components have risen while the value of exports has fallen in real terms. Table 6.1 shows imports and exports of parts and accessories from 1980 to 1984.

Table 6.1 - Balance of Trade in Vehicle Parts and Accessories 1980-84.

	1984*	1983	1982	1981	1980
UK Exports (£m current prices)	2,138	2.024	1,950	2,059	2,044
UK Imports (£m current prices)	+204	+131	+481	+905	+1,053

* January to November.
Source: Department of Trade and Industry.

(1) Reported in the Financial Times, 18 January, 1985.

The UK still retains a small trade surplus in parts and accessories, but the trend is ominous.

In individual component sectors import penetration increased rapidly between 1978 and 1983. In metal components, for example, it rose from 36 per cent to nearly 60 per cent; in tyres from 22 per cent to 32 per cent; and in glass products from 16 per cent to 24 per cent.

Total sales (in the UK and abroad) of all motor components manufactured in the UK fell from £3.9 billion in 1979 to £3.4 billion in 1982.[1]

It is clear, then, that despite some pressure on BL to buy components abroad, the chief factors in the decline of the UK component industry have been wider market trends. As Harold Musgrove observed in March 1984,

> "I can't save the components industry alone".[2]

3 In response to these changing market circumstances many component manufacturers have been looking to diversify their operations and to avoid over-reliance on any single purchaser or any single market. Some have looked to foreign markets, others to product diversification or to moving parts of their manufacturing operations overseas.

(1) Figures quoted in <u>The West Midlands Automobile Components Industry</u>, West Midlands County Council, 1984, page 37 ff.

(2) Reported in the <u>Daily Telegraph</u>, 28 March, 1984.

Some, like <u>GKN</u>, have explored all three options. In response to British Leyland's troubles during the 1970's GKN opened plants in West Germany, where it manufactures transmissions, and the USA where it produces front wheel drive systems and constant velocity joints. Sales from its US operations now account for 18 per cent of GKN's turnover. The company has also diversified its domestic operations, manufacturing and distributing steel products and household hardware goods. Recently it has boosted its domestic component business by taking over a distribution network from Smiths Industries.

<u>Automotive Products</u> has also looked to boost its overseas operations. It won an order to supply Fiat with brake parts from a factory in north-west Italy. Automotive Products has also developed its business with Renault and Peugot-Citroen-Talbot from its French factories. The company is now looking to expand its US sales and Automotive Products' Chairman said recently that it was his aim to increase foreign sales from a thrid to a half of total turnover in the next five years.[1]

<u>AE</u> has negotiated a joint venture to supply the South Korean vehicle industry with engine pistons and foreign sales now account for over 50 per cent of turnover. Both <u>Lucas</u> and <u>Dunlop</u> depend extensively on overseas production and exports from UK plants.

Figures compiled by the Centre for Policy Studies show that even in 1981 these large component manufacturers depended on BL for less than 20 per cent of their total sales. For GKN it was 5 per cent; Automotive Products 18 per cent; AE 7 per cent; Dunlop 4 per cent; Lucas 12 per cent; Birmid Qualcast 12 per cent; Rubery Owen 15 per cent and Smiths Industries 8 per cent.[2]

(1) Reported in the <u>Financial Times</u>, 10 January, 1984.

(2) <u>BL: Changing Gear</u>, 1983, page 29.

All of these companies experienced deteriorating profitability as the recession bit, but very little of this can be directly attributed to a fall in sales to BL. In the last year or two almost all the major component manufacturers have returned to profitability or shown improved profits following major rationalisation and restructuring.

4 In the competitive and depressed market which prevailed from 1979 onwards, many smaller component manufacturers went out of business. Austin Rover alone cut the number of its suppliers by half, to around 800, between 1981 and 1983. Management's increased reliance on single-sourcing and a further placing of contracts abroad has cut this number still further.

The major manufacturers have also been badly hit, despite having weathered the storm and survived. Both Lucas and Dunlop have undertaken major restructuring and have cut their work-forces significantly, Lucas Electrical by 22,000 since 1981. AE cut its workforce from 22,600 in 1980 to 14,800 in 1982, and Automotive Products from 11,500 in 1980 to 6,000 last year, with a further 1,000 redundancies to follow. These are considered the success stories.

The extent of rationalisation within the industry is illustrated by the fact that between 1980 and 1982 the numbers employed in the manufacture of metal components alone fell from 146,500 to 108,000, and gross output from £2.6 billion to £2.3 billion.(1) The Financial Times reported in May 1983 that 160,000 jobs had gone in all sectors of the component sector in the previous three years.(2)

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(1) Census of Production data.

(2) 26 May, 1983.

Orders from BL are of great significance in specific instances and can be crucial in justifying development or investment expenditure. For example, in April 1984 Austin Rover awarded a three year contract for the supply of wheels to Dunlop's Automotive Engineering Division at Coventry. Dunlop had argued that the contract was vital in its decision to go ahead with a £5 million investment programme to develop new modern wheel-making capacity. The company warned that without the contract the division might cease to be viable and between 700 and 1,200 jobs might be at risk.(1)

A recently published report has estimated that Austin Rover's top 38 suppliers in the West Midlands, respresenting some 80 per cent of its locally-made components supply and just under a third of Austin Rover's total UK supply, employed almost 52,000 in 1983, of which just over 17,000 were directly dependent on Austin Rover derived employment.(2) The report calculated that including jobs amongst other direct suppliers and indirect suppliers between 40,700 and 68,500 jobs in the West Midlands component industry depended on Austin Rover, a ratio of between 2.3:1 and 3.9:1 given Austin Rover's 17,600 employees in the region.

However, in an increasingly international market for vehicles, knocked-down kits and components, UK manufacturers must look to their international competitiveness for their future survival. The recent weakness of the pound, particularly against the other major European currencies, works in their favour, both in boosting exports to other European countries and resisting imports from their component suppliers.

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(1) Reported in the Financial Times, 10 and 11 April, 1984.

(2) The West Midlands Automobile Components Industry, West Midlands County Council, 1984, chapter 7.

The opening of Nissan's plant in Washington will open up new opportunities for component suppliers, particularly as Japanese manufacturers like to operate a 'just in time' sourcing policy with component suppliers sited close to their assembly plants. It has recently been rumoured that Honda may open a manufacturing plant at Swindon and if they go ahead this would create still further opportunities for the industry.

The upheavals within the industry are now largely over. The industry has emerged structurally healthier and in general less dependent than previously on BL or other UK manufacturers, though of course in specific regions strong industrial links remain. Larger suppliers have diversified their markets and their product ranges and small companies have begun to co-operate on cost-saving measures and marketing activities to increase their competitiveness. All companies now appreciate that picking winners in product development is crucial and the one outstanding worry remains the availability of finance for investment. BL will no doubt continue to buy British where it can, but component suppliers can expect few favours, and orders from BL alone cannot create a high volume industry.

Section 7 Conclusions, Prospects and Options

Conclusions and Options

It is now possible to review BL's performance in the last four years and to take appropriate decisions on its future on a more rational and less apocalyptic basis than in January 1981, when the only choice available was between further subsidy or liquidation. At that time Sir Keith Joseph is reported as having considered that two thirds of the business would have been irrecoverable in the event of closure. Fundamental to the Cabinet's dilemma was the belief that to allow BL to go down would send shock-waves through the components industry and suppliers in other sectors.

Four years later the decline in the component sector anticipated as a consequence of BL's demise has occurred regardless. BL remains a major force in UK manufacturing and a significant contributor to the visible trade balance. But, as the review of BL's recent performance in Section 3 demonstrates, BL's anticipated recovery, precarious enough until 1983, petered out in 1984 and in some parts of its business, notably in its Land Rover-Leyland division, performance has slipped badly below short-term forecasts made in the 1981 Corporate Plan.

BL's current financial position is not dissimilar to that prevailing in late 1980 and early 1981. The company is arguing that it will need funding to finance development of new product ranges and that its recent poor performance has left it unable to meet its future investment requirements from internally-generated sources. When new funding was approved in January 1981 it was built into future funds flow forecasts that from 1983 profits would begin to make a net contribution towards capital requirements.

The Government has already stated categorically that no further aid is available for BL, and in its statement accompanying the company's interim results for 1984 the board declared:-

> "In future BL's funding will be met from operating cashflow, proceeds from the return of constituent businesses to the private sector and from private borrowings."

Given BL's recent results and immediate prospects there is little likelihood that profits will contribute to funding requirements in the short term. The company now makes less generous provision for depreciation and amortisation than previously and this change will further deplete cash provision for investment. Furthermore, BL has expressed its reluctance to borrow funds from the market given current high real interest rates.

On the other hand, considerable success has been achieved at cutting overheads and introducing new and more efficient design techniques and manufacturing systems, albeit at great cost in provision for plant closures and redundancies. Austin Rover, for instance, now possesses the technology to manufacture as efficiently as most domestic or overseas competitors and its collaborative ventures with Honda have cut development costs, most importantly in developing new power-train and transmission units.

1985 is a crucial, perhaps even make or break, year for Austin Rover. Its future viability depends on meeting higher production and sales targets, and exploiting its new flexible manufacturing systems to match its competitors' unit costs and labour productivity. Austin Rover must increase its penetration of the domestic market, particularly in the fleet sector, and boost exports. With a new and competitive range and more favourable exchange rates, it is clear that if the company is ever to be viable now is the time it must begin to increase sales volume to the point where profits can be generated.

However, it is doubtful whether Austin Rover can survive a protracted or savage discounting war against Ford and GM. On present trends it appears inconceivable that worldwide sales can quickly be pushed above 1984's 425,000 towards the 600,000 to 650,000 estimated as necessary to achieve profitability.

Austin Rover has recently announced its intention to launch a major assault on the US market in 1987, led by the eagerly-awaited XX joint venture with Honda. But unless the company's sales improve significantly in 1985 and 1986 it may not be able to survive in its present form until 1987. Recent press reports suggest the Government is concerned that Austin Rover's proposed new model development programme, with its associated investment expenditure (perhaps £750 million over the next five years), may be over optimistic and that the company's sales and output targets may be unrealistically ambitious.

In the long term Austin Rover may be compelled to enter into more extensive collaboration with Honda or another foreign manufacturer in order to survive. It has recently been reported that Austin Rover will manufacture Honda transmissions under licence and may also assemble Honda cars for the European market using some of its surplus manufacturing capacity.

As yet neither Austin Rover nor Honda is prepared to concede that the possibility of Honda taking an equity stake is a serious option. Such a step would, however, offer attractive benefits for both partners. Both would benefit in areas of engineering expertise where the other has an advantage. Honda would gain a major foothold in the lucrative EEC volume car market, where it currently has only a limited presence. Austin Rover would secure the backing of a worldwide corporate organisation with extensive financial resources, and access to export markets at present out of its reach.

In the commercial vehicle sector prospects for BL's manufacturing divisions are variable and unpredictable. Leyland Vehicles is perched on the precipice, and in 1983 the division appeared technically insolvent on the basis of the accounts provided. Losses were reduced in 1984, but if the division were part of a private sector corporation of similar size it is inconceivable that it would still be trading in view of its recent performance.

