



cc Hoskyns

PRIME MINISTER

BL CORPORATE DEVELOPMENT

In my minute to you of 6 August about BL, I said that I would write to you again when BL had been able to provide me with further details, including costings, of their proposal to divide ... their present business into four major companies. I attach a letter sent to me by Michael Edwardes on 11 September. This raises major issues of Government funding, and has implications for the whole future of BL volume car production over the coming years. I do not think that Michael Edwardes would expect me to comment substantively on these issues before he has presented the BL Corporate Plan for 1981 in October.

2. You will see that the figures involved in supporting BL Cars and BL Commercial Vehicles beyond the current financial year are potentially very large - a total of £800 million over the next four years. Michael Edwardes foresees new Government equity of £300 million for Cars and £50 million for Commercial Vehicles in 1981, £200 million for Cars and £50 million for Commercial Vehicles in 1982, and £100 million in each of the next two years for Cars. We must consider the options very carefully before we decide whether we are prepared to fund BL Cars next year and beyond. If we decide to support the Corporate Plan we shall face funding next year of at least an additional £275 million (this is the BL figure of £350 million less the £75 million which was included

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in our public expenditure White Paper (Cmnd 7841) - say £250 million at 1980 Survey prices). But, as the work of officials demonstrated, in the short term at least a more drastic rundown at BL Cars could well add still larger sums to public expenditure and the PSBR. Clearly, before we come to a decision on these very complex issues we need to clarify the options and their financial and other consequences so that we can act speedily when we get the Corporate Plan. I am arranging for the Interdepartmental Group of Officials which has previously examined BL's affairs to look into the options as a matter of urgency.

3 There are, however, two points on which we must form at least an initial view in advance of the Corporate Plan. The first is the proposition that BL should submit four separate Corporate Plans instead of one, in recognition of the fact that BL Cars, BL Commercial Vehicles, Land Rover and Unipart, although reporting to the BL Board, would have a separate managerial and financial identity. In my view this would in no way prejudice our decisions on the future of BL, and would have a desirable effect on the prospects for privatising the more saleable parts of BL (Land Rover and Unipart). If you and Geoffrey Howe agree, I propose to tell Michael Edwardes of my provisional agreement that his Board should plan on the basis of four businesses, but that we shall not take a final decision until we have seen the Corporate Plans and can assess the consequences, and in particular the potential effect on Government funding, of separating BL in this way. I also propose to tell him that it would be helpful if BL were to submit with the Plans a covering paper pulling them





all together, so that the implications for the BL Group as a whole were plain. I think it would be best, particularly in view of the likely impact of any publicity on BL's forthcoming pay round and on their collaboration prospects, if both we and BL were to maintain confidentiality about this, as Michael Edwardes suggests.

4 The main development in BL's thinking, which has been influenced by their financial advisers, since my talk with Michael Edwardes before the recess, is that a majority of shares in Land Rover and Unipart would probably be floated in 1982 instead of 1981. As you will recall, Michael Edwardes' earlier view was that some £200 million might be generated from the floating of Land Rover and Unipart. However, it now seems that it would involve disposing of shares at a discount and the repayment of loan stocks at par, with consequent refinancing of debt at higher interest rates. We must obviously ask BL for their latest estimate of the proceeds of a flotation. However, I think that this idea has great intrinsic merit, although it seems likely that it would make a smaller net contribution to the easing of public sector financing problems than I had hoped.

5 The other point on which we need to form an initial view in advance of the Corporate Plan concerns the LC10 (BL's project for a new medium-sized car). Funds to keep this project going pending a firm decision to proceed were authorized last July. As foreshadowed in his letter, Michael Edwardes has now written to me pressing for an early Government decision on Phase 1 of the LC10 programme

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- now redesignated LM10 - (costing £108 million) which BL have just submitted to this Department. A copy of his letter of 12 September is attached. He suggests that you might announce Government approval of the project during your speech at the SMMT Dinner in Birmingham on 16 October. The LM10 programme is, of course, the cornerstone of BL's recovery plans for the Cars Division, and substantial further investment in the LM10 family of cars would be required in due course. I do not see how we could consider it in isolation from and in advance of BL's 1981 Corporate Plan which we shall not receive until next month. I therefore propose to tell Michael Edwardes that I shall not be able to agree to the timing he proposes. However, I take his point that it could be positively damaging to BL's dealership network if you did not say something in your speech about the LM10. This could be on the lines that the Government had received the LM10 programme which had recently been approved by the BL Board. The Government fully understood how critical this was to BL's recovery plans. Funds had been provided to keep the project going, so that no time was being lost while the Government examined the funding implications. A decision would be reached as soon as possible in the context of the Government's consideration of BL's 1981 Corporate Plan, of which LM10 was a part.

