Prime Minister

A very good brief.

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7/12

Qa 04373

To: MR LANKESTER

From: SIR KENNETH BERRILL

CPRS

British Leyland

1. On Monday, E Committee will be discussing Sir Keith Joseph's important paper on the future of British Leyland. I attach a CPRS brief on this which the Prime Minister might find useful for her weekend box.

2. I am sending a copy of this minute and the attachment to Sir Robert Armstrong, and to Mr John Hoskyns who has been a member of the interdepartmental working group.

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7 December 1979

Atts

BRITISH LEYLAND: THE STRATEGIC DECISIONS

1. The Prime Minister will have received Sir Keith Joseph's memorandum and recommendations on British Leyland (E(79)74). The CPRS has worked on the problems of the United Kingdom motor industry for a number of years and has taken an active part in the most recent interdepartmental studies on British Leyland (BL). The Prime Minister may like to have our views on the BL problem. In summary, these are:

(i) Whatever views Ministers might have about the long-term future of BL, the wisest course at this moment is for the Government to be seen to be giving full support to Sir Michael Edwardes and to be going along with the key aspects of his Plan, particularly on new model development, collaborative ventures, and plant rationalisation.

(ii) Nevertheless, it is our view that BL is already well into a vicious circle of decline and will not become viable as an independent volume car producer. Any solution to relieve Governments from large and open-ended financial commitments will have to be far more radical than the proposals in the Edwardes' Plan.

(iii) Longer term, BL will either have to be broken up and sold piecemeal, or sold complete as a package if a buyer can be found. Sale complete is much the better alternative but as time goes on the number of possible purchasers will diminish.

(iv) Ministers might put it to Sir Michael Edwardes that, while they back his Plan, would he in the coming year increase his talks with other major companies (General Motors, Ford, and the Japanese) partly on 'collaboration' but also to see if there is a possible buyer.

The immediate decision: to accept or to reject the Edwardes' Plan

2. If the BL negotiations over pay and productivity reach a satisfactory outcome, the Government will probably find itself with no practicable option but to go along with the Edwardes' Plan for the time being (except on details of funding, where we believe there may be some room for manoeuvre, though

less than originally supposed because of BL's rapidly deteriorating financial state). The main reasons for giving immediate support to the Plan are:

(i) To take advantage of the Plan itself. The first year of the Edwardes' Plan is, we suspect, very similar to the first year of a plan designed specifically to bring about either a controlled rundown or a controlled disposal of the company. Acceptance, therefore, gives Ministers maximum flexibility.

(ii) To retain control of events. Rejection of the Plan will most probably lead to an uncontrollable decline in the company's operations, even if the Board could be persuaded not to resign. Acceptance would leave the Government and the Board in control of events.

why?

(iii) To contain the erosion of confidence. What little confidence remained in BL has been badly shaken by its poor performance in recent months. Even a non-committal reply by the Government would accelerate the worrying rate of defections by middle management, by skilled workers, by dealers, and by customers, both private and fleet.

(iv) To take advantage of the new spirit of co-operation in the Company.

For the first time the Board may have a grip on the workforce and the management. Also the Board are now able to take actions (for example over Robinson) that they could not have contemplated before the change of Government. The BL workforce has demonstrated their goodwill over their acceptance of the rationalisation plans and may do so again over the negotiations on pay and conditions. The future existence of the two largest BL plants (Longbridge and Cowley) depends critically on this spirit of co-operation being maintained, whether under the Edwardes' Plan or any radical alternative.

(v) To minimise costs. We are in little doubt that an uncontrolled rundown would be the most expensive outcome, and the bulk of the extra costs would fall in 1980/81. By comparison, the financial risks in going along with the Edwardes' Plan for the time being are quite small.

See John Hoskyns' brief on this point (page 3) R.

3. Early approval of the Plan is we believe the least expensive way for the Government to proceed. Ministers may wish to discuss, however, whether formal approval should be withheld until the negotiations over pay and conditions are concluded. In this, the issue of maintaining confidence in the company will be an important consideration. Prolonged uncertainty over the Government's intentions would be damaging.

The second decision: to leave the initiatives with BL or not

4. Ministers may wish then to discuss whether, if they accept the Plan, they should leave all the initiatives with Sir Michael Edwardes and the BL Board. Ministers could choose between:

(i) Accepting the plan without conditions (apart perhaps from modifications to the financing package). This would leave BL with the single-minded objective of making the Plan work. The Government would then be in a position of waiting for BL either (a) to deliver their next Corporate Plan in a year's time, or (b) to approach the Government during the year to say that all is not well.

and more money

(ii) Accepting the plan with a condition that the BL Board take serious initiatives to assess radical alternatives to the Plan that would involve sale of the company either as a whole or in parts.

