



## 10 DOWNING STREET

From the Private Secretary

22 May 1980

Dear Sir,

British Leyland

As you know, the Prime Minister held an informal dinner last night for Sir Michael Edwardes. The following were also present in addition to your Secretary of State: the Chancellor of the Exchequer, Sir Austin Bide, Mr. David Andrews and Mr. Robin Ibbs. The following is a summary of the main points which came up in discussion.

Sir Michael Edwardes first outlined the progress which had been made at B.L. towards recovery. A strong Board and improved management team had been established. Since 1977, manpower had been reduced by some 30,000. The closure programme had been pushed ahead. Important changes in work practices were being implemented. At a time when other companies were settling for much more, B.L. Cars had achieved a pay deal averaging 7½ per cent. And an excellent new product, the Mini Metro, was to be launched in the autumn - with a manufacturing facility up to the best European standards. In addition, two important collaboration deals - one with Honda, the other with Z.F. - were already in place, and other major deals were on the horizon.

Sir Michael implied that, as far as those matters within the Company's control were concerned, B.L. was doing as well as could be expected. However, they faced a much worse trading environment than had been assumed when the 1980 Plan was prepared, and even more so than had been assumed back in 1977. In particular, the U.K.'s higher rate of inflation and sterling's appreciation had meant a drastic deterioration in competitiveness. (At this point, Mr. Andrews handed out some graphs, copies of which I enclose.) Exporting to some countries, such as the U.S.A., was now being done at a loss; and even the export profitability of the Land Rover was beginning to come under pressure. B.L. did not benefit much from lower import prices because nearly all of its bought-in materials came from U.K. suppliers. However, the Company were now looking very critically at the cost of U.K. components, taking into account in particular the fact that many suppliers had concluded pay settlements of 15 per cent and more, and were trying to pass the extra cost on to B.L.. B.L. were clearly not in a position to pay uncompetitive prices; and although they had an interest

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in the survival of the U.K. components industry, they were now telling their suppliers that they would have to take into account the latter's pay settlements in deciding whether or not to agree price increases. (Sir Michael handed over a list of settlements in the components industry - copy enclosed.) In parenthesis, Sir Michael said that he wished Ministers would do more to educate the public on the trade-off between high pay settlements and jobs. The Government's policies were having a slower effect than Ministers must have hoped: their early success was essential for BL's success.

Sir Michael went on to say that on the new economic assumptions which they were using (and which were, if anything, at the optimistic end of the range) BL's cash flow would fall several hundred million pounds short over the Plan period. This meant that there would not be funds for some of the new products which had been planned. But even eliminating this expenditure would still leave the company with a large cash shortfall. They would be able to live within the £300m cash limit for 1980, but the £130m provisionally set aside for 1981 and the assumption that no Government funding would be necessary thereafter were now unrealistic. The BL board were not yet in a position to express a view as to whether they could achieve long term viability; but they were clear that more Government funding would be needed.

The most critical element in the Plan was the success or failure of the Mini-Metro. If the Metro failed, the Plan would be finished. The other crucial aspect - and this would affect the amount of extra funding required - was whether BL could complete an important collaboration deal with a major German manufacturer. Sir Michael would not name the company, but said that B.L. were entering into urgent talks with a view to collaboration, including an element of equity funding, in the Rover/Triumph and Four-wheeled Drive product groups. It would offer the prospect of investment savings for both companies. They should know by about mid-June whether this was likely to come off; the prospects seemed quite good. If a deal was completed, this could substantially reduce the amount of extra funding required. Nonetheless, up to £500 million extra could still be required over a three to four year period.

Against this background, the Government would be faced with the political decision later in the year of whether to provide additional funds, or to withdraw support; or as a further alternative, though he realised this was largely hypothetical, to impose import controls. If the Government decided not to provide the extra funding needed, he doubted whether the Plan could be aborted with a "soft landing". The prospects for selling most parts of the business in the near future were not good, and the costs of run down would be very substantial.

Sir Michael said that he had been doing everything possible to explore the possibilities for collaboration and sale. As regards collaboration, the hoped-for deal with the German company seemed the best prospect available. As regards outright sale, there was no company in

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the world interested in purchasing the business as a whole. The Japanese were not interested because it was cheaper to manufacture vehicles in Japan and export to the UK and Europe; the US companies had enough difficulties at home; and none of the European companies were interested in either. It was possible that the Japanese might be more interested if there was a real threat of import controls.

As regards selling off parts of the business, only Land Rover could be sold off at a good price at the moment; but if it were sold, this would remove BL's best product and leave the rest of the business seriously weakened. The prospect of selling other parts of the business would be better in a year or two's time as the recovery programme moved ahead. Sir Michael mentioned that the Japanese were interested in purchasing BL's Belgian plant or alternatively, their plant at Solihull; there were attractions for BL in both of these possibilities, but they also had to take into account the effect that "letting the Japanese in" would have on their relations with European manufacturers. There was a considerable risk that - if BL helped the Japanese to set up a manufacturing base - this would spoil BL's prospects of collaboration in Europe.

The Prime Minister said she had been very disturbed by Sir Michael's letter of 15 May insofar as it failed to confirm that long-term viability was attainable. Although Sir Michael and his team had achieved a great deal, she was now even more concerned in the light of Sir Michael's assertion that extra funding would be needed. Whatever the causes for the deterioration in cash-flow, BL was failing to meet their plan targets. She could not accept that factors external to BL should take all the blame; and to the extent that they were responsible, BL would have to make the necessary adjustments in performance and scale of operation. With heavy calls on the Contingency Reserve already in prospect there could be no presumption that additional funds would be provided. Sir Keith added that for the Government to provide additional funds would have immense significance for its whole approach to economic and industrial policy: it could only conceivably be defensible if further significant progress could be demonstrated.

The Prime Minister said that the Government would need to take stock in the light of BL's talks with the German company, the contingency work being undertaken by Mr. Grenside and the revised forecasts which the company would be preparing.

Following the dinner, the Prime Minister said that Ministers will need to meet to discuss BL again - certainly before the summer recess. In the meantime, the CPRS will be doing further work to refine the options for Government, as no doubt your Department will too.

I am sending copies of this letter and enclosures (including a short statement which Sir Michael left behind) to John Wiggins (HM Treasury), David Wright (Cabinet Office) and Robin Ibbs (CPRS). In view of the sensitive nature of the discussion, could you and they please ensure that copies have the most restricted circulation.