6 I should welcome your comments and those of Geoffrey Howe at this stage on this and on the four Corporate Plans issue.

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7 I am copying this minute to Geoffrey Howe, Jim Prior,  
John Hoskyns, Robin Ibbs and to Sir Robert Armstrong.

*KJ*

K J

*22* September 1980

Department of Industry  
Ashdown House  
123 Victoria Street



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FROM SIR MICHAEL EDWARDS

The Rt Hon Sir Keith Joseph, Bt  
Secretary of State for Industry  
Ashdown House  
123 Victoria Street  
LONDON SW1

12 Sep 1980

*Dear Secretary of State,*

LC10 PROGRAMME

As you know, the Board approved Phase 1 of the LC10 Programme at its 9 September meeting, and the Programme is being forwarded to your Department and the NEB through the usual channels for approval. I am taking the additional step of sending you a copy of the full Programme and writing to you direct because the Board is determined that you should be fully aware of the value of early Government approval for this Programme.

The LC10 family will provide considerably higher profit margins for BL Cars than will Metro; this is inevitable when the market as a whole traditionally permits higher margins to be earned on medium cars than on small cars. In addition, we have felt the effect of an out-dated product range more severely in the medium car sector than on small cars because the Mini has held on to its market base more effectively than have the Allegro and Marina. Consequently, there is no doubt that, if we were starting again at the time of the Ryder Report, we would have decided to proceed with LC10 before Metro. It follows that we must await the impact of LC10 launch before we can really judge the fundamental viability of BL Cars; and we cannot afford any avoidable delay in proceeding towards that launch.

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The Rt Hon Sir Keith Joseph, Bt

12 Sep 1980

For the same reasons LC10 is vitally important to our dealers. The squeeze on volumes and margins this year is almost certainly causing most of our dealers to operate at a substantial trading loss. Announcement of our half-year results today will certainly cause nervousness throughout the whole dealer network and may cause many of them to consider whether loyalty to BL Cars is now too great a commercial risk. Fortunately, the launch of Metro will tend to offset this, by giving their morale a major boost, but it will not solve their margin problem. It will also prompt the raising of further questions about whether LC10 is really going to happen.

As a company, we are doing all we can to prevent further erosion of our dealer network. In addition, therefore, to announcing today that the Board has approved the first phase of the Programme and is submitting it to the Government, we see an overriding need to make a positive statement about LC10 in mid-October, when the launch of the Metro and the Motor Show will combine to focus the spotlight on our product development plans. If we were compelled to duck questions about LC10 at that time, the Metro launch could be undermined in a way which would be irreparable even by the strongest statements of support a month later.

An additional complication is the Prime Minister's visit to the Motor Show and her major speech at the SMMT Dinner on 16 October. In our view, this presents both a great risk and a great opportunity. It would be an enormous boost to confidence, and thus market share and cash flow, not only amongst our dealers but in our key suppliers, our managers, our bankers and our potential collaborators, if she were able to announce Government approval of LC10 on that occasion. But if the PM declines to answer the major question as to whether LC10 is to go ahead, this would be especially damaging to us. Frankly, if the latter

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The Rt Hon Sir Keith Joseph, Bt

12 Sep 1980

|| approach were inevitable, we would advise strongly that she should reconsider her visit. There is a great deal at stake and especially so for the Midlands which is to be the venue for the SMMT Dinner.

X | It will, of course, be argued that approval of the LC10 Programme implies approval of the BL Cars Plan as a whole, or at least of the principle that further funding for BL Cars will be provided. In submitting the LC10 Programme for approval in advance of the Corporate Plans, the BL Board itself has not subscribed to this view, for the following main reasons. First, the investment of £108m required for LC10 accounts for only a small proportion of the total funds requested. Secondly, it is the norm rather than the exception to approve investment programmes between the annual Corporate Plans rather than simultaneously. Thirdly, an immediate start must be made on the major product and facility developments required to keep LC10 launch on schedule, and it would be less than honest to continue solely on the basis of long-lead funds when we are moving into the main part of the Programme.

