JU847

If we are to have decisions on para 6 by the end of the year the papers will need to be round early next week (on Monday the 14th Dec.) not

← Told Ian Ellison by phone 14/12

cc JV
AD

SECRETARY OF STATE FOR INDUSTRY

CONFIDENTIAL

Prime Minister

John Hoskyns will no doubt have comments to make early next week.

Mr Jenkin wants to make a statement before Christmas. Will you want a meeting on this, or are you broadly content with his approach, subject to comments from colleagues?

Yes not. ←

MAP 11/12

PRIME MINISTER

BL'S 1982 CORPORATE PLAN

An interdepartmental group of officials, under the chairmanship of Mr Gordon Manzie, a Deputy Secretary in my Department, has been studying BL's 1982 Corporate Plan. The Treasury, the Scottish Office, the Department of Trade, the Department of Employment and the CPRS participated in the group. A copy of their report is attached.

2 As you will recall, the Government decided last January to approve BL's 1981 Corporate Plan and to provide funds for the first two years of the Plan (that is, £620 million in 1981-2 and £370 million in 1982-3) subject to the regular monitoring of progress in achieving the Plan. In the case of the Cars, Land Rover and Unipart Groups, the Plan is essentially an updating of the 1981 Plan. However, in the case of the Leyland Group, the BL Board have now put forward, as we requested them last July, a radical review of the various options for the trucks business.

3 The Group's conclusions are set out on pages 24-28 of the Report. Briefly, these are that there is no change in the position or prospects of the Cars and Unipart Groups which would justify a decision not to continue funding the Plan agreed last year for the remainder of the two year period ending in March

CONFIDENTIAL

1983; the Land Rover Group has suffered a deterioration in the past year but is not facing sufficiently severe problems to justify reconsideration of continued Government funding; with regard to the Leyland Group, Departments other than the Treasury judged that the prospect of a return to profitability by 1983 or 1984 without the need for any extra Government funding beyond that already provided for was reasonable, though subject to substantial risks; the Treasury, on the other hand, judged that the risks and opportunities were more finely balanced. However, taking account of the additional public expenditure and PSBR costs of closure, the recommendation of the Group as a whole is that the Leyland Group Plan should be approved subject to monitoring of progress and a review in the context of next year's Corporate Plan.

4 I agree with the advice of officials and their recommendation that the Government should approve the 1982 Corporate Plan as a basis for the continued funding required by BL in 1982/3.

5 In view of the fact that we agreed last year to two-year funding and that BL are not seeking any extra Government funding to carry out their Plan, I suggest, subject to your views and those of other colleagues, that this matter might be dealt with in correspondence. I have told Sir Michael Edwardes that the Government will do their best to reach decisions on the Plan in

CONFIDENTIAL

time for me to make a statement in the House before the Christmas recess. Any announcement of the Government's approval of the Plan would, of course, be contingent upon the ending of the current strike at Longbridge. The BL Board would of course withdraw the Plan for the Cars Group if there were no prospect of a satisfactory solution of this problem.

6 I hope to make further recommendations to you and other colleagues by the middle of this month about the highly confidential matter of BL's future structure and the related question of privatisation. Sir Michael Edwardes is seeking decisions on this by the end of the year. Though we clearly need to reach decisions on the 1982 Corporate Plan before deciding on BL's structure, I do not think this need affect the timing of a statement on the Corporate Plan.

7 I am copying this minute to the Chancellor of the Exchequer, the Secretaries of State for Scotland, Trade and Employment, to Mr Robin Ibbs and to Sir Robert Armstrong.

PJ

P J

11 December 1981

Department of Industry
Ashdown House
123 Victoria Street

CONFIDENTIAL

CONFIDENTIAL

bcc Duguid
Ingham
Ind Pol

10 DOWNING STREET

From the Private Secretary 17 December 1981

Dear Ian,

BL's 1982 Corporate Plan

The Prime Minister was grateful for your Secretary of State's minute of 11 December.

The Prime Minister is content, subject to the views of colleagues, with the approach proposed by your Secretary of State.

I am copying this letter to John Kerr (HM Treasury), Muir Russell (Scottish Office), John Rhodes (Department of Trade), Richard Dykes (Department of Employment), Gerry Spence (CPRS) and David Wright (Cabinet Office).

Yours sincerely,

Michael Scholar

Ian Ellison, Esq.,
Department of Industry.