Industry forecasts of the likely size of the truck and bus markets in the short term are not encouraging, and in the domestic and European markets Leyland will continue to meet stiff competition. GM has signalled its intention to seek further penetration of the European market and this alone is a major threat. According to Leyland's management, the division cannot return to profit until 1988 at the earliest, but even this target looks out of reach.

Land Rover's prospects are more encouraging, given its products' reputation for quality. Recent movements in exchange rates should help the division in its all-important export drive, but with the collapse of some Third World markets, competition elsewhere will be fiercer still.

Land Rover is currently restructuring its manufacturing operations, offering the hope of further reductions in costs and increases in productivity. The division returned a small profit in 1984 and restructuring should enable Land Rover to build on this turnround if overseas sales hold up.

Options

The most recent Government policy statement on BL, published in February 1985, imposes two clear objectives on the board. First,

> "to return BL and its constituent businesses, either together or separately, to the private sector as soon as practical",

and secondly, to reach a position of being able

> "to attract external funds on normal commercial terms without Government support".

The slump in BL's financial results in 1984, and uncertain prospects across all vehicle markets, effectively ends any hope of moving into the sustainable recovery phase envisaged in 1981, and therefore of privatising BL as a single entity. Furthermore, as the discussion of the relationship between BL and government in Sections 1 and 2 showed, differences in political and commercial judgements have in the past hindered the privatisation of the major constituent businesses within BL. The BL board has consistently argued that the premature sale of profitable businesses would damage the viability prospects of those operations which remain unprofitable.

It is now time to change policy towards BL, and to alter the basis on which decisions on the timing and phasing of privatisation are made. The only way in which the Government's ultimate objectives for BL can be achieved is to consider the future of each business group independently. Commercial and political decisions on the inherent viability of each of BL's existing manufacturing divisions, or its potential for privatisation, should no longer be allowed to impinge on similar decisions on the future of the remainder.

The main manufacturing divisions within BL - Austin Rover, Unipart, Land Rover and Leyland Vehicles - are already Companies Act companies and return separately audited accounts. It is the BL board's existing policy to encourage the development of each business group as an independent entity. However, while these remain wholly-owned subsidiaries of BL plc it is hard to see how the obstacles which have dogged the Government's efforts to return BL to private ownership can be overcome.

It is therefore desirable that BL plc be wound up and its assets vested in BL's three vehicle manufacturing divisions, each of which would be run as entirely independent concerns with separate boards of directors, management teams and capital structure. The Government should buy out the holdings of the remaining private shareholders at an appropriate price, leaving the Secretary of State for Trade and Industry as sole shareholder. UK and overseas subsidiaries could either be grouped within each of the manufacturing divisions where appropriate, sold off or established as separate companies in their own right where they would be viable.

Timing would be a matter of political judgement, but 31 December, 1986 might be an expedient date at which to terminate the activiteis of BL plc. This would permit the sale of Unipart to be completed and also allow both Land Rover and Leyland Vehicles to carry through their current restructuring plans and emerge in leaner commercial shape.

It is hard to see how disaggregation would harm the commercial prospects of the three separate companies. There are no discernible economies of scale across BL's current vehicle manufacturing operations, and in external purchasing of components or inter-company vehicle sales the separate companies or their subsidiaries could negotiate agreements according to normal commercial practice, just as Unipart has been doing with Austin Rover as a prerequisite for its return to private ownership.

In setting the capital structure for each company the Government should look to providing a balance sheet resembling that of private sector companies where this can be achieved. Thus, for example, Austin Rover's balance sheet could be restructured to convert, say, 80 per cent of the company's loans from BL plc into equity, with the company looking to the markets for 20 per cent of its capital and offering a repayment to government of this amount. If, however, Leyland Vehicles' latest results show that its revenues remain insufficient to meet its cash operating costs, and that it would be unable to service debt charges even at such a low debt to equity ratio, all its capital would need to be converted into equity.

Each company should submit separate plans, forecasts and targets to the deparment, avoiding the horse-trading currently involved in the consideration of BL's annual Corporate Plan, and making monitoring procedures more relevant to day-to-day management decision-making.

Where it is judged best in the commercial interests of the relevant company, decision on the timing and method of privatising would be arrived at by agreement between the Secretary of State and the board, without fear that any such decisions could impinge on the viability of another part of BL. Proceeds would go to the Government. It would be for the department, throught its monitoring procedures, to assess a company's short-term prospects and long-term chances of viability, and to recommend political options to the Secretary of State.

In making these assessments the views of the respective boards and of departmental officials should be supplemented by an independent review of the commercial prospects and potential market value of each company commissioned from management consultants or a merchant bank prior to the winding up of BL plc.

Such a review should set realistic financial and performance targets to give the Secretary of State a clearer basis on which to make more rigorous contingency plans on the future of each business than has thus far been possible. This process would also allow for the setting of a more definitive timetable within which given profitability targets are to be achieved or plans for privatisation formulated.

It would be easier, for example, to persuade Austin Rover that its future lies in a marriage with Honda rather than a casual affair. Both Land Rover and Leyland could be given clearly specified periods in which to return to profit and prepare for privatisation, with alternative options in readiness if the desired profits do not materialise.

Thus, if, for example, it were to be decided that in view of continued lasses Leyland Vehicles should be given notice that its time had run out, the Secretary of State would have the capacity to sell the division as a whole if a buyer could be found, or invite bids for any of its subsidiary businesses (the profitable Leyland Parts for example) where they could be salvaged.

In setting appropriate financial targets and a timescale which would allow each of the companies the best chance of achieving profitability and an eventual return to private ownership, the Government would in the interim be able to exercise greater flexibility in ensuring that future funding requirements are met from market borrowings. At present government effectively underwrites any commercial loans negotiated by BL. However, by winding up the holding company the Government would be in a position to rescind the Varley-Marshall assurances where the balance sheet and commercial prospects of the company would warrant it, but maintain the commitment longer where commercial loans could not be negotiated without it, as at present with Leyland Vehicles, if this is deemed desirable.

To sum up, there seems no reason why each of the main vehicle producing divisions of BL should not now stand on its own. BL's overall recovery strategy, as envisaged by Sir Michael Edwardes, has been blown off course. In February 1981 Sir Keith Joseph told the Industry and Trade Committee that:-

> "the taxpayer is locked in until the company makes a profit or is sold or liquidated".[1]

Liquidation is no longer a serious threat, at least for the bulk of BL's remaining operations. But if the Government is to give BL's main vehicle manufacturing divisions every chance of viability and at the same time make its political will a reality, it must take the disaggregation of the declining BL empire a stage further.

(1) HC 294, Q. 41.

DUTY CLERK

No 10

BL file

27582 CABOFF G

ATTN: A. TURNBULL (PRIVATE SECRETARY)

THIS INFORMATION SOURCE IS STRICTLY CONFIDENTIAL.

AS PART OF MY JAPANESE TOUR I TODAY MET THE SENIOR MANAGING DIRECTOR AND HIS STAFF OF OUR COMPANY. IN OUR DISCUSSION HE MENTIONED THAT OUR COMPANIES SIZE 3-5-6 ARE SO WELL DEVELOPED AS NOT TO NEED ANY FURTHER MAJOR DEVELOPMENT. MY COMPANY IS GOING TO MANUFACTURE THE SIZE 3,5 AND 6 AT S.

THE SIZE 3,5 AND 6 WOULD MEET ALL THE EUROPEAN STANDARDS AND HAVE A FULLY COMPETITIVE PERFORMANCE. IT IS ESSENTIAL THAT THIS IS SO SINCE THESE WILL BE INCORPORATED IN OUR PRODUCTS. (!) 90 PERCENT OF OUR PRODUCTS ARE FOR EXPORT.

THE SENIOR MD OF MY COMPANY HOPES THAT YOUR COMPANY WILL PURCHASE SIZE 3-5-6 BEYOND CURRENT CONTRACTUAL AGREEMENT.

THE INITIAL OBJECTIVES OF MY COMPANY WAS TO DEVELOP FACILITIES FOR C-B-1 AND 3-5-6 AT S. YOUR COMPANY PROTESTED AND SUGGESTED THAT THEY WERE UPDATING ASSEMBLY FACILITIES AND THERE WAS NO NEED TO HAVE MY OWN FACILITY FOR C-B-1 AT S.

KMR

CENHYATT J29411
27582 CABOFF G

SECRET

File
BF / ~~SCAT~~ on 23/5

MR TURNBULL

14 May 1985

PRIVATISATION - LAND ROVER LEYLAND

DTI believe the GM negotiations are proceeding satisfactorily and anticipate that by the end of the month GM should have a fair idea of the sort of restructuring they want, and therefore whether they wish to proceed to full commercial negotiations. Their interest in Land Rover and Leyland Trucks seems strong, but is less so for Leyland Bus and perhaps Freight Rover.

GM were originally expected to have made up their minds by the middle of this month; the DTI forecast for the end of the month may yet prove optimistic. Until GM have made their decision DTI are not considering alternative bids for the constituent businesses (despite Private Secretary letters from both the Prime Minister and the Financial Secretary two months ago requesting them to do so). There are a number of bids around - at least two for Land Rover, one for Leyland Bus, one for Ashok Leyland in India, and other bidders who have been turned away or would bid if they thought the businesses were genuinely for sale. Meanwhile, GM appear to be continuing their discussions with MAN, DAF, ENASA (and Seddon Atkinson) to name the few we know.

Clearly, nothing must be done to frighten off GM or to make them believe that the Government is dealing behind their backs. But they have been given a good clear run and it is time that others were allowed in - both to keep GM honest, and to act as a fall-back should they only want some of the businesses, or indeed drop out altogether. Proper negotiations should start with all other interested parties as from 1 June.

Peter Warry

PETER WARRY

SECRET

FT: 11 May 85

BC

UK N

Ex-director attacks state policy on Austin Rover

BY JOHN GRIFFITHS

A SCATHING attack on the Government's attitude towards Austin Rover and the UK car industry has been made by Mr Brian Fox, the company's former director of vehicle manufacturing, who left Austin Rover about 10 days ago, it was disclosed yesterday.

Mr Fox said that he had not resigned from Austin Rover as a direct protest against the Government's insistence on £250m cuts in BL's proposed 1985 corporate plan, but disillusionment with the Government's attitude and its encouragement of Japanese car makers into the UK had been a significant factor.

Mr Fox, 47, who had been with Austin Rover for 12 years, said that he was leaving the motor industry altogether. He had several offers of jobs.

He described the Government's attitude as horrific and claimed that Austin Rover's success, first instituted by Sir Michael Edwardes, had proved an embarrassment to the Government.

"They wanted the company to grovel, to turn out as a lame duck so that they could shut it down and the population could heave a sigh of relief and cheer the Government for doing so. It hasn't happened," Mr Fox said.

"The company is a success and has a good future. I believe it should warrant the Government's support, and that isn't happening." It was "ludicrous to allow the Japanese to set up plants in the UK. It's like a fighter letting his opponent limber up in his own back yard, knowing that he's going to get punched on the nose."

The corporate plan was a sensible business strategy for the next five years. The Government should evaluate it as a business plan and ensure that whatever funding was needed was made available.