For all these reasons the Board urges you to press ahead with early consideration of the LC10 Programme, in the hope that you will announce the Government's decision in the first week of the Motor Show - indeed, if the Prime Minister were prepared to do so at the SMMT Dinner, this would do more to secure the future of the motor industry than anything else I can think of in the short term.

Yours sincerely,  
Michael Swain.



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FROM SIR MICHAEL EDWARDES

The Rt. Hon. Sir Keith Joseph, Bt.MP.,  
Secretary of State for Industry,  
Ashdown House,  
123 Victoria Street,  
LONDON SW1.

11 September 1980

*Dear Secretary of State,*

BL CORPORATE DEVELOPMENT

At our meeting on the 31st July, I outlined a proposal to divide our present business into four major companies which, although reporting to the BL Board, would have separate managerial and financial identities. Subject to your agreement we would then submit four separate Corporate Plans in place of one. I explained that, although the proposal would provide the option to release funds by enabling two of the four companies (Land Rover and Unipart) to be floated, it would also have the effect of highlighting the heavy funding requirements of the remainder of BL Cars. You therefore asked me for a broad indication of what these requirements were likely to be to help you to understand fully the implications of our approach.

We agreed that we would provide this broad indication in the context of financial and manpower profiles of the four new companies which would approximate as closely as possible (at this early stage in our Plan development) to the four Plans which we expect to submit to you in October. These profiles have been considered by the BL Board which believes that they indicate the likely general shape of the four businesses, and I therefore enclose the profiles, together with summary sheets drawing out the implications for funding and manpower. These tables largely speak for themselves, but the Board wishes to draw the following points to the Government's attention -



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1. Status of Profiles

The Board is not yet due to consider, let alone approve, the detailed Corporate Plans for the four companies. Although the profiles represent our best estimate of the overall shape of these plans at the present time, the Board could well make substantial changes following their review of the Corporate Plans. In particular, the Board would want to review the whole future of BL Cars if (contrary to our firm expectations) the Metro launch were a failure or if there were a major disruption of production in the course of BL Cars' forthcoming round of pay negotiations. The Board also has reservations about the profile for Leyland Commercial Vehicles, particularly with regard to the adequacy of the rate of return envisaged for the medium term, but will have resolved these issues before the plan is submitted.

2. Timing of Decisions

Nevertheless the profiles will provide useful background to enable the Government to prepare for the taking of early decisions on the four Corporate Plans when they are formally submitted, thus avoiding too long a period of confidence-sapping uncertainty. I am writing to you separately about the particular need for an early decision on Phase 1 of the LC10 Programme which has now been approved by the Board.

3. Economic Assumptions

The profiles assume a major task for the Government - to provide a climate in which the rapid deterioration in the UK's economic competitiveness (which has been so damaging to our manufacturing industry over the last year) can be arrested. In our discussions with your officials, there has been no substantial disagreement with our economic assumptions. But if in the event these are not borne out, or if there is no effective restraint of foreign competition exploiting unfair trading advantages, the Board will see little prospect of success in holding the UK motor industry together.



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### 4. Internal Objectives

The external climate is one matter; what we have to achieve internally is another. Our internal task is formidable, particularly for BL Cars. We need to attain a cost structure fully competitive with our European rivals within the next five years despite our relatively smaller scale of production. This requires ruthless switches of component sourcing where suppliers will not keep their costs (particularly wage costs) down; a further 40% reduction in BL Cars fixed costs (at constant prices) made up principally of severe staff reductions; further reductions in manpower bringing BL Cars manpower, by the end of 1984, to only 50% of its level when the present Board took over at the end of 1977; holding pay increases to single figures for the third successive year (we have decided to limit wage increases in both BL Cars and Leyland Vehicles to a figure of the order of 7% in the next round); and further rationalisation of product programmes and facilities, including for example, examination of such possibilities as the ultimate disposal (or use for contract assembly) of the Rover plant at Solihull and the closure of major facilities in Leyland Vehicles.