5. The short-term prospects for BL. The CPRS sees a high risk of BL foundering in the next year or so, if BL are restricted to the sums of money requested under Plan. In the short-term, all the financial risks are down-side and BL's position is deteriorating month by month. The

company is in a vicious circle of decline and many of the assumptions underlying the Plan for the next year already look decidely optimistic:

(i) Market share. The Plan assumes that the Company's slide in UK car market share can be halted at around the 20 per cent level:

Actual						Plan forecasts	
1974	1975	1976	1977	1978	First Half 1979	1979	1980
33%	30%	27%	24%	23%	20½%	20½%	20½%

There is no basis for the assumed stable market share of 20½ per cent. In recent months it has continued to fall and in November was moving towards 16 per cent. Next year, BL's model range becomes a year older and competitors will continue to introduce new models. There is no "natural" floor to BL's market share.

(ii) Dealer defections. BL are finding it increasingly difficult to cope with dealer unrest, particularly among the large dealer groups, as throughput/dealer falls below economic levels. Dealer defection is particularly serious in Europe. Loss of dealers leads inevitably to loss of sales, particularly as some customers are more loyal to their dealer/service agent than they are to the marque of car they own.

(iii) Customer defection. In recent year, BL have been more successful in holding on to fleet customers than to private customers. However, now that the larger importers are well-established with nationwide service networks, BL are beginning to lose many of their fleet customers as well.

(iv) New models. BL desperately require new models, particularly in the vital mid-car market. The only mid-car action in 1980 will be a face-lift to the Marina. BL's competitiveness will continue to fall and this will limit BL's ability to raise prices in line with its main competitors.

(v) BL's financial position. BL will enter 1980 in a far worse financial state than was envisaged when the Edwardes' Plan was put together. Losses at the 1979 year-end will be perhaps £60 million higher than forecast. BL are now bidding for an additional £100 million of Government funds before next April i.e. in the present 1979/80 financial year. The prospects of declining market share coupled with the need to price competitively gives little comfort for next year where even if the Plan's target could have been met there would be a cash outflow of over £250 million. BL have now pointed out that, because of the worsening outlook, their own contingency provision of £138 million that was built into the Plan for the whole year could be fully used up in the early part of 1980.

The odds seem to be that the Plan's financial targets for 1980/81 will be missed by a wide margin. If this were to happen, the BL Board have implied that they would abandon the Plan and would make proposals to the Government on handling the resulting situation with the minimum of damage.

6. The long-term prospects for the company. If the Edwardes' Plan were a 100 per cent success, could BL survive in the long-term without being a permanent burden on the Government? In our view BL would be nowhere near ?? large enough, particularly in the volume car business, to compete at sustained levels of profitability. There would no doubt be profitable years in which there could be no call on Government funds. But we do not see how a volume car producer of that size could generate year in year out the cash to develop new models to keep it abreast of its major competitors - all several times its size.

7. Collaborative deals of the Honda type, however necessary in the short-term, are not the long-term answer. The Honda deal, if it goes through, would give BL a new model earlier and should help to stop the dealer network from collapsing. But it will not provide BL with the profits to develop new models of their own.

8. Selling off the easily disposable bits of BL is equally not the answer. BL would then be left with the core of their problem unsolved - the volume plants at Longbridge and Cowley.

9. BL will remain a drain on public funds as long as it remains independent. We question the wisdom of putting much more Government money into BL (either directly or indirectly by assuring its private-sector borrowings) without making every effort to dispose of the company, preferably in toto, to one or more of the large motor manufacturers. Only under the umbrella of a healthy international motor manufacturer could the decline in BL be arrested.

10. If Ministers share our view, when should the effort be made to dispose of the company, by whom, and to whom? It is here that the attitude of the Board is crucial. The CPRS understands that Sir Michael Edwardes would accept the logic of much of the above and be willing to undertake further discrete talks (under cover of discussions on collaboration) to try to find a buyer.

11. Ministers would need to consider if there would be any buyers they would not accept. (The French will not be happy with a Japanese buyer as they have demonstrated over the modest Honda deal.)

Conclusions

12. The CPRS concludes that BL's contribution to the United Kingdom economy will continue to decline year by year if it remains independent of the international motor manufacturers. Ministers may decide that they will go along with the BL Board and their Plan for the time being. However, we believe that at some stage Ministers will wish to pursue radical alternatives to the Plan. These alternatives could include -

(i) Total sale. Using the relatively attractive parts of BL (Jaguar, Rover, Land Rover, Triumph, Trucks and Buses) as a sweetener to persuade a large motor manufacturer to take over the whole of BL and to preserve output in the volume car assembly plants at Longbridge and Cowley. Perhaps only Ford and General Motors would entertain such a proposition.

(ii) Total disposal in parts. There should be no lack of purchasers interested in the Specialist Cars Division and in the Trucks and Buses Division. The front runners for Specialist Cars might be Ford, Volkswagen, General Motors, and Daimler-Benz; for Trucks and Buses, International Harvester and Iveco (Fiat) might be the front runners. The difficulty lies in disposing of the Volume Cars Division, and in particular of the plants at Longbridge and Cowley. One possibility that should be examined is to attract Japanese manufacturers to take over these plants by persuading them of the need to begin local assembly operations in Europe, and to increase the local content of the cars they sell here.