He was not opposed to collaboration with the Japanese, as had already occurred between Austin Rover and Honda, but it was extremely short-sighted of the Government to resist the company's planned £250m investment in a new small engine range, the K series, to preserve Austin Rover's engineering integrity, particularly when Continental governments were lending substantial support to their own car industries.

UP TO 11,000 West Midlands motor industry jobs could be lost if the Government refuses BL's plan to develop a new car engine and gearbox, Mr Dan Jones, senior research fellow at Sussex University's Science Policy Unit, said yesterday.

If the Government insisted BL's Austin Rover lopped £250m from its investment budget and the engine development went to Honda of Japan instead "that would tear the heart out of the business. Austin Rover would cease to be a major car maker. It would be a national disaster," Mr Jones told a West Midlands County Council seminar on industrial decline.

However, if Austin Rover achieved a vehicle output of 550,000 by 1988, West Midlands could expect a net gain of 3,500 jobs even if the proportion of imported components in the car rose from the current level

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CC PM,

1. CDP
2 NBPM

AT 8/5

PM/85/43

PRIME MINISTER

Leyland Buses: Bangkok

1. I have seen a copy of your Private Secretary's letter of 7 May recording the outcome of your discussion with Norman Tebbit and Peter Rees on this subject yesterday.

2. I share Peter Rees's concern that we should not break ranks on the OECD consensus. It is in our interest to support this and work to improve international discipline in the use of subsidised credit.

3. I accept too that we must do all we can to support UK firms as effectively as other governments. I am therefore ready to agree that we should be prepared to match the Belgian offer by finding up to £21 million from the Aid and Trade Provision. Our offer should be made in terms which do not leave us open to a charge of having broken the OECD consensus. I am, however, very doubtful whether significant amounts of aid should be made available to the Thais beyond that if they try to play OECD countries off against each other. For the moment we should certainly take the position with all the parties concerned that there should be no question of further aid.

4. I am copying this to Norman Tebbit and Peter Rees.

GEOFFREY HOWE

Foreign and Commonwealth Office

8 May, 1985

CONFIDENTIAL

IND. POL: BL: PT 9.

9 MAY 1985

CONFIDENTIAL

File

cc Mr Warry

CC Master

SRW AAK

10 DOWNING STREET

From the Private Secretary

7 May 1985

LEYLAND BUS : BANGKOK

Following the meeting of OD today the Prime Minister discussed this case with your Secretary of State and the Chief Secretary. The Prime Minister said that following the difficulties with Westland in India and the loss of the Bosphorus Bridge contract she was concerned at the way Britain was failing to clinch major export deals with important job opportunities for this country. Your Secretary of State said the SALTON negotiations would be influenced by the extent to which the Government was seen to be backing BL in pursuit of export orders. The Chief Secretary urged that the Government should not break ranks on the OECD consensus. Not only would this weaken the Government's position in confronting the Japanese and others but it was not clear that Britain would benefit in the long run from competing against other countries with a longer purse.

Following a brief discussion, it was agreed that the Government should be prepared to offer £21 million if that was necessary to secure the first £80 million of the project. The Thais should be told that this was being offered on the assumption that the rest of the project would be unaided and that BL would be awarded a substantial proportion of it. However, it would be understood between Ministers that the option of offering aid for later parts of the project should not be closed off. This offer should be made quickly in order to ensure that there was no risk of losing the project through delay on the part of the Government.

I am copying this letter to Peter Ricketts (Foreign and Commonwealth Office), Rachel Lomax (HM Treasury), Richard Broadbent (HM Treasury) and Michael McCulloch (Foreign and Commonwealth Office).

ANDREW TURNBULL

John Mogg Esq
Department of Trade and Industry

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SRW

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Mr. Turnbull
[illegible]
Economic Affairs PS
No 10 D.St.

CONFIDENTIAL

FM BANGKOK 051400Z MAY 85

D E S K B Y 060900Z MAY 85

TO IMMEDIATE F C O (FOR RESIDENT CLERK)
[TELNO u/n OF 5 MAY]
INFO PRIORITY ECGD

YOUR TELNO 090 (NOT COPIED TO ECGD) : LEYLAND BUS

GRATEFUL YOU PASS FOLLOWING TO PEP1, DTI.

1. WE FIND YOUR PROPOSAL INGENIOUS BUT HAVE SOME DOUBT ABOUT WHETHER IT WOULD WORK IN PRACTICE.

2. TO TAKE YOUR POINTS SERIATIM:

A) LEYLAND HAVE DONE WELL TO GET THIS FAR. HOWEVER WE CANNOT YET BE CONFIDENT THAT THEY WILL SECURE THE PROJECT AS CURRENTLY ENVISAGED, SINCE:-

1) THEIR PROPOSALS HAVE STILL TO BE PUT TO THE COMMUNICATIONS MINISTRY FOR ENDORSEMENT. ALTHOUGH MINISTER SAMAK IS AWARE OF THEM AND MAY WELL GIVE THEMFA SMOOTH PASSAGE, HE MAY EQUALLY REVERT TO THE IDEA, WHICH HE MENTIONED SOME MONTHS AGO IN DISCUSSION WITH ME, OF SHARING THE CONTRACT BETWEEN THE TWO LEADING CONTENDERS (THOUGH IT IS DIFFICULT TO SEE HOW THIS COULD BE ARRANGED).

11) WE CANNOT ASSUME THAT AT THIS JUNTURE THE CABINET WILL AGREE TO SO LARGE A PROJECT INCLUDING A SUBSTANTIAL FOREIGN EXCHANGE COMPONENT, SOMMAI IN PARTICULAR MAY OPPOSE IT (THERE HAVE ALREADY BEEN INDICATIONS OF THIS), ON THE GROUNDS THAT IT WOULD INCREASE THAILAND'S OVERSEAS DEBT SERVICE RATIO AT A TIME WHEN THE GOVERNMENT IS TRYING TO HOLD IT DOWN AND THAT IS EVEN IF HE ACCEPTS THAT THE BMTA'S OPERATION SHOULD BE REHABILITATED, THERE ARE CHEAPER (ALTHOUGH ARGUABLY LESS EFFECTIVE) OPTIONS. IN CONSIDERING THIS ISSUE, SOMMAI'S JUDGEMENT COULD BE INFLUENCED BY PERSONAL CONSIDERATIONS I.E. HIS PRO-JAPANESE STANCE AND HIS, AT TIMES STORMY, RELATIONSHIP WITH SAMAK.

111) EVEN IF LEYLAND'S PROPOSALS ARE APPROVED BY CABINET, THE THAIS COULD ON PAST FORM ENGINEER A DUTCH AUCTION IN THE HARD BARGAINING WHICH WOULD FOLLOW, LEAVING LEYLAND WITH A VERY MUCH SMALLER (IF ANY) SLICE OF THE CAKE.

/ (X)

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1V) LEYLAND MAY BE BEING USED AS A STALKING HORSE.

B) WITH THE EXCEPTION OF THE DEFENCE AND SECURITY FIELDS, THE THAI GOVERNMENT AND BUREAUCRACY DO NOT HAVE A GOOD REPUTATION FOR KEEPING SECRETS. THE GOVERNMENT WOULD INEVITABLY HAVE TO REVEAL DETAILS OF ANY CONFIDENTIAL UNDERSTANDING WITH HMG TO A NUMBER OF INTERESTED DEPARTMENTS (INCLUDING COMMUNICATIONS, FINANCE, NATIONAL ECONOMIC AND SOCIAL DEVELOPMENT BOARD AND THE PM'S OFFICE), AS WELL AS THE BMTA ITSELF. EXPERIENCE SUGGESTS THAT IT COULD NOT REMAIN CONFIDENTIAL FOR LONG. THE BMTA IN PARTICULAR WOULD BE ALMOST CERTAIN TO LEAK IT: IN THIS CONTEXT, SEE PARAGRAPH 3 BELOW.

C) AS ALREADY REPORTED IN BANGKOK TELNO OTTER 119, LEYLAND HAVE TOLD US THAT ONLY THE QUESTION OF AID REMAINS OUTSTANDING IN THEIR DISCUSSIONS WITH THE BMTA EVALUATION COMMITTEE. WE HAVE NO REASON TO DISBELIEVE THEM. CLEARLY THERE MUST BE A LIMIT TO THE NUMBER OF OCCASIONS ON WHICH THE COMMITTEE IS WILLING TO MEET ON THIS ISSUE AND COME AWAY EMPTY-HANDED. IN OUR JUDGEMENT UNLESS A FIRM AID OFFER IS MADE WITHIN THE NEXT FEW DAYS, THERE WILL BE A REAL DANGER OF THE COMMITTEE LOSING PATIENCE WITH THE UK SIDE AND MOVING ON THE THE NEXT CONTENDER.

V3. SATURDAY'S BANGKOK NATION REPORTED, UNDER THE HEADLINE '' LEYLAND WINS BMTA 'DEAL', THAT WELL INFORMED SOURCES (PROBABLY PICHATE) HAD INDICATED THAT THE BMTA HAD DECIDED TO AWARD THE CONTRACT FOR RESTRUCTURING THE AUTHORITY TO THE LEYLAND CONSORTIUM. THE ARTICLE READS, IN PART: ''IT WAS AGREED YESTERDAY THAT ABOUT BAHT 11 BILLION WOULD BE REQUIRED FOR THE RESTRUCTURING PART OF WHICH WILL COME AS A GRANT FROM THE BRITISH GOVERNMENT. THE GRANT INCLUDES BAHT 300 MILLIO FOR CONSULTANCY AND 2 YEARS OF SPARE PARTS FREE OF CHARGE. LEYLAND WILL PROVIDE A BAHT 300 MILLION GUARANTEE FOR ACQUISITION OF LAND FOR MAINTENANCE AND DEPOT FACILITIES. THE SOURCES SAID THAT THE BAHT 11 BILLION WILL COME FROM FINANCING SUPPORTED BY THE EXPORT CREDITS GUARANTEE DEPARTMENT OF THE BRITISH GOVERNMENT. THE FACILITY WILL CARRY 9 PER CENT INTEREST PER ANNUM AND A REPAYMENT PERIOD OF 10 YEARS''.

4. AS THE AID INPUT OF BAHT 300 MILLION WHICH IS QUOTED ABOVE IS VERY CLOSE TO THE £10 MILLION WHICH YOU PREVIOUSLY HAD UNDER CONSIDERATION, IT WOULD APPEAR THAT LEYLAND HAVE, DESPITE WHAT THEY HAVE BEEN SAYING TO US, INFORMED THE EVALUATION COMMITTEE THAT THAT AMMOUNT AT LEAST IS LIKELY TO BE OFFERED. HOWEVER THAT MAY BE, I DO NOT BELIEVE THAT AN OFFER OF THAT AMOUNT AT THIS STAGE WILL BE ENOUGH TO CLINCH THE DEAL. ESPECIALLY IN THE LIGHT OF THE LATEST BELGIAN POSITION, THIS WOULD AT BEST BE LIKELY TO STIMULATE THE THAIS TO HOLD OUT FOR MORE,

AND COULD WELL CAUSE THEM TO MOVE ON TO NEGOTIATIONS WITH A RIVAL CONTENDER. IN MY JUDGEMENT, IF WE WANT LEYLAND TO STAY IN THE RACE, WE MUST BE PREPARED TO PUT UP AN OFFER IN THE REGION OF £20 MILLION. AS (FOR THE REASONS GIVEN IN PARA 2B. ABOVE) IT WOULD BE UNWISE TO SEEK THE SORT OF CONFIDENTIAL DEAL YOU HAVE SUGGESTED, I BELIEVE THAT WE MUST ALSO BE PREPARED TO ACCEPT THAT LEYLAND WOULD NOT NECESSARILY SECURE THE ENTIRE DEAL IN RETURN FOR OUR £20 MILLION: THEY SHOULD AT LEAST HOWEVER (IF THE DEAL DOES INDEED GO AHEAD) GET A SUFFICIENTLY SUBSTANTIAL SLICE TO MAKE AN OFFER OF THIS SIZE WORTH WHILE.

