

Ref: A0897

PRIME MINISTER

---

BRITISH LEYLAND  
(E(79) 74)

BACKGROUND

1. The choice is stark. Either the Government cuts its losses now - at a PSBR cost in 1980-81 of some £1,400 million and 200,000 unemployed; or it finds £130 million extra in 1980-81 in the hope that British Leyland (BL) will struggle through to viability (with a less than 50/50 chance of success). In his paper, Sir Keith Joseph recommends the second course, and, in particular -

a. approval of BL's corporate plan covering the next five years, but without any firm commitment on funding beyond the end of 1980;

b. the precise limit of funding for 1980 to be left to the Chancellor and himself to negotiate, so as to minimise the excess over existing PESC provisions;

c. an announcement of the Government's approval of the plan to be made before the Christmas recess, without waiting for the completion of the BL wage negotiations. The need for urgency arises because otherwise BL will lose the opportunity of signing a collaborative deal with the Japanese firm Honda, for a new middle-sized car - the LC9 which BL plan to assemble from mainly Honda components.

2. Sir Keith Joseph concedes in his paper that the chances of success of the plan are less than 50/50, and that "sooner or later it is likely to be clear that there is no hope for BL in its present form and that continued run-down and break-up are inevitable." But he thinks support at least for another year is inevitable, partly because of the presentational difficulty of pulling the

rug without giving Sir Michael Edwardes a chance after his recent successes with the workforce, and partly to avoid the resignation of the BL Board and the resulting sudden collapse of BL after the very high redundancies and PSBR costs which this would entail.

## HANDLING

3. After asking Sir Keith Joseph to introduce the paper, you might guide the Committee to concentrate on the main issues -

- a. Does the plan have any real chance of success?
- b. Is there a credible alternative strategy?
- c. Even if the plan has little chance of success, is conditional financial support for an extra year the best option?
- d. Timing - in relation to the wage negotiations and Honda deal - and presentation.

4. Some points that might be made on each of these issues are as follows -

A. The chances of success of the plan

5. These are poor; and you might ask Sir Kenneth Berrill for his views: the CPRS have very strong doubts. The reasons for the doubts include -

- a. Every annual plan of BL (including this one) forecasts major improvements; but every year things get worse instead of better. Most fundamentally BL's market share for cars in the United Kingdom has slumped from 35 per cent in 1974 to 20 per cent this year and 16 per cent in the last 2 months. BL's position is similar with commercial vehicles and in exports. The basic cause of BL's uncompetitiveness is its low productivity: two thirds that of its European competitors, and less than that in relation to the Japanese. To be competitive, BL needs to improve its productivity by something like 50 per cent. It begins to look as if the illness is terminal: Things seem to have gone too far for these

trends to be reversed even with new models, the first of which are not due anyway until the end of next year, when all their competitors will have new models too. So BL's expectation in their future plan of an increase in market share to  $24\frac{1}{2}$  per cent by 1985 looks highly optimistic. Even improvements in the strike record are not going to help much: BL's big problem for the last year has been inability to sell the cars they produce.

b. BL's main proposals for new cars after the Honda model (the LC10 and LC11) look very risky, because they will be produced in much smaller numbers than most of their competitors.

c. The situation has already deteriorated since the plan was written. As Sir Keith says (end of paragraph 6), BL have just told his Department that part of the money earmarked in the plan for next financial year (up to £100 million equity) will instead be needed in this financial year. This is mainly because their profit forecast for 1979 has changed from a £13 million profit before interest and tax in the plan to a £50 million loss. This in turn is mainly due to a further downward shift in BL's market share in cars in the last few months, which is equally making the assumptions in the plan about sales out of date.