CONFIDENTIAL

CONFIDENTIAL

SECRETARY OF STATE FOR EMPLOYMENT

S/C JV AD

(2)

Prime Minister

To note

MCS 21/12

PRIME MINISTER

BL

1. Patrick Jenkin copied to me his minute of 11 December about BL's Corporate Plan for 1982.

2. I have considered whether liquidation of the Leyland Group's Trucks Division is a practicable option for us, but I do not believe that it is. Apart from the obvious drawbacks of this course, such as the greatly enhanced cost to the PSBR and the large numbers of redundancies - concentrated in areas of very high unemployment such as Bathgate - which it would entail, we should find it very difficult to justify it when Michael Edwardes and his Board, who are not generally regarded as a soft touch, were maintaining that the Leyland Group was still viable, were putting through a radical set of measures to turn it around and were not asking for any more money beyond what we agreed last January.

3. I therefore support Patrick's recommendation that we should approve the 1982 Plan and confirm our previous approval of the funding BL require for 1982-83.

4. I am copying this minute to Patrick Jenkin and to those to whom he copied his.

NT

NT

21 December 1981

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

BL'S 1982 CORPORATE PLAN
REPORT BY THE OFFICIAL GROUP ON BL

TABLE OF CONTENTS	Pages	Paragraphs
Introduction	1-2	1-4
Assessment of the profit shortfall in 1981	2-3	5-9
- Cars Group	2	6
- Land Rover Group	3	7
- Unipart Group	3	8
- Leyland Group	3	9
Key features of the Plan for the Cars, Land Rover and Unipart Groups	3-14	10-30
- Projected financial performance and funding implications	3-6	10-15
- Product and manufacturing strategy	6-8	16-19
- Collaboration	8-9	20-22
- Disposals	9	23
- Introduction of private capital	10	24-26
- Appraisal of risks (Cars, Unipart and Land Rover Groups)	10-14	27-30
The Leyland Group Plan	14-23	31-62
- Background	14-15	31-33
- Facilities, models and manufacturing method	15-16	34-37
- Manpower and productivity	16	38
- Sales volumes, market size and market share	16-17	39-41
- Collaboration	17-18	42-44
- Financial forecasts and funding implications	18-19	45-48
- Appraisal of risks	19-21	49-53
- Options	21-23	54-62
Conclusions on Cars, Land Rover and Unipart	24-25	63-68
Conclusions on the Leyland Group Plan	26-28	69-75

ANNEX A - Assessment of profit shortfall in 1981

ANNEX B - BL's economic assumptions - main case and alternatives

ANNEX C - Leyland Trucks: effects of closure

ANNEX D - Regional Employment Consequences

Department of Industry
2 December 1981

CONFIDENTIAL

BL: 1982 CORPORATE PLAN

REPORT BY THE OFFICIAL GROUP ON BL

INTRODUCTION

1 On 26 January 1981, the Secretary of State for Industry announced the Government's decision to approve BL's 1981 Corporate Plan and "to fund the first two years of the Plan, including the first phase of the LC10 programme - that is, £620m in 1981-2 and £370m in 1982-3 - subject to regular monitoring by the BL Board of progress in achieving the Plan". Ministers accepted BL's arguments that funding needed to be approved for two years rather than the normal one, in order to maintain the confidence of dealers and management up to the launch of the LM10 in spring 1983. In essence, therefore, the question normally facing the Government with BL's Corporate Plan - whether to agree to its funding implications - is not relevant this year, since BL are not asking for more funding than that agreed last year. However, there are questions on the 1982 Corporate Plan which still need to be answered.

2 The two-year funding was agreed to only on the understanding that both the BL Board and the Government would monitor the company's performance closely, and Sir Michael Edwardes and the Board recorded their determination to take whatever decision were necessary to keep BL on the path to profitability. Two questions therefore arise on the 1982 Plan for the Cars, Land Rover and Unipart Groups:

a) how has their performance in 1981 compared with their forecasts;

b) are these Groups, therefore, still on course for profitability?

These questions are addressed below. We have not, on this occasion, assessed the effect of any alternatives to continued funding of these three Groups.

3 The second aspect for consideration this year concerns the Leyland Group (the commercial vehicle business), for which BL have finally prepared a concrete set of proposals. The task on the Leyland Group differs from that on the rest of the Plan. The BL Board have put forward a Plan for the radical restructuring of the Leyland Group as a response to the sharp fall in the truck market in the UK and the lack of competitiveness of British exports, and they have also, at the Government's request, examined the effects of liquidating the truck manufacturing part of the Leyland Group. The Official Group has, therefore, considered the Plan for the Leyland Group in isolation from confirmation of the two-year funding decision, has assessed the proposals for the Leyland Group and the option of liquidation, and has considered whether there are any other options open to the Government.