STAPLES

LIMITED	COPIES TO:-
SEAD	PS/S OF S DTI
TRED ← ODA	PS/NO 10 DOWNING ST.
PS	PS/CHANCELLOR OF EXCHEQUER
MR MAUD	CHIEF SEC OF TREASURY
MR WILSON	ECGD
	PEP1 DTI

①

PRIME MINISTER

Mr. Tebbit seeks agreement to matching the Belgian offer, breaking the OECD rules if necessary.

Treasury raise no objection to the extra aid (£21 million over three years), nor to the exhaustion of ECGD cover as Thailand is a good enough risk to justify a higher ceiling. But they oppose putting ourselves in the wrong with OECD.

However, they believe that with the help and connivance of the Thais a matching counter offer can be made which maintains the appearance of adhering to the consensus. The Bangkok Embassy is being asked for advice - see attached telegram.

(i) Agree a matching offer if Bangkok advise the risk of exposure can be taken? Yes

(ii) If there is a risk of exposure reconsider in margins of OD on Tuesday morning?

Yes mt

AT

(ANDREW TURNBULL)

3 May 1985

DD 040200Z BANGKOK
GRS 336
CONFIDENTIAL
DESKBY 040200Z
FM FCO 032132Z MAY 85
TO IMMEDIATE BANGKOK
TELEGRAM NUMBER 90 OF 3 MAY
FROM RESIDENT CLERK

LEYLAND BUSES

FOLLOWING MIPT OFFICIALS HAVE BEEN CONSIDERING A POSSIBLE ARRANGEMENT WHICH MIGHT SECURE THE THAI DEAL. THE BASIS OF THIS ARRANGEMENT WILL BE PUT TO MINISTERS OVER THE WEEKEND. YOUR ADVICE IS THEREFORE URGENTLY SOUGHT.

HMG COULD MAKE AN AID OFFER TO THE THAIS WHICH MATCHED THE SUBSIDY ELEMENT OF WHAT WE BELIEVE THE BELGIANS ARE OFFERING. PUBLICLY, THE OFFER WOULD INVOLVE AN ATP GRANT OF SOME POUNDS STERLING 21 MILLIONS AGAINST A CONTRACT WORTH POUNDS STERLING 80 MILLION. BUT OUR OFFER WOULD BE CONDITIONAL ON THE THAIS EFFECTIVELY COMMITTING THEMSELVES TO AN AGREEMENT THAT THE POUNDS STERLING 370 MILLION BALANCE WOULD BE AWARDED TO LEYLAND AS A SEPARATE CONTRACT, OR CONTRACTS, ON NO-AID TERMS. THUS, IN EFFECT, OUR POUNDS STERLING 21 MILLION AID WOULD NEED TO SECURE THE ENTIRE POUNDS STERLING 450 MILLION BUSINESS.

THE OFFER HAS TO BE STRUCTURED IN THIS WAY IF WE ARE TO AVOID BREAKING OECD ASSOCIATED FINANCE RULES WHICH DEMAND A MINIMUM 25 PER CENT SUBSIDY LEVEL. IT ALSO HAS TO BE ON THE STRICT UNDERSTANDING THAT THE CONDITIONAL LINKING OF CONTRACTS REMAINS CONFIDENTIAL BETWEEN HMG AND THE THAI GOVERNMENTS SINCE SUCH LINKING IS CONTRARY TO OECD RULES.

OUR PROPOSAL MIGHT ALLOW THE THAIS OPPORTUNITY TO TRY TO POCKET THE POUNDS STERLING 21 MILLION IN EXCHANGE FOR ONLY AN

POUNDS STERLING 80 MILLION CONTRACT. THEY MIGHT ALSO CHOOSE TO LEAK THE UNDERSTANDING AS A MEANS OF FURTHER ERODING THE NO-AID AGREEMENT AND HOPE THEREBY TO OPEN UP AN INTERNATIONAL AID AUCTION.

WE WOULD THUS BE GRATEFUL FOR YOUR URGENT ADVICE NO LATER THAN MONDAY, 6 MAY 18.00Z:-

1. WHETHER A DEAL ALONG THE LINES IN PARA 2 MIGHT CLINCH THE BUSINESS,

2. WOULD THE THAIS RESPECT ABSOLUTE CONFIDENTIALITY OF THE UNDERSTANDING, AND

3. YOUR BEST JUDGEMENT OF THE TRUE DEADLINE BEYOND WHICH LEYLAND MIGHT LOSE THEIR LEAD POSITION

YOU SHOULD NOT CONSULT EITHER THE LEYLAND REPRESENTATIVES OR THE THAI GOVERNMENT.

HOWE

NNNN

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MR MAUD
DR WILSON
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cc 10

CONFIDENTIAL

5510

JU396

PRIME MINISTER

LEYLAND BUS: BANGKOK

Since my minute of 1 May, we now have more information about Belgian financing intentions on the £450m Bangkok bus project. On the assumption that the project will be divided into phases, the Belgian official agencies are - as a result of their Prime Minister's offer in Bangkok - offering a subsidy equivalent to £21m towards a contract worth approximately £80m. This represents a subsidy level of about 26%.

The Belgians have quite clearly broken the no-aid agreement. However, if one accepts their assumption that the project will be broken down into phases, their proposed offer is framed so that it falls within the OECD rules on levels of subsidy. In short, it could be portrayed as being consistent with the international guidelines on associated financing.

With the Belgian offer in the background, the Thais are pressing hard for an offer of aid from HMG. If none is forthcoming, they threaten to abandon the Leyland bid and begin negotiations with others, notably the Belgians. Having been selected as the favoured bidder and called in for substantive negotiations before submission of recommendations to the Thai Cabinet, Leyland are in a vulnerable position. If they fail to satisfy the evaluation committee on aid and are knocked out of the running at this stage, the Thais could well not recall them for negotiations for even a part of the full £450m contract.

This situation poses an awkward dilemma. An aid grant within the OECD rules for a project of this size would be prohibitively large - £112m. This is not a realistic option against a total ATP budget of £66m per annum. We are therefore left with two choices. We could refuse aid (apart from a minimal $1 million for technical co-operation) and rely on any further price cuts Leyland may be able to make to clinch the contract. Or we can match the £21m amount over three years (but not the subsidy level) of the proposed Belgian offer. The latter would involve breaking the OECD rules on mixed credits.

If we refuse to back Leyland with the £21m aid, there is a real risk that they will lose all the business. As you know the order is highly significant, being large enough to have a substantial impact on Leyland Bus's prospects over the next few years. In particular I believe that it would substantially enhance the chances of early privatisation of the company, whether through SALTON negotiations or otherwise. In the circumstances I do not think we can stand by and risk Leyland losing this contract due to the unscrupulousness of competition. By providing matching aid I realise that we would stand accused of breaching the OECD guidelines, but I believe our action would be defensible considering the behaviour of the Belgians in breaking the no-aid agreement. Certainly I would rate any OECD opprobrium a great deal less than the domestic political difficulties, particularly so soon after the Bosphorus bridge, which we would face if Leyland were seen to have lost this contract because of our continued determination - despite the Belgians - to 'play cricket'.

I am therefore writing to seek colleagues' urgent agreement to the following support for Leyland involving:-

i a matching ATP offer of £21m; and

ii effective exhaustion of the present ECGD Section 2 cover for Thailand in order to accommodate the project.

To be absolutely sure of not risking Leyland's position this offer should be conveyed to our Bangkok Post before Monday, 6 May. I would therefore welcome agreement as soon as possible today.

I am copying this minute to Geoffrey Howe, Nigel Lawson, Peter Rees and Timothy Raison.

NT

N T

3 May 1985

Department of Trade & Industry

Ind. Pol. : BL 179.

cc AT

FROM:CHIEF SECRETARY
DATE: 3 May 1985

PRIME MINISTER

File with AT

LEYLAND BUSES: BANGKOK

I have seen Norman Tebbit's 1/5. minute to you today on the contract on which I have the following comments.

2 I agree with Norman that an ATP offer of £112 million is not an option. Indeed I am doubtful whther we need to make any offer of aid at this stage. With Leyland clearly in the lead for this business there is still a very good chance that they will win it without aid. Even more so if they can be persuaded to reduce their price so as effectively to match what the Belgians are said to be offering.

3 Regrettable though the Belgian conduct is in resiling from the no - aid agreement - and I hope we will protest to them about it - it is a much more serious matter for us to break the OECD rules - which the Belgians are not doing.

4 We have as you know just managed to agree new tighter rules for the use of mixed credits in OECD and there are good prospects for further improvements. The UK has been very much in the lead in this and our international position would become very difficult if we were now to so clearly go against what we have been fighting for. Moreover it will weaken our position in complaining about the Bosphorus Bridge case in which the Japanese did not break the OECD rules, while at the same time breaking the rules ourselves.

5 If Norman Tebbit is convinced that doing nothing will put the contract at risk, I think we could overcome the problem by simply matching the Belgian offer. We could tell the Thais formally that if the Belgians do make an offer for part of the contract and the Thais decide that they wish to split the contract which they would have to do to entertain the Belgian offer, then we would match the Belgian offer on £80 million worth of the business. This could be done within the international rules and would leave the rest of the order open to commercial competition in which Leyland would have every prospect of winning.

6 I am copying this minute to Geoffrey Howe, Norman Tebbit and Timothy Raison.

for PETER REES

[Approved by the Chief Secretary]

IND. POL: BL: Pt 9.

balance would be awarded to Leyland as a separate contract or contracts, on no-aid terms. Thus, in effect, our £21 million aid would need to secure the entire £450 million business.

The offer has to be structured in this way if we are to avoid breaking OECD associated finance rules which demand a 25 per cent subsidy level. It also has to be under strict understanding that the conditional linking of contracts remains confidential between HMG and the Thai Government, since such linking is contrary to OECD rules.

Our proposal might allow the Thais opportunity to try to pocket the £21 million in exchange for only an £80 million contract. They might also choose to leak the understanding as a means of further eroding the no-aid agreement and hope thereby to open up an international aid auction.

We would thus be grateful for your urgent advice no later than Monday 6 May 1800Z, whether:

(i) a deal in para 2 might clinch the business;

(ii) the Thais would respect absolute confidentiality of the understanding; and whether

(iii) an offer is needed urgently if Leyland are not to lose their position.