There are two major risks that we shall not achieve our internal objectives. Firstly, the business may not be able to stand the required degree of further "surgery"; and secondly, Metro, LCI0, Bounty and other products may not be successful. But the Board's view is that we have no alternative but to take these risks; to attempt less would mean perpetuating a cash drain which would make the even greater upheaval of total closure inevitable.

### 5. Contingency Planning

We have deliberately not waited for Government decisions on the 1981 Plans before taking many of the actions envisaged in the profiles, such as the staff cuts in BL Cars, the further work on product and facility rationalisation and the preparatory work for the division into four companies. This is not because the Board seeks to pre-empt any Government decisions; nor is it to avoid cash calls on Government beyond the £300 million agreed this year, though we still hope to do so, despite the fact that these measures will increase our cash outflow in the short term because of redundancy and closure costs.



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Rather it is that these actions are consistent with the contingency planning envisaged in the Grenside Report and will be beneficial whatever the ultimate fate of BL Cars. They are essential to give the business a prospect, however uncertain, of ultimate viability. Equally, they will contribute to alleviating the pain of any subsequent decision to close the business. For example, redundancies and plant closures would have to happen anyway if BL Cars were to disappear; continuing investment programmes give a chance of setting up some parts of the business, such as Metro, for sale; and the four-company division helps to insulate the other three businesses from the fate of BL Cars. We considered the additional possibility of extracting Jaguar as a separate company from BL Cars, already having separated it organisationally as far as is practicable. But this would have endangered the survival of our dealer network, and Jaguar is in any case a loss-maker at present, with a largely new management team. Given time, the managerial separation of Jaguar which we have now effected should provide the basis for a return to viability, thus making it possible for Jaguar ultimately to stand alone if circumstances require this.

### 6. Flotation of Land Rover and Unipart

You will see from the profiles that these two businesses can be free-standing financially (with Land Rover being able to meet its modest initial cash needs through external borrowings on commercial terms). Our initial feasibility studies indicate that flotation of shares in the two companies should be feasible, provided that a number of technical problems can be overcome. 1982 appears to be a more practical objective for flotation than 1981, because this would provide the time to solve these technical problems. In particular, it is necessary to ensure that no needless tax liabilities are incurred and that financial data suitable for Stock Exchange purposes can be prepared. The Board must make it clear that flotation has serious commercial disadvantages. It would involve disposing of shares at a substantial discount off asset values (compared with selling control to a single bidder), and conversely it would almost certainly require the repayment of BL's existing loan stocks at par (because of the conditions attached to the relevant Trust Deeds) compared with the substantial discount at which they stand in the market today.



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We would need to be sure that we could re-finance our long-term debt from the private sector, and the re-financing would in all probability be at higher interest rates than are presently paid on the loans which would fall to be redeemed. But on this basis, flotation of 60% of Land Rover and 60% of Unipart is a major option, if the priority is to reduce our cash requirements.

We have of course considered whether we could float the entirety of Land Rover and Unipart. As regards Unipart, its close and complex relationship with the Cars business requires continuation of management control for the foreseeable future, and a 40% BL shareholding is the minimum needed to ensure this. For Land Rover, retention of management control for the time being would be desirable for similar reasons, but even more important is the need for more time to strengthen Land Rover organisation and complete its expansion programme before leaving the company to stand entirely on its own feet. Moreover it features importantly in our collaborative discussions with our German partners. However, the possibility of floating the remainder of Land Rover would be reviewed regularly in the light of progress on these matters.

7. Leyland Commercial Vehicles

The attached profile of this business is included as background information at this stage, recognising that we still have major decisions to take on our Commercial Vehicle strategy before we submit the Plan for this business to you in October. The Board considers that we must either find a partner for Leyland Vehicles in a major collaborative agreement or reduce the business to a size at which it can stand alone on a commercially viable basis. The 1981 Plan will reflect the conclusions which we expect to reach at our October Board on this strategic choice. However, irrespective of this decision, it is clear that Alvis and Coventry Climax are not essential elements of the business and should in any event be sold. The current profile assumes that we are successful in finding buyers over the next two to three years.