4 The Report is therefore divided into the following sections - an assessment of the company's performance in 1981, including the Leyland Group; the key features of the Plan for the Cars, Land Rover and Unipart Groups, with financial forecasts for the whole of BL, and the risks attaching to the prospects for these Groups; and a more detailed examination of the proposals for and prospects of the Leyland Group.

ASSESSMENT OF PROFIT SHORTFALL IN 1981

5 BL as a whole is forecast to make a loss of £267m before interest and tax in 1981, £124m worse than projected in the 1981 Plan. Leyland Group performance accounts for most of this shortfall:

Forecast 1981 PBIT compared with 1981 Corporate Plan

£m	1981 Plan	1982 Plan forecast for 1981	Forecast shortfall
Cars	(190)	(194)	(4)
Land Rover	33	4	(29)
Unipart	24	12	(12)
Leyland Group	(1)	(75)	(74)
Other companies and contingency	(9)	(14)	(5)
Total BL	(143)	(267)	(124)

18 A detailed examination by Group of the reasons for this shortfall is contained in Annex A. A summary of the position by Group is below.

Cars Group

6 The small forecast shortfall of £4m arises from a balance of opposing forces: there has been a higher than expected value of sterling, which has had an adverse PBIT effect of £74m, and a worse than anticipated general economic climate. Total adverse factors added up to a profit shortfall of £83m. To balance this, internal performance during the year has been impressive - higher market share, and greater cost and efficiency performance than envisaged even in BL's exacting forecasts. While export volumes and margins were below budget, the positive PBIT effect of these improvements was £79m. Within the overall figures for Cars, the performance of Jaguar has been turned round from a declining UK market share and exports, and losses of £2m a month in the first half of the year, to budget levels of UK market share, greatly increased exports to the USA, and breakeven on a monthly basis.

Land Rover Group

7 Of the £29m shortfall against budget, exchange rate factors clearly account for £12m. They also probably contribute to the £15m shortfall attributable to a decline in export volumes, though this principally reflects severe competition from the Japanese in third markets. UK market share of Freight Rover, the light commercial vehicle (Sherpa) subsidiary of Land Rover, has fallen because of lack of model competitiveness against the Ford Transit and Japanese imports; this has had a £7m PBIT effect. Again, cost performance and efficiency improvement have served to offset adverse factors by some £11m. In addition, PBIT is now forecast, on the basis of very good results in September, to total £8.3m for 1981, double the level noted in the Plan. Contributing to this is an improvement in the market share now being achieved by Freight Rover.

Unipart Group

8 The shortfall of £12m is a direct result of the recession; this has resulted in dealer de-stocking which could only partially be offset by cost performance.

Leyland Group

9 The Leyland Group's profit shortfall in 1981 is estimated at £74m. Although performance was severely affected by the collapse of the market for trucks in the UK, a reduced market had already been forecast, and lower than estimated demand only accounts for £8m shortfall. Far more important was the different mix of models sold, dealer de-stocking, and lower margins arising from exchange rate factors, which together account for a shortfall of £29m. Unlike Cars, however, a major reason for the shortfall lies in internal factors - a decline in market share, in export volumes, and in cost performance - which accounted for half the total shortfall.

KEY FEATURES OF THE PLAN FOR THE CARS, LAND ROVER AND UNIPART GROUPS

Projected financial performance and funding implications

10 As in the 1981 Plan, Cars Group is projected to achieve break-even before interest and tax in 1984. The Unipart and Land Rover Groups are expected to show increasing profitability over the Plan period. The Leyland Group is still forecast to return to profit in 1982:

PBIT - £m

	1980	1981	1982	1983	1984	1985	1986
Cars Group	(297)	(194)	(122)	(31)	30	64	97
Unipart	14	12	13	25	34	40	49
Land Rover	27	4	12	32	39	58	70
Leyland	(30)	(75)	9	58	134	163	189
Other companies/ consolidation/ contingency	(8)	(14)	(57)	(57)	(49)	(54)	(48)
Total BL	(294)	(267)	(145)	27	188	271	357

Note: the large negative sums appearing under the heading "other companies/consolidation" are mainly due to a contingency held centrally by BL against non-achievement of the forecast PBIT for the Leyland Group. This, and the Leyland Group financial forecasts generally, is discussed in more detail in paragraphs 45 to 48 below.