NOTHING TO BE WRITTEN IN THIS MARGIN

MR TURNBULL 3 May 1985

BANGKOK ORDER FOR LEYLAND BUS

Last year Leyland Bus lost £14 million before interest and tax on a turnover of £107 million. Without the Bangkok order the prospects are grim and the business should really be broken up. The Bangkok order, at the right price, would transform the business - it would double the number of buses sold in 1984. The worst situation would be if Leyland Bus secured merely the first year of the Bangkok order at a punitive price. This would lumber the State with a doubly subsidised loss-maker but prevent it from taking the action necessary to remedy the position.

We believe the aid should be provided but on the following conditions:

1. That there is an acceptable level of proof that the Belgians have breached the International Aid Agreement.

2. That the £21 million only be offered in support of a full five-year contract and not otherwise.

3. That the price to Leyland Bus is no worse than break-even on a fully accounted basis. (The Bangkok order doubles the current level of Leyland Bus output and cannot therefore be costed on a short-term marginal basis).

4. That on the receipt of the order BL immediately place Leyland Bus for sale as a separate entity unless the Salton negotiations have already produced a more favourable outcome.

Peter Warry

PETER WARRY

OO.

1. CDP ✓ CDP 1/5

2. Prime Minister (2)

AT 1/5

cc JR

COMMERCIAL IN CONFIDENCE

PRIME MINISTER

mo

LEYLAND BUS : BANGKOK

A Leyland consortium is the leading short listed leader for a £450m contract, involving predominently Leyland content, to modernise the Bangkok bus network notably by the supply of 4,500 new vehicles. After technical and financial adjudication, the Thai evaluation committee assessing bids has put Leyland ahead of its main French, Belgian, Spanish and joint Korean/Japanese competition. It is having further discussions with the UK group before making its recommendations, now expected in the next month.

2 For Leyland Bus, the contract is of crucial importance. It is by far the biggest single prospect in their sights and could transform their results over the next few years. Beyond that, requirements for replacements and spares would run well into the 1990s. Moreover an order of this size in

JH3BRC

Bangkok would be a first class advertisement in the potentially lucrative Asean region.

3 Bidding for the project, has been the subject of a no-aid agreement between the OECD countries involved. The Leyland consortium achieved its lead position on the strength of its own proposals and, so far, has been resisting Thai pressure for aid to help clinch the deal. However the Belgian Prime Minister appears to have broken the no-aid agreement during a visit to Thailand last week. He was reported as making a soft loan/aid offer. These press reports were subsequently confirmed by the Belgian Embassy in Thailand: we are urgently seeking details from Brussels. There have also been rumours that the French, who instigated the no-aid agreement, and the Spanish are contemplating similar offers.

4 If, as seems likely, the reported Belgian offer is confirmed and constitutes a breach of the no-aid agreement, I am sure that we should be prepared to respond promptly and positively to protect Leyland's position, achieved within the rules and on its own merits. It is also important to do

COMMERCIAL IN CONFIDENCE

so if no-aid agreements are to remain a credible means of halting the escalating use of "mixed credits".

5 My purpose at this stage is simply to alert you and colleagues to an issue on which we may soon have to take urgent decisions. I am therefore copying this to Geoffrey Howe, Nigel Lawson and Timothy Raison.

NT

N T

1 May 1985

Department of Trade & Industry

JH3BRC

999-49

-1 MAY 1985

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CONFIDENTIAL

cc PW

Prime Minister ②

To note

AT 25/4

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

JF7955A

PS/ Secretary of State for Trade and Industry

25 April 1985

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Dear Andrew,

The Prime Minister might like to know that Ray Horrocks today resigned from the Board of Jaguar plc. There were policy differences between him and Mr Egan, and he therefore thought it right to step down. Jaguar propose to agree a low-key statement with Mr Horrocks which will simply announce his resignation and thank him for his contribution to the work of the Board. The statement will be issued tomorrow.

Yours ever

John Mogg

J F MOGG
Private Secretary

991-1

E.R.

File

(2)

PRIME MINISTER AT 19/4

The ruse for seeing Professor Bhattacharya - inviting him to the lunch for the Finnish Prime Minister and getting him to stay on afterwards - will not work. It is a dinner and not a lunch and is preceded by talks. Also 21 May may be too late.

An alternative might be to send Peter Warry to see Professor Bhattacharya. Peter could prepare a report on the Professor's views, particularly on the implications of collaboration with Honda. Having seen the report you could decide whether you needed to see the Professor yourself. The optimum time for this would be after Mr. Tebbit has circulated his paper on BL, promised for week beginning 13 May, and discussion with Ministers, scheduled for following week.

Agree Peter Warry seek Professor Bhattacharya's views in first instance, with possibility of meeting kept open?

AT

I ~~don't~~ think this would put the Professor in a difficult position.

MT

19 April 1985

10 DOWNING STREET

Prime Minister (2)

we have not yet tracked down a copy of Sir Austin Bide's terms of reference, but hope to do so shortly. However, the attached extract from a Treasury paper on privatisation indicates that the objective was as at X. Only one group, Jaguar, has been sold.

AT

19/4

Thank you

File (BL)

C1

SECTION C: FUTURE PRIVATISATIONS

1. BL

Department	**Department of Trade and Industry**
Responsible Minister	**Mr Tebbit**
Responsible Treasury Official	**Mr Lovell**
Responsible Dept Official	**Mr Lingard**

Key Statistics	Turnover	£3421M	1983
	Manpower	101,000 (UK 80,000)	1983
	CCA Loss	£213M	1983
	Net Assets	£1036M	1983
	Public Expenditure Cost:	£520M	1981-82
		£370M	1982-83
		£90M	1983-84

Decision in principle to privatise all or part. "Visible progress" required towards privatisation within 2 years (August 1982). This is defined as sale of or advanced preparations for the sale of at least 2 of the 5 BL groups by August 1984.

Restructuring necessary Yes

Legislation needed No

Regulation needed post-privatisation No

Advisers. BL appointed Hill Samuel to act for them in preparing Jaguar and Unipart for sale.

Capital structure post-privatisation agreed No

Personnel policies agreed No

Me... d of sale In August, Unipart acquired Edmunds Walker for £15 million as a prelude to privatisation. Assuming no problems on assimilation, the target date for privatisation is mid 1985. Disposal will be by placement or flotation.

Employee involvement Not decided.

Likely timing of sale Unipart - mid 1985

Likely receipts Unipart - £75-100M

Public position Privatisation of BL expected within this Parliament by stages. As component businesses are restored to viability they will be disposed of.

Summary of current position

Of the other businesses: the BL Board have proposed privatisation of Land Rovers/Leyland Vehicles as a single business. The Government has indicated that it doubts whether privatisation of Land Rover/Leyland Vehicles as a whole will be feasible within an acceptable timescale. Exploratory discussions will shortly be taking place to establish whether there is a case for rationalisation of the UK commercial vehicle sector involving BL and Ford or GM. In the meantime BL have been asked to prepare options for the separate disposal of Land Rover and Leyland Bus, with assessments of the consequences of disposal for other parts of BL. The three month time limit set by the PM for the conduct of the Land Rover study has been exceeded; it now looks unlikely that the results of the study will be available much before the 1985 BL Corporate Plan. On Austin Rover, the BL Board have been asked to present in the 1985 Corporate Plan a consideration of the options for improving the prospects of privatisation earlier than is now foreseen, with the object of identifying privatisation prospects in 1987.

Disposal receipts from the sale of BL's component companies will not be paid to HMG but will be retained by BL to finance the remainder of the Group. This will allow BL to be independent of HMG equity after 1983-84.

Action expected during third quarter 1984-85

Unipart to assimilate EW. BL Board to prepare 1985 Corporate Plan, and complete separate studies.

DI

Austin Rover
Jaguar
Unipart
Trucks
Buses

14 September 1984

ds

c X/O

PW

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

JU310
Secretary of State for Trade and Industry

17 April 1985

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COMMERCIAL IN CONFIDENCE

Robin Butler Esq
Principal Private Secretary
to the Prime Minister
10 Downing Street
London SW1

c. Mr. Warry

Note DTI working towards an E(A) paper though a meeting with PM may be needed en route.

AT 18/4

Mr. Turnbull

NBPM, I suggest.
But you might discuss with DTI whether they envisage taking this through E(A) or some smaller group.

FERB 18.4.

Dear ~~Robin~~,

BL: CORPORATE PLAN

Following the meetings between the Prime Minister and my Secretary of State on 1 and 3 April you will wish to know of the timetable which has been established for the further work on the Austin Rover Plan which the Prime Minister commissioned.

Austin Rover are preparing urgently an assessment of the options for reducing their capital expenditure budget by £250m over the Plan period, and of the effects of the proposed collaborative deal with Honda. The analysis will be considered by the BL Board at its meeting on 25 April and will be submitted to the Government immediately thereafter. Officials here and in the Policy Unit and in the Treasury will then assess BL's response urgently with the objective of circulating a Ministerial paper in the week commencing 13 May for decision in the week commencing 20 May. BL believe that they have a reasonably good chance of keeping Honda on the hook until then, but that the risk of losing them increases sharply thereafter.

I am sending copies of this letter to Rachel Lomax (HM Treasury) and Richard Hatfield (Cabinet Office).

Yours ever

John Mogg

JOHN MOGG
Private Secretary

18 APR 1985

Confirmation Copy.

BL File.

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AAAA
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FM CABINET OFFICE LONDON
TO AIRBORNE O IMMEDIATE
BT
CONFIDENTIAL
AIRBORNE 003
FROM ADDISON TO BUTLER, PRIME MINISTER'S PARTY.

STERLING CLOSED IN LONDON AT DOLLARS 1.1940 (DOWN FROM 1.2050 AT TODAY'S OPENING):
AT DM 3.7862 (DOWN FROM 3.7982).
THE STERLING INDEX CLOSED AT 76.3 (DOWN FROM 76.7).
THE 3 MONTH INTER-BANK RATE CLOSED AT 13 AND FIVE SIXTEENTHS.
CURRENT (2045 HOURS GMT +1) DOLLAR RATE 1.2010:
DOLLAR/DM RATE 3.1575.

NO TREASURY MARKET REPORT AVAILABLE TODAY.

PA REPORT FOLLOWS:
+NERVOUS FOREIGN MARKETS. THE DOLLAR POSTED WIDESPREAD GAINS ON LONDON FOREIGN EXCHANGES AHEAD OF U.S. EMPLOYMENT FIGURES AND MONEY SUPPLY DUE TOMORROW. BUT DEALERS REPORTED THAT THE MARKET WAS EXTREMELY THIN AND NERVOUS STILL UNDECIDED ABOUT THE LIKELY FUTURE COURSE OF THE DOLLAR.
STERLING FLUCTUATED BETWEEN 1.200 AND 1.2060 AGAINST THE DOLLAR FOR MOST OF THE DAY, BUT SLID TO 1.1950 AT THE CLOSE AFTER NEWS THAT BNOC HAD CUT ITS BRENT OIL PRICE. THE POUND FINISHED WELL BELOW ITS EARLY BEST ON THE CONTINENT.+

MAIN NEWS AT 6 P.M.:
THE DISPUTE THAT THREATENED BRITAIN'S POSTAL SERVICES HAS BEEN SETTLED WITH AN AGREEMENT WHICH POST OFFICE CHAIRMAN SIR RON DEARING HAILED AS +AN HISTORIC EVENT+.
EVERY POSTAL WORKER GETS POUNDS STERLING 100 AS PART OF A POUNDS STERLING 250 BONUS FOR AGREEING TO NEW METHODS. P.O. RECKON TO SAVE POUNDS STERLING 100-180 MILLION A YEAR FROM THE NEW TECHNOLOGY.

X

LATEST LEYLAND.
HONDA HAVE SAID THEY DO NOT WANT A STATEMENT ISSUED, BELIEVING IT TO BE PREMATURE. THEY HAVE ASKED FOR A TRIPARTITE MEETING (BL, HONDA, GOVERNMENT) NEXT WEEK TO ESTABLISH THE GOVERNMENT'S POSITION. DTI SAY THEY HAD TO AGREE. IT WILL BE CHAIRED BY A DTI OFFICIAL. DTI SAY THEY ARE CLEAR THAT HONDA CAN BE GIVEN NO COMMITMENTS. LEYLAND REMAIN NERVOUS ABOUT THE POSSIBILITY OF HONDA PULLING OUT. THEIR SECRETARY OF STATE GAVE THE FOLLOWING LINE TODAY TO THE BL CHAIRMAN FOR USE IN BIDE'S DISCUSSIONS WITH HONDA:
+I AM ABLE TO CONFIRM THE GOVERNMENT'S CONTINUING INTEREST IN COLLABORATIVE VENTURES BETWEEN BL AND HONDA. GOVERNMENT WELCOME THE LATEST DISCUSSIONS WHICH THEY VIEW WITH CONSIDERABLE INTEREST. THESE PROPOSALS UNFORTUNATELY ARRIVE AT A TIME WHEN GOVERNMENT STILL HAVE TO TAKE DECISIONS ON BL'S CORPORATE PLAN: IT WILL THEREFORE TAKE A LITTLE WHILE FOR THE GOVERNMENT TO CONSIDER THE IMPLICATIONS OF THE PROPOSALS FOR THE PLAN, AND REACH A VIEW ON THEM. HMG ARE MOST ANXIOUS THAT THIS NECESSARY DELAY SHOULD NOT BE INTERPRETED BY HONDA AS A LACK OF INTEREST. MR. TEBBIT LOOKS FORWARD TO MEETING MR. KUME IN TOKYO.+
UNDERSTAND THE TEBBIT/KUME MEETING TO BE ON 18 APRIL.
MEANWHILE DTI SAY THEY WILL BE UNABLE TO HAVE THE PROPOSAL FULLY COSTED AND ANALYSED FOR THE PRIME MINISTER'S RETURN= THEY ARE AIMING INSTEAD FOR THE END OF THE MONTH. THE POLICY UNIT IS BEING KEPT POSTED.

ENDS
GRS450
NNNN

K

SLH (EL3AFX)

CONFIDENTIAL AND COMMERCIAL IN CONFIDENCE

File

cc: Peter Warry

10 DOWNING STREET

From the Principal Private Secretary

4 April 1985

Dear John,

AUSTIN ROVER AND HONDA

The Prime Minister has read overnight your Secretry of State's manuscript minute of 3 April covering a proposed statement by British Leyland and Honda and the statement of understanding between the two companies.

The Prime Minister doubts the need and the wisdom for a joint statement at this stage. She feels that a statement would only build up a presumption in Parliament and elsewhere that collaboration arrangements on the lines proposed will go ahead before the Government has seen or had an opportunity to consider the financial implications of the arrangements. She cannot see why Honda should not make a statement about the attitude of their Board while British Leyland say that they will have to discuss details with the Government before they could reach a view.

As regards the memorandum of understanding itself, the Prime Minister regrets the phrasing of Clause 1.7 (a) in which Austin Rover take up the position that Austin Rover would not accept engines from a new Honda UK facility for incorporation into Austin Rover cars other than the R200 series.

The Prime Minister recognises, however, that discussions between Austin Rover and Honda may have reached such a point that the company cannot retreat from a joint statement withour serverely damaging the relations between the two companies. If that is so, she would not wish to prevent such a statement, provided that it is cleared with the Treasury. But she would wish to see two amendments made:-

(i) she would not wish the statement to contain a commitment to an objective that each company should use its own engines in a jointly designed and developed vehicle; and with this in mind the second sub-paragraph of indent one might best be omitted.

(ii) She dislikes the reference to a "new Corporate Plan" in the last sentence, which might be taken to imply both new money and more delay. She would prefer the last sentence to read:- "in the case of British Leyland, however, the pursuit of these things must form part of the British Leyland Corporate Plan requiring the approval of HMG who have asked for further study of the financial and commercial details".

I am copying this letter to Rachel Lomax (H M Treasury).

Yours sincerely,

Robin Butler

John Mogg Esq
Department of Trade and Industry

E.R.

Prime Minister
Peter Warry and I have discussed. We think that the last sentence of the statement protects the Government, especially if it is amended on the lines at X1 below. Approve the statement subject to (1) and (2) below and the statement being cleared with the Treasury?

FERB 3.4.

1

MR BUTLER

AUSTIN ROVER AND HONDA

The timing of the presentation of the Honda deal has clearly been contrived to try and overturn the very necessary financial belt tightening at ARG. Nevertheless collaboration properly pursued could and should help ARG.

Yes

The MOU cannot be assessed in isolation from the overall ARG plan - for example we need to know that the proposed new car will replace both the planned AR5 and AR7 cars and cost ARG less.

MT

A neutral stance must be right - happy to let negotiations take place but deferring any approval of the project until detailed and costed proposals have been presented, showing to our satisfaction that the collaboration achieves a net improvement to ARG, and keeps it within the reduced capital spending that you set on Monday.

P.S. I doubt the need and the wisdom of such a statement now.

The draft press statement needs two amendments:

(i) the reference to each company using its own engines in the new car should be removed. It is a quite unnecessary hostage at this stage and removes one of the major benefits of collaboration.

MT

(ii) the reference to a "new" Corporate Plan implies both new money and more delay. Better just to say: "in the case of BL, however, the pursuit of these things must form part of the BL Corporate Plan requiring the approval of HMG who have asked for further study of the financial and commercial details".

MT

Peter Warry

Peter Warry
3 April 1985

CC MASTER
Subject

File

CC P. Warry

10 DOWNING STREET

From the Principal Private Secretary

3 April 1985

Dear Callum,

BRITISH LEYLAND

Your Secretary of State came for a further discussion with the Prime Minister this afternoon. The Financial Secretary to the Treasury was present as were Mr Gregson (Cabinet Office), and Mr Warry (No 10 Policy Unit).

Your Secretary of State said that there had been some further developments since the discussion which he had had with the Prime Minister earlier in the week. Firstly, it had to be remembered that, whether or not the negotiations with GM for the sale of Land Rover Leyland went ahead, it was likely that at least Land Rover/Range Rover could be sold and this would reduce the Group's capital expenditure by £196 million by 1989, as well as bringing in the proceeds of the sale. Second, he had spoken to Sir Austin Bide and Ray Horrocks, and the latter had agreed to see how near he could get to cutting £250 million off the capital expenditure of Austin Rover. But, since the Corporate Plan had been prepared, the emissions directive had been agreed and this was expected to have an adverse effect on their cash flow of £200-250 million over the period, which was roughly evenly divided between the cost of adapting vehicles and the effect on product development and sales. Third, rumours of the Honda deal were breaking in Japan and the Chairman of Honda would be coming over in the following week. The proposals covered joint model development, a unit at Swindon at which Honda would manufacture the 1.3 engine and Honda's use of facilities at Longbridge for production and assembly. Bringing the facilities into use by Honda at Longbridge would require additional capital investment estimated at £22 million in 1986, £71 million in 1987, £73 million in 1988 and £17 million in 1989 before the effect on British Leyland became positive. British Leyland would have to make some response to the approach by Honda and the tone of this response would be crucial: the Government had therefore to decide whether in principle it wished to encourage the proposed deal between British Leyland and Honda or not.

In discussion, it was pointed out that no precise details of the proposed agreement between BL and Honda were available and the financial effects on BL's Corporate Plan would have to be very carefully considered before the Government could take a view about the merits of the proposals. It was not clear why BL rather than Honda needed to incur the investment to bring the production facilities at Longbridge into use. Nor was it clear how much Honda were directly investing overall. There were dangers that they were getting a further foothold in the British motor market at minimum cost to themselves. On vehicle emissions, the company's claim that compliance with the directive would cost them substantial sums also needed close examination: if they were to adopt established Honda engines instead of developing the new engine which they envisaged, the cost could be much reduced. The effect of all these developments on the Corporate Plan needed to be carefully considered, together with the treatment of the proceeds of the sale of Land Rover/Range Rover. On the other hand, it was pointed out that the Government had encouraged BL to seek collaborative ventures on new models and Honda's proposal to manufacture their 1.3 engine at Swindon was attractive. All that was necessary at this stage was to determine the tone which BL used in responding to Honda's approach.

Summing up the discussion, the Prime Minister said that the Government did not have sufficient details, and particularly financial details, to form a view on the merits of the Honda approach. She was not prepared to authorise any commitment to Honda's proposals at this stage: personally she was very sceptical about them. All that could be said was that the Government would consider any specific proposition, provided that the effects of the various developments which were under discussion on the BL Corporate Plan were clearly set out. The Government might well require an examination of these by independent experts. She would be prepared to meet the Chairman of Honda at some stage, but at present the proposals were so unprecise that it did not look likely that there would be a sufficient basis for such a meeting on his forthcoming visit.

I am copying this letter to Rachel Lomax (H M Treasury) and Richard Hatfield (Cabinet Office).

Yours ever,

Robin Butler

Callum McCarthy Esq
Department of Trade and Industry

MR BUTLER 3 April 1985

AUSTIN ROVER AND VEHICLE EMISSIONS

The European agreement on emissions was much better than the UK's bottom line. It entails three-way catalysts for cars larger than 2.OL from October 1988, and lean-burn technology for smaller cars starting in October 1990 for those less than 1.4L and October 1991 for those between 1.4L and 2.OL. This ought to be satisfactory to all manufacturers.

The ARG Corporate Plan has four basic engines for the 1990s on which they are spending £200 million: 'K'-1.3L, 'S'-1.6L,'O'-2.OL, 'V6'-2.3L. The K series and V6 are totally new engines. ARG have done little work so far on lean-burn and do not have sufficient skilled people to develop it across the board.

The sensible solution is to use the Honda 1.3 engine (currently fitted in the Rover 200) instead of the new ARG K series, and not to substitute an ARG V6 for the Honda V6 in the XX (Rover replacement). The Honda engines already meet the emissions legislation and ARG would save £160 million by not proceeding with its own new engines.

Peter Warry

PETER WARRY

From the Secretary of State

3/4/85

Prime Minister,

Mr. Kume of Honda is expected here on 10th April. He expects to break the ground for a Honda predelivery inspection plant at Swindon. He is personally committed to a collaborative programme with B.L. and will ask his Board to approve the M.o.U. on 5th April (Friday).

