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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BL CORPORATE PLAN

Note by the Central Policy Review Staff

The attached background note setting out some of the factors which influence BL's requirement for Government funding is circulated to the committee for information. On some key figures the note gives comparisons drawn from successive BL Corporate Plans and also provides some observations on what is needed if the latest plan is in the event to be fulfilled.

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## BL's ESCALATING REQUESTS FOR GOVERNMENT EQUITY.

1. Last year's Corporate Plan foresaw a need for about £130 million of new Government equity in the period 1981 and beyond. In this year's Plan, that sum has grown by £1 billion. This paper looks at some of the reasons why.

| New Government Equity £million | 1981 | 1982 | 1983 | 1984 | 1985 | Aggregate |
|---|---|---|---|---|---|---|
| 1979 Corporate Plan | 75 | - | - | - | - | 75 |
| 1980 Corporate Plan | 93 | 13 | 27 | - | - | 133 |
| 1981 Corporate Plan | 520 | 420 | 150 | 50 | - | 1140 |

2. The escalating requests for Government funding are predominantly due to the poorer outlook for profits.

| PBIT £million | 1981 | 1982 | 1983 | 1984 | 1985 | Aggregate |
|---|---|---|---|---|---|---|
| 1979 Corporate Plan | 215 | 269 | 328 | 386 | 478 | 1676 |
| 1980 Corporate Plan | 115 | 217 | 286 | 370 | 424 | 1412 |
| 1981 Corporate Plan | (157) | (19) | 134 | 217 | 330 | 505 |

3. The key question is has BL gone far enough in reducing their profit forecasts? The main risks to profitability are a continuation of the high exchange rate, failure to achieve UK market share, failure to export in sufficient volume for total production to reach economic levels, inability to price vehicles at profitable levels given that BL is a high cost producer, and failure to reduce production costs.

4. The Exchange Rate. The Plan assumes an effective exchange rate of 74 next year, falling steadily to 65 by 1985. Recently the rate has been around 77 - 78, and was over 80 earlier in November. BL have themselves now suggested a higher sterling profile as an alternative. They calculate that the higher profile would add £½ billion to their request for Government funding over the Plan period.

5. Failure to Hold UK Market Share. BL's share of the UK car market has been in long-term decline. As recently as the mid-1970's, it was well above 30%. This year it will be well below 20%. Successive plans have taken gloomier views of BL's ability to recover this lost ground.

| UK Car Market Shares % | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|
| 1979 Corporate Plan | 25.3 | 26.3 | 24.5 | 24.6 | n/a | n/a |
| 1980 Corporate Plan | 20.5 | 21.8 | 20.8 | 21.1 | 23.9 | 24.6 |
| 1981 Corporate Plan | 18.3 | 18.5 | 19.2 | 20.0 | 20.7 | 21.0 |

6. Until the Metro, BL's share of the market was being rapidly eroded through a combination of uncompetitive models, low levels of customer satisfaction (mainly because of poor quality and reliability), a declining dealer network, and action by BL's competitors.

- Uncompetitive models. The Metro and the Bounty will help, though neither spells much in the way of profits for either BL or their dealers. The new mid cars are a long way away - over two years to the hatchback (LM 10) and over three years to the saloon (LM 11).

- Quality and Reliability. This is probably BL's main weakness. Every Corporate Plan has said so. But relative to the rest of the industry, there has been little, if any, improvement.

- Dealer network. BL lost over 200 dealers in 1978 and another 200 in 1979. They now have under 1800. The decline has been halted by a combination of the Metro's success and the fact that few other franchises are recruiting.

7. Each one percentage point shortfall against Plan in their UK market share would according to BL add about £100 million to BL Cars' funding needs over the Plan period.

8. Failure to Export. BL Cars cannot achieve economic levels of production unless they export in sufficient volume. Europe is their main market.

| European Car Sales (Austin Morris) '000s | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|
| 1980 Corporate Plan | 94 | 140 | 120 | 168 | 184 | 201 |
| 1981 Corporate Plan | 56 | 70 | 104 | 109 | 132 | 148 |

9. BL Cars now have half the sales they had in Europe five years ago. They are losing dealers. They also have one of the worst reputations in Europe for quality and reliability. Earlier this year, for example, the West German Technical Examination (their MOT) ranked the bottom five cars (after examining 7 million cars for faults) as:

| | |
|---|---|
| 79 | BL Allegro |
| 80 | Chrysler Simca |
| 81 | Autobianchi A 112 |
| 82 | Skoda |
| 83 | BL Mini |
| 84 | Alfa Romeo Giulia GT 1300 |

10. The West German ADAC (their AA) published statistics on breakdowns per 1000 registrations, the final part of which read:

| | |
|---|---|
| Alfa Romeo | 57 per 1000 |
| Lada | 63 per 1000 |
| BL | 68 per 1000 |

11. Against this background, BL are planning to double their sales in Europe over the next three to four years.





12. Inability to Price at an Economic Level. BL Cars are a high cost producer of volume cars. This year their average loss (PBIT) per car produced will be nearly £600. For comparison, Japanese importers are thought to be enjoying profit margins well in excess of £600 a vehicle.

13. BL's competitors are reacting to the Metro launch with a price war, which they can afford but BL cannot. Both Fiat and Ford have recently chopped around £300 off the price of their Metro-equivalent. More worrying in the long-term would be aggressive marketing by the Japanese. At present, Japanese car sales are up against their VRA limits so there is no need for discounting. Local Japanese assembly plants or a collapse of the VRA would change that and undermine any prospect of high-cost producers being able to sell at a profit.

14. Each £100 shortfall (almost 2½% of average ex-works price) in estimating future levels of market price would add about £250 million to BL's funding requirement over the Plan period.

15. Economic Levels of Production. It is a rule of thumb in the motor industry that volume cars such as the Metro need annual production runs of at least 200,000 - 250,000 to be cost competitive. Much larger manufacturers such as Volkswagen, Renault, Ford, General Motors, Nissan and Toyota have little difficulty in exceeding this level across their entire range of volume cars.

16. For Metro, the BL Plan forecasts annual production runs of around 180,000 units at peak. To achieve sales of that level, the Plan assumes that 40 - 45 per cent of Metro's output can be exported, largely to Europe.

17. There are perhaps better prospects that the new mid-car family will achieve economic production levels. The Plan forecasts joint production (ie LM 10/11/12) of around 300,000 units a year. About one-quarter of the output is assumed to be exported, again mainly to Europe.

18. Financing Risks. The 1981 Plan assumes that BL can raise £400 million in term loans from the private sector. Hill Samuel believe this should be possible provided that the Government are prepared to give assurances stronger than exist under the Varley/Marshall statements. If either (a) the assurances are not strengthened, or (b) BL's trading position deteriorates, or (c) Hill Samuel have overestimated the ceiling of lending capacity for BL, the requirement for new Government equity would increase correspondingly.