#### B. Alternative Strategies

6. The key question is whether the BL Board have done - or indeed can be expected to do - enough to examine alternatives. In the long run, disposal of as much of BL as possible as going concerns to other manufacturers (including foreign manufacturers such as the Japanese) may be the best way of keeping the plants alive. If so, then arguably the sooner this is done the better, as disposals might be easier if BL had deteriorated less far. There has been one proposal for a takeover of Leyland Vehicles - reported in the press on Friday. But this particular bid may not be much of a starter. BL have examined some options in the past and still have some collaborative deals in mind. But these are on a limited scale. The main problem is that, as long as the BL Board are primarily concerned with making their existing plan work, it may be difficult for them simultaneously to plan disposals of major parts of their business,

especially if these imply effectively the end of BL as an entity. Yet if alternatives are not prepared in advance, it seems very likely that the Government will be faced with exactly the same choice next year about whether or not to fund the next plan (except that BL will be even weaker), with the same arguments in favour of continuing funding. Sir Keith suggests (paragraph 10) that the plan should be approved "on the understanding that the BL Board will keep me regularly informed...about progress...and will seriously explore further disposals, in particular the truck and bus business." Should BL be given a rather firmer push towards looking at the scope for disposals - including the car business?

C. Funding the Plan

7. The key questions here are -

a. Is there a case for rejecting the plan, rather than funding it? It is likely that Employment and perhaps even the Treasury will join Industry in wanting to keep BL in being. If the plan is funded for a year and then fails, the extra cost may be about £200 million (again very uncertain) on top of the eventual costs of collapse.

b. What level of funding should be given? BL's bid in their plan is shown against PESC allocations below -

£ million	BL's bid	Amount in PESC	Difference (in 1979 prices) (adjusted) (ie implied call on the contingency reserve)
1980/81	297*	150	150
1981/82	95	75	28
1982/83	13	-	22
1983/84	27	-	30
	<hr/>	<hr/>	<hr/>
Total	430	225	210

\*NB: Sir Keith now says some of this £297 million will be needed in 1979/80.

The £225 million in PESC represents what is left of the £1,200 million which Lord Ryder said in 1974 was necessary to bring BL back to viability. Sir Keith's main argument for allowing more is that estimates made 5 years ago are bound to be subject to changes in the light of events, particularly inflation. He also thinks it might be possible for him to negotiate a lower level of funding closer to PESC, but he thinks that there is no chance of getting the BL Board to accept funding right down to PESC levels. So insisting on funding up to PESC levels and no more would in his view amount to rejection of the plan, the Board's resignation and BL's collapse. You might particularly ask Sir Keith about the latest request for extra funding this year. Does this mean the total of this and next year would still be the same?

c. Is there further scope for private sector finance? Sir Keith proposes to explore this in negotiations with BL. The scope seems there, but limited. One important point is that switching from public to private funding will not help the Government's total financial exposure, as the Government effectively guarantees private sector loans.

D. Timing of decisions

8. The main questions here are -

a. Can the Government give BL any kind of support for the plan before the wage negotiations for their car workers are completed? In a recent letter the Chancellor implied not. Sir Keith disagrees: the wage negotiations might take some time (the management are trying to negotiate a very tough package), and in the meantime BL could collapse suddenly. As an alternative could the Government approve the plan, but make it clear their approval would be later withdrawn if the wage negotiations ended unsatisfactorily? Would this strengthen the managements hand in trying to get a tougher settlement.

b. Should BL be allowed to sign up with Honda on 20 December? The arguments for this seem quite strong: it is a way of keeping options open (the cancellation charges if BL later pull out are only £5.5 million). But how definite an assurance is needed about Government approval for the plan before Honda will be prepared to sign?

## CONCLUSIONS

9. The basic decision is whether to support the plan at all for another year, recognising the plan's low chance of success and that support within PESC limits seems impossible. If colleagues do decide that further support is desirable or inevitable, then you will want to record the conditions attaching to approval. These might be -

a. A one-year commitment only;

b. Negotiations with BL by the Secretary of State for Industry and the Chancellor for funding arrangements as close as possible to present PESC ceilings with their findings reported back to you, if possible before BL need to sign the Honda deal;

c. It should be made clear to BL that the Government's support [could] [will] be withdrawn in the event of BL's wage package not being satisfactorily agreed;

d. Sir Michael Edwardes to be given a very firm - but confidential - instruction to examine urgently the scope for alternative strategies - including major disposals of both cars and trucks - ready to be considered for implementation by the Government if the plan is seen to be clearly failing;

e. BL to be authorised to sign the Honda deal - but only after successful negotiation on funding, as under b.

*M.A.*  
*PP*

ROBERT ARMSTRONG

7 December 1979