We have no way of stopping him from saying that his company backs the proposals in the M.o.U. The B.L. Board are bound to say that they want to follow the path outlined in the M.o.U.

I enclose a draft of a statement which B.L. might make.

I also enclose a copy of the draft M.o.U. It is for your eyes only at this stage. You will see B.L. is not committed to any expenditure at all, let alone that they will bear the costs of capital investment for the production facility at Longbridge.

I hope under these circumstances you will agree that I may authorise the draft statement. In the meantime I have initiated steps towards a rigorous examination of all BL's proposals.

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PROPOSED PRESS STATEMENT BY BL + HONDA.

As a result of a collaboration which has been successfully developed between ARG and the Honda Motor Company over the past six years, represented by the Acclaim, the Rover 200 series and the very impressive progress to date on the jointly designed and developed XX car project, ARG and Honda have been discussing plans which would further strengthen the links between the two companies.

Several areas of mutual interest have been discussed. Specifically:

1. As a further development of the encouraging progress of the XX project, the establishing of another joint design and development programme on a new car, bringing to it the best appropriate technology of both companies.

The objective is not only jointly to design and develop a vehicle with each company using its own engines, but also the manufacture by each company of the other's version of the car.

2. Other points which have been discussed cover the establishment by Honda of an engine manufacturing facility at Swindon to provide UK source engines for the Rover 213 and subsequent Honda versions of vehicle built by ARG for Honda.

The above points are satisfactory in principle to the Boards of both BL and Honda. In the case of BL, however, the pursuit of these things must form part of a new BL Corporate Plan requiring the approval of HMG who have asked for further study of financial and commercial details so that they may be considered within the new Corporate Plan.

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CONFIDENTIAL

Revised Draft: 27.3.1985

STATEMENT OF UNDERSTANDING BETWEEN
HONDA MOTOR CO., LTD. AND
AUSTIN ROVER GROUP LIMITED

1. INTRODUCTION

1.1 In recent months the two companies have been discussing the way in which their relationship might develop in the future.

1.2 This Statement sets out the objectives and strategic considerations upon which any further collaboration should be based and recognises the need for the longer term collaborative strategy to take full account of each company's individual policy aims. While the provisions of this Statement will not constitute legally binding obligations on either party, each party recognises the need for good faith, and adherence to the general principles set out in this Statement, in future discussions as to the detailed implementation of the projects referred to herein.

1.3 It is further recognised that, even in the context of a Statement of Understanding it is not possible for either party to commit itself unreservedly to any of the listed projects and developments in isolation, since it is acknowledged that the feasibility and/or success of particular projects is likely to be directly related to progress on other projects and developments described in this Statement.

1.4 The following projects or developments are regarded as central to the longer term collaborative strategy of the two companies:-

(a) the joint design and development of a specific new vehicle on the basis of a programme similar in concept to that adopted for XX, i.e. involving shared design and development and subcontract manufacture by each company for the other;

(b) the establishment by Honda in the UK of an engine plant;

(c) subcontract manufacture by ARG of the Honda Ballade and joint investigation of the feasibility of subsequent subcontract manufacture of the 5-door Honda Integra by ARG for Honda; and

(d) the vehicle build of further Honda products, other than the jointly designed and developed vehicles, within the UK.

1.5 In setting out their respective intentions as to the way in which the above projects should inter-relate and be implemented, each company has recognised certain basic policy decisions made by the other.

1.6 Thus, ARG recognises:-

(a) that Honda has no intention of jointly developing engines with another manufacturer at the present time;

(b) that Honda's willingness to pursue the possibility of a longer term joint design and development programme will be influenced by progress made in discussing the detailed terms on which ARG could manufacture the Honda Ballade on a subcontract basis incorporating locally produced Honda engines.

1.7 Honda in turn recognises:

(a) that while ARG would accept engines from a new Honda UK engine facility for use in Honda subcontract vehicles built by ARG, ARG would not in principle accept engines from such a facility for incorporation into ARG badged vehicles other than the Rover 200 Series;

(b) that ARG's willingness to undertake subcontract manufacture of the Honda Ballade will depend, not only upon the commercial feasibility of such a project, but also upon the progress which is made in the detailed discussion of the longer term joint vehicle design and development programme; and

(c) that in view of ARG's willingness to manufacture any jointly developed vehicle on a subcontract basis for Honda, ARG will take a close interest in the compatibility of models produced at any Honda vehicle build facility in the United Kingdom or Europe.

1.8 Subject to the principles outlined above, the parties' intentions with regard to the various projects and developments listed above are set out in the remainder of this Statement.

2. JOINT DESIGN AND DEVELOPMENT OF A NEW VEHICLE

2.1 The following general principles are agreed by the parties to be fundamental to further joint product developments:

(a) every project should provide a balance of input.

(b) both parties will seek to attain balanced benefits and individual elements which are to the primary benefit of one party can only be agreed in the context of an overall, balanced strategy.

(c) jointly developed products should only be built in Japan by Honda and in Europe by ARG.

(d) neither party shall have undue influence over the other's technology or ability to make commercial decisions.

2.2 The details of the Understanding reached on a specific new project, which reflect these general principles, are set out below.

Vehicle Concept

2.3 The next collaborative vehicle will be a medium sector car with engines in the range of approximately 1.3 to 1.6 litres. It will be suitable in overall size, specification and design cost as a replacement for the Rover 200. It is anticipated that this will make the core vehicle a four door notchback or five door hatchback saloon. However, the strategy in relation to additional derivatives will be considered and, if appropriate, the sharing of resources will be discussed. Either party will in any event have freedom to develop such derivatives on its own behalf.

2.4 The vehicle will be designed to have sporty and prestigious appeal. Its design will not be constrained by an insistence upon commonality of technology with any other existing or planned vehicle in either party's range, unless it is agreed that such a constraint would not be prejudicial to either party.

2.5 The vehicle shall be designed to accommodate power units to both Honda's and ARG's design.

Technology

2.6 As a general principle, the technology used in the joint project shall be the latest appropriate technology developed by each party. This shall exclude technology at the research stage at the time of commencement of the development programme. The general principle is to exclude technology superseded (or planned to be superseded) in either party's range at the time the joint development programme is started, although the parties may agree that such technology is appropriate for inclusion in particular cases.

2.7 The overall design of the vehicle shall be jointly owned. Subject to industrial property rights of third parties the ownership of elements of the vehicle will also be joint, with the exception of engines and any other areas where it is agreed in advance that technology developed by one party independently of the joint project be used. No royalty shall be payable on the vehicle. Any plant and equipment supplied by one company to the other shall be entirely at the discretion of the purchasing party and under commercially competitive supply terms.

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Manufacturing

2.8 Each party agrees to subcontract manufacture the jointly developed product on behalf of the other. In addition, either party may request that derivatives of the core product be manufactured on a subcontract basis by the other, and every effort will be made to meet this request, subject to normal commercial acceptability.

Component Sourcing

2.9 Each party shall have freedom to choose its source for components for the models built by it which will carry its badge. In order to ensure this, each party accepts the responsibility for ensuring that either its suppliers will co-operate with the other party on terms for component supply or on the release of design technology, or that the other party will be advised at the earliest possible opportunity, before the final decision on the allocation of design responsibility, that these conditions cannot be met. Where design responsibility for a component is subcontracted to a supplier, other than where the design requirement is met totally by a proprietary item, this should be on terms which allow the parties equal access to and free use of the design. If this requirement cannot be met, the other party will be advised prior to the final decision on the design source being made. These obligations apply equally in respect of all suppliers, whether wholly or partly owned or independent.

2.10 Later in 1985, the parties will be conducting at senior management level a thorough and overall review of the XX programme. In the new joint development programme it is intended that the best procedures identified by that review should be adopted for access to, and relationships with, component suppliers.

Timing

2.11 The companies will aim to achieve the following timetable:

. Discussion of joint vehicle (j.v.) pre-concept (2)	May	1985
. XX Review	May	1985
. Complete feasibility study on Ballade manufacture	May	1985
. Establish provisional j.v. pre-concept (1-a) (2)	Sept	1985
. Agreement on subcontract manufacture of Ballade (1-b)	Sept	1985
. Honda's internal review	Oct	1985
. Finalise j.v. pre-concept	Nov	1985
. Finalise j.v. hard points/basic structure	Feb	1986
. Proposal for j.v. Design and Development Agreement (provisional design responsibilities)	April	1986
. Finalise j.v. Design and Development Agreement(3-a)	June	1986
. Commence commercial production of Ballade (3-b)	June	1986
. Finalise j.v. Manufacturing Agreement	Autumn	1986
. Production launch of j.v.	Autumn	1988

Notes:

(1) Linked events: (1-a) must occur before (1-b).

(2) Pre-concept includes preliminary identification of the following:
- Broad definitions of sector.
- Principal body type.
- Other body types to be considered.
- Wheelbase, track, approximate overall length, height, width, and front overhang, key interior package dimensions.
- Engine/gearbox families to be accommodated.
- Key mechanical constraints or commonalities.
- Legislative requirements.
- Key timetable points.
- Provisional volume targets.
- Commonality between Honda and ARG versions.
- Main areas of design leadership.

(3) Linked events: (3-a) must occur before (3-b).

<u>Split of Design Responsibilities</u>

2.12 The parties agree to consider the most effective use of design resources, given experience gained through the XX programme. Specifically, the companies will aim to work more closely on those areas of the vehicle whose design has an effect on other aspects of the vehicle. Development should only be carried out by one party in isolation, where:

- there is no risk that other design areas will be affected and one company has particular expertise; or

- that aspect of the design was agreed not to be owned jointly (e.g. engines).

3. <u>ESTABLISHMENT BY HONDA OF A UNITED KINGDOM ENGINE FACTORY</u>

Honda will keep ARG informed as to the timing and progress of establishment of any such facility. Honda currently intends that such a facility would be operational by [Spring 1986] in order to facilitate achievement of the local content timetable. ARG intends to purchase engines from that facility for installation in the Rover 213. The companies will discuss the terms applicable to such purchase with a view to achieving an equitable balance of any commercial benefits which may derive from local sourcing of engines, but in any event the terms shall be no less favourable to ARG than those on which such engines are currently purchased from Japan. ARG will consider supplying certain components to that facility.

4. SUBCONTRACT MANUFACTURE BY ARG OF THE HONDA BALLADE

4.1 In parallel with the discussions on the joint development of a new vehicle, the two companies will give detailed consideration to the commercial terms on which subcontract manufacture by ARG of the Honda Ballade will take place prior to jointly developing the new vehicle and the parties intend to finalise the contract for such subcontract manufacture by September 1985.

4.2 It is currently contemplated by the two parties that such subcontract manufacture will start in mid-1986 and the engines for such Ballade vehicles will be supplied from Honda's engine plant in the United Kingdom.

5. HONDA VEHICLE MANUFACTURE

5.1 Honda wishes to see the manufacture of its vehicles established more closely to the European market place. No firm plans for this in terms of timing and scale of operation have yet been established. However, Honda have established two objectives:-

(i) a preference for such a facility to be in the UK, and;

(ii) a desire to maintain independence and flexibility in meeting changing market conditions.