8. BL Cars

Despite the drastic actions we are already taking, the combination of recession, inflation and the high pound means that we cannot bring this business back into trading profit



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before 1983. Given the performance of most other car manufacturers around the world outside Japan and the financial assistance being made available by Governments in the United States and Europe, the Board believes these results are the best that can reasonably be expected. On the basis of a competitive cost structure, BL Cars will then have the prospect of earning a modest profit and securing a positive cash flow in the longer term. In the Board's view, there will inevitably be a substantial risk of not achieving these objectives. An unsuccessful launch of Metro would in particular undermine the dealer network which is already under severe strain. In that event there would be no point in investing further funds. The funding implications of supporting BL Cars are substantial - £300m in 1981, £200m in 1982 and £100m in each of 1983 and 1984.

Clearly, as the Board said to you when you were considering the 1980 Plan, BL Cars is not a commercial proposition, and the Board would not recommend an ordinary shareholder to invest in it. But the Board believes that the Government will wish to view this issue in a broader context; and the Board wishes to draw the Government's attention to the fact that the profile for BL Cars indicates the possibility of a viable business in five years' time and thus the chance of saving employment within BL and its suppliers. At this particular time we have the opportunity to build on such possible developments as the improvement in our industrial relations, the reforms of working practices in BL, the new facilities at Longbridge and, above all, the launch of the Metro. Moreover, to close BL Cars now would jeopardise the chances of successfully detaching the other three businesses as we now propose. We recognise nevertheless that this is essentially a decision for the Government to take.

9. Longer-term Assurances for BL Cars

If the Government decides to support BL Cars, that support must be clear and unambiguous. To limit agreement to short-term funding could be counter-productive because it would simply fuel speculation about BL Cars' future and drive away dealers and customers as well as key senior managers within the company. This has been the pattern of recent years. The division into four companies will make it all the more necessary to ensure that there is no doubt about our intention



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to see BL Cars through the recession, by which time further big investment programmes, such as LC10 and the lightweight Jaguar, will be coming to fruition. The Board consider it essential that funding for BL Cars should be accompanied by an assurance that the Government intend to fund the first three years of the Plan, provided that the Metro is a success and that cash flow targets are met each year. In addition, BL Cars will need sufficient assurance of the Government's willingness to stand behind its obligations in order to raise substantial further borrowings from the private sector; this will of course contribute to limiting the direct call on Government funding.

I should emphasise that the advantage of our proposed division into four companies is that the three-year funding assurance, and perhaps also any specific guarantees, can be confined to BL Cars; but a three-year funding assurance cannot be avoided if we are to give BL Cars a fair chance of long-term survival by bolstering confidence amongst its managers and employees, dealers, customers, bankers, components' suppliers and potential collaborators. It may be argued that a three-year funding commitment will, by the same token, appear to guarantee the jobs of the workforce and thus release the discipline we have successfully applied in that quarter. We do not believe this to be so. We can meet this problem by pointing to the proviso that we must achieve our Plan, which assumes a 50% increase in productivity and reasonable continuity of production. Moreover, the essential difference between our present position and that prevailing in the years immediately following the Ryder Report is that our credibility with trade unions and workforce is high - they are in no doubt that we are prepared to go through with major closures and redundancies and if necessary with the total closure of the Cars business.

10. Collaboration

The profiles prudently refrain from making specific assumptions about collaborative deals. However, collaboration will be necessary in certain cases to achieve sales volumes or provide engineering resources which we would have difficulty in achieving or providing on our own. Beyond this, collaboration provides an opportunity to perform better than our current projections. But it would be misleading to suggest that it can necessarily offer major investment savings.



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I shall of course be ready to discuss with you the present status of our various negotiations with other manufacturers either before or after the formal submission of our Corporate Plans. In particular our talks with our German partners are going well.

11. Net Overall Funding Requirements

The Board recognises that the requirement for further funds will be unwelcome but trusts that the Government will consider BL's problems in the wider context both of the motor industry recession throughout the Western world and of the financial assistance which is being, or has been, developed by several Governments to see their motor manufacturers through similar difficulties.

The development of four separate Corporate Plans will of course involve many staff within the Company, and the risk of leaks will increase as we proceed. We hope that we can maintain confidentiality until you are ready to make an announcement in Parliament, particularly as a premature release could damage our collaboration prospects. But for this reason it is important that we should not be caught out, and it would be helpful if we could agree at staff level on our response to any leaks.

We shall of course be ready to elaborate on the issues raised in this letter, both in our Corporate Plan documents and in the ensuing discussions.

Yours sincerely,  
Richard S. ...