11 Since the Plan was submitted, BL have revised their forecast PBIT for 1981 for the Land Rover Group to £8.3m as a result of increased sales in September; and for the Cars Group to £183.1m, as a result of improved cost performance levels. These revised forecasts seem robust. Although the trend of financial performance shown in the above table is generally consistent with the 1981 Plan (apart from the obvious exception of the Leyland Group), projected profits over the period 1981-5 for BL as a whole are some £445m lower in the 1982 Plan. The breakdown of projected shortfall is as follows:

PBIT better/(worse) than in the 1981 Plan

£m	1981	1982	1983	1984	1985	Total 1981-5
Cars	(4)	(6)	(25)	(7)	(30)	(72)
Unipart	(12)	(16)	(12)	(9)	(9)	(58)
Land Rover	(29)	(31)	(27)	(37)	(33)	(157)
Leyland	(74)	(19)	14	76	84	81
Total BL	(124)	(126)	(107)	(29)	(59)	(445)

Note: the discrepancy between the total of the shortfalls for the four Groups above, and the total BL shortfall, is accounted for by the central contingency on the Leyland Group, and other (mainly non-mainstream) companies.

12 The shortfall both in 1981 and thereafter is concentrated in the Land Rover and, relatively speaking, Unipart Groups. Lower

profits are forecast for Cars, Unipart and Land Rover over the Plan period than in the last year's Plan mainly because a more pessimistic view has been taken of exchange rates and levels of UK demand and therefore of sales volumes and pricing levels. This worse view of the economic conjuncture is expected to be only partially offset by greater cost reductions than envisaged in the 1981 Plan. The marked improvement for the Leyland Group is accounted for by the radical changes proposed for the Leyland Group compared with the interim basis of the 1981 Plan.

13 However, in contrast, over the Plan period cash outflow is held broadly at the levels forecast in the 1981 Plan:

1982 Plan cashflow forecasts

£m	1981	1982	1983	1984	1985	1986
Cars	(376)	(334)	(219)	(94)	(29)	2
Unipart	(20)	2	1	8	17	28
Land Rover	(28)	(40)	(4)	20	39	45
Leyland	(84)	(97)	(10)	16	69	93
Total BL	(546)	(557)	(305)	(111)	30	88

1982 Plan cashflow forecasts: better/(worse) than 1981 Plan

£m	1981	1982	1983	1984	1985	Total 1981-5
Cars	49	46	(2)	48	28	169
Unipart	4	10	(7)	(11)	(2)	(6)
Land Rover	12	(12)	(2)	(15)	(20)	(37)
Leyland	15	(20)	27	17	57	96
Total BL	51	(41)	(16)	(6)	2	(10)

The holding of the cash outflow shortfall to £10m has been achieved mainly by further improvements in working capital both from increased effort in cutting inventory, and from the effects of the lower volumes now projected. A further, lesser, factor has been the lower capital expenditure (£200m over 1981-5) than forecast in the 1981 Plan. No major programmes have been dropped in achieving this capital expenditure reduction; which rather follows BL's progress this year and last year in negotiating lower prices from suppliers. As BL have in 1981 on the whole proved very capable of controlling working capital, they should be able to achieve the savings needed to offset the greater losses.

14 The company does not in the 1982 Plan request any funds in excess of those envisaged in last year's Corporate Plan (£620m in 1981-2 and £370m in 1982-3). This Plan does, like last year's, identify a need for a further £150m equity during 1983-4 though,

like last year, no formal request is made for this to be provided by Government. In January 1981, the then Secretary of State for Industry, while not excluding the provision of this by the Government, said that he hoped that BL would be able to raise this additional £150m from the private market.

15 In the 1981 Plan, BL proposed negotiating £400m new medium term loans from the private sector, £200m for 1981 and £100m each for 1983 and 1984. Negotiations on these loans are well advanced and the 1982 Plan contains no different proposals for private sector loan finance.

Product and manufacturing strategy

16 The stretegy outlined in the 1982 Plan for the Cars, Unipart and Land Rover Groups is essentially unchanged from that presented in the 1981 Plan. The key points are set out below.