Recognising the currently prevailing circumstances of manufacturing over-capacity in Europe, Honda has two possible options for the manufacture of vehicles other than those jointly developed with Austin Rover. They are as follows:-

(a) To make use of existing Austin Rover manufacturing facilities in the UK. Austin Rover and Honda will discuss the conditions for such local manufacture to seek in good faith to provide Honda with a satisfactory degree of independence and flexibility. This recognises that Austin Rover is opposed to the establishment of additional vehicle assembly capacity within the UK and continental Europe.

(b) To establish a new Honda vehicle facility in the UK.

Both parties will hold a joint review, at regular intervals to be established to examine the prevailing circumstances in Europe. In recognition of these circumstances at this stage it is agreed by both parties that option (a) above is the preferred route and Honda agrees that it will only decide to follow option (b) if it considers in good faith that option (a) is not feasible, whether for technical, commercial or managerial reasons. Such a decision would only be made after an in depth investigation of option (a).

In carrying out this investigation both companies will approach the subject in the most constructive, expeditious and open fashion with the declared intention of seeking a speedy and successful conclusion to problems which may arise, and ensuring that such conclusions are to the mutual benefit of both companies.

If, following such investigation, option (b) is selected then, notwithstanding Austin Rover's opposition to the establishment of additional capacity, Austin Rover and Honda would intend that this situation would not adversely affect their commercial relationship on projects already in existence or contemplated by this Statement. Both companies recognise that the subsequent initiation of further projects may be affected.

5.2 In order to safeguard Austin Rover's allocation of capacity in subcontract manufacture, any other Honda vehicle build in the UK or continental Europe will not be of vehicles belonging to the same family as the jointly developed vehicle, as defined in the Appendix to this Statement. Moreover, Honda wishes positively to promote complementation and co-operation with Austin Rover, for the benefit of both parties, through such means as being supplied with certain vehicle components from Austin Rover and Austin Rover's established component suppliers.

6. <u>CONFIDENTIALITY</u>

Both the existence and the terms of this Statement shall be kept confidential by the parties and shall not be disclosed to any third party except by mutual agreement, save where either party is specifically required by applicable law or regulation to make such a disclosure.

....	....
For and on behalf of	For and on behalf of
HONDA MOTOR CO., LTD.	AUSTIN ROVER GROUP LTD

APPENDIX

DEFINITION OF VEHICLE FAMILY RELATIONSHIP

(1) **Purpose**

To define on a basis agreed between ARG and Honda the characteristics which will qualify a vehicle comprised in one Party's model range as being of the same family as the proposed future joint vehicle, to be used in deciding the manufacturing location for the purposes of paragraph 5.2 of the Statement.

(2) **Exclusion of certain Honda vehicles**

Notwithstanding (1) above and (3) below, it is accepted by ARG as being of overriding importance to Honda that there should be no restriction on its manufacturing freedom in respect of vehicles in the Accord and Civic families.

Equally, it is accepted by Honda that ensuring the productive use to the maximum reasonable extent of ARG's investment in subcontract manufacture of the joint vehicle is of overriding importance to ARG. In order to ensure this it is recognised by both parties that the joint vehicle will not be a derivative of either the Civic or Accord families.

(3) **Definition**

Subject to (2) above, a derivative of any model range will be considered as being of the same family where the overwhelming majority of the following criteria apply:-

Component Commonality

- same engine family/families as joint vehicle;
- front suspension and steering systems of similar design and having substantial number of detailed components in common with joint vehicle.

Body Structure

- front floor pan, upper and lower dash, and front structure generally of same design as joint vehicle.

Suitability for Build on Common Facility

- capable of being constructed in same BIW facility, assembled on same production line and tested on largely the same equipment as the joint vehicle, with minimal additional investment.

If there is any doubt, the parties will seek to agree in good faith where a model should be built, taking into account:

- ARG's commercial interests.
- Honda's commercial freedom.
- The economics of alternative manufacturing sites.
- The ability of ARG to fulfil Honda's volume requirements.

SUBJECT
cc Master

JR
(47)
bc PW

10 DOWNING STREET

From the Principal Private Secretary

1 April 1985

BRITISH LEYLAND

The Prime Minister held a discussion with the Chancellor of the Exchequer, the Secretary of State for Trade and Industry and the Minister for Industry about the British Leyland Corporate Plan this afternoon. Mr. Gregson (Cabinet Office) and Mr. Warry (No. 10 Policy Unit) were present.

Your Secretary of State said that the performance of British Leyland had been disappointing. But the scale of its operation had to be taken into account. It was a larger producer than Ford, Vauxhall, Talbot and Jaguar taken together. It also had to be borne in mind that the capacity of vehicle producers exceeded the supply and that many other volume producers had recently been losing money in trying to protect their share of the market. Unless the Government were prepared to cut its losses and close down British Leyland, the only available course was to restrict the company's borrowing and reduce the Government's exposure. With this end in view, the Company should sell off as many parts of the Group as were viable, but it should be recognised that there would be a rump with which the Government would be left which would include the Austin Rover Group. In dealing with the remaining problems of the Group, the Government should restrict investment and borrowing on the lines recommended by the Official Group. It should also encourage an arrangement with Honda on the lines set out in his minute of 29 March, provided that satisfactory terms could be agreed.

The Chancellor of the Exchequer shared the dissatisfaction of his colleagues on the way in which the affairs of British Leyland had been moving. But unless the Government were to close the Group, he believed that there was no alternative to endorsing the conclusions of the Official Group, in particular that Austin Rover should be asked to prepare options for reducing its capital expenditure budget over the planned period by at least £250 million, that it should go ahead with selling Unipart as soon as possible, and with the discussions with General Motors about the disposal of Land Rover-Leyland and

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that borrowings covered by the Varley Marshall Assurances should be limited to £300 less than forecast.

Summing up the discussion, the Prime Minister said that the picture presented by the Corporate Plan was appalling. It reflected very badly on the management of the Group, and there had to be doubts about the production and sales strategy of Austin Rover in particular. It was essential to limit the calls which the Group were making on the taxpayer, under the cover of the Varley Marshall Assurance. It was essential that Unipart should be sold as soon as possible and that all possible avenues for the disposal of Land Rover-Leyland and any other parts of the Group which could be sold - should be explored urgently. The Official Group's recommendations should be implemented quickly, and in particular Austin Rover should be asked to produce proposals for reducing the capital budget by at least £250 million over the period of the Plan and drawings under the Varley Marshall Assurances should be restricted as proposed by the Official Group. The Secretary of State should consider proposals for setting a profile for the reduction of these drawings, commencing with borrowings of £600 million for years 1985 and 1986. There were grounds for anxiety that the deal with Honda might simply result in Austin Rover losing more sales while giving Honda access to established production facilities and an established workforce: the Government's position in relation to the Honda deal must therefore be reserved until the terms could be considered. The treatment of the proceedings of the Unipart sale would also need further consideration, since the first priority for the use of such proceeds must be to reduce British Leyland's indebtedness to the taxpayer. The Secretary of State should bring forward proposals on these matters as the situation developed.

I am copying this letter to Rachel Lomax (HM Treasury) and Richard Hatfield (Cabinet Office).

(F.E.R. BUTLER)

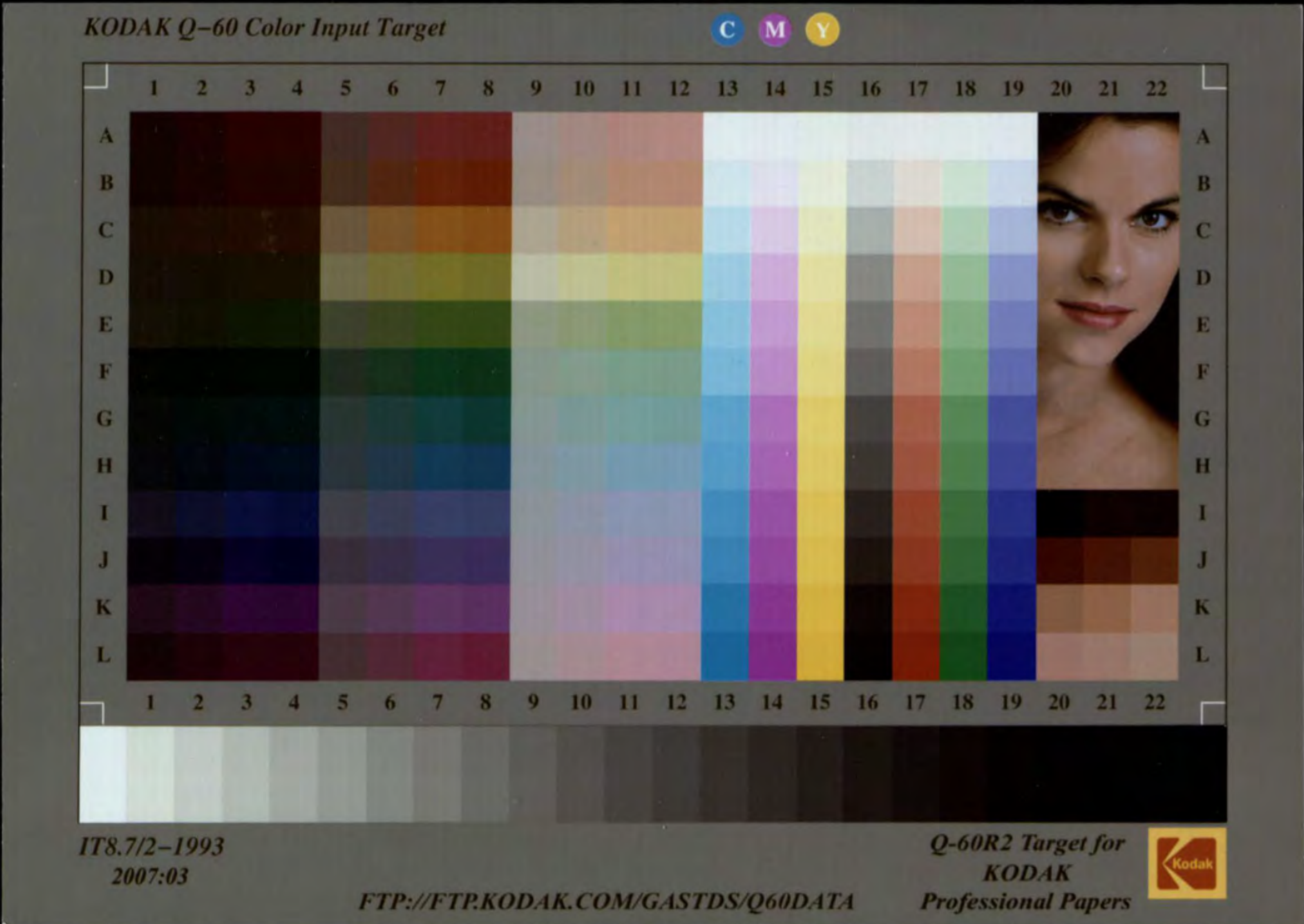
Callum McCarthy, Esq.,
Department of Trade and Industry.

PART 8 ends:-

Prof. Bhattacharyya to PM 29.3.85

PART 9 begins:-

FERB to DTI 1.4.85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