17 The proposals for the Cars Group constitute a product-based revival.

a) The phasing out of old models and introduction of new models continues so that in 1984 the company will have a streamlined product range of three model families. This process is well advanced, with the ending of production of the sports cars, Maxi and Dolomite and introduction of the Metro and Acclaim already completed by the end of 1981. In Jaguar, the initial emphasis is on improving quality and reliability to re-establish its market position before the introduction of a new model in 1984.

b) Complementary to this model strategy is the rationalisation of plant facilities. This process will be virtually completed in 1982 with the (already announced) closure of Solihull, Speke No 1, Coventry Engines and CAB2 at Longbridge, and the disposal of Alford and Alder and Rearsby Components. It was envisaged in the 1981 Plan that Solihull would close in 1985.

c) The effect of model strategy and plant rationalisation is to achieve a coherent manufacturing and marketing base by the mid-1980s as follows:

Plant	Models and launch dates		Late 1980s product range
Longbridge	Metro	Oct 1980	small car family
Cowley	Acclaim	Oct 1981	
	LM10	spring 1983	medium/executive family
	LM11	spring 1984	
	LM14/XX	1985	
Browns Lane	Jaguar XJ40	early 1984	luxury family
	XJS	continues	
	XJ41	to be decided	

d) Accompanying the reduction in product range will be a reduction in the range of engines and gearboxes produced in-house (see para 20 below). Outsourcing components such as gearboxes and the high degree of commonality designed into the new mid-car family will enable the company to reap economies of scale and hence, with the greater bargaining power, reduce the costs of materials.

e) Collaboration will also enable the Group to benefit from economies of scale and BL have announced their intention to collaborate with Honda in production of the LM14/XX executive car (see para 20 below).

f) The programme of manpower reductions will be almost complete by the end of 1982. Together with more efficient manufacturing facilities and working methods and increased output this is projected to improve productivity as follows:

	1980	1981	1982	1983	1984	1985	1986
Manpower (000)	74	59	51	50	50	50	50
Production (000)	417	450	437	480	518	574	585
Vehicles/man/year	5.6	7.6	8.6	9.6	10.4	11.5	11.7

To the end of September this year, productivity has averaged 7.43 vehicles/man/year, a shortfall of 0.45 against budget. Given BL's success in achieving virtually all the large increase forecast for this year, and the more modest increases for later years, these forecasts look achievable.

g) Capital expenditure, forecast in the 1982 Plan to total £145m in 1981 (some £27m less than forecast in the 1981 Plan) will continue at about the same yearly rate over the Plan period:

Capital expenditure - £m

	1981	1982	1983	1984	1985	1986
Cars	145	163	185	153	164	175

The savings in 1981 and thereafter represent BL's revised assessment of their ability to negotiate keener prices from suppliers.

18 The proposals for the Land Rover Group are best described under the two main operating divisions: Land Rover Limited, which manufactures Land Rovers and Range Rovers, and Freight Rover, which manufactures the Sherpa van.

a) Land Rover Limited plans to maintain its share of the world market for the four-wheel drive sector with a programme of product and facilities renewal. The Stage II Land Rover model is to be introduced in 1982 and a V8 diesel engine in 1983.

Productivity improvements will be achieved by the use of robots in manufacture of the Stage II model and the application of new arrangements for assembly which have already led to improvements in productivity on current models.

b) Land Rover Limited is nearing the end of a period of heavy capital expenditure. £180m has been and will be invested in the new production facilities, and this programme carries the main capital expenditure burden through the Plan period. The virtual completion of the Stage II programme by 1983, with the accompanying increased sales from the revised model, is a major contributor to the improved PBIT and cashflow position evident from that year.

c) Capital expenditure is forecast as follows:

£m	1981	1982	1983	1984	1985	1986
Land Rover Ltd	20	32	29	25	25	20
Freight Rover	8	12	9	3	1	5

d) Concentration of management effort and a product-led revival are the key elements of the drive to restore Freight Rover's competitiveness. The emphasis on quality and marketing, together with the introduction of a thoroughly facelifted Sherpa van in 1982 and the new MT210 in 1983, are designed to revive Freight Rover's declining market share. The product plan will enable Freight Rover to offer a wider range of vehicles and this is considered essential if inroads are to be made into the fleet market.

e) The Plan contains justified expectation that Japanese imports in the light commercial vehicle market will be restrained from 1982 under either an industry or a Government-to-Government agreement.

19 Unipart's fortunes are currently largely dependent on the performance of the Cars Group. Emphasis is therefore placed on expanding the business of manufacturing parts for non-BL models ("all-makes") and on introducing an 'arms length' relationship with other Groups of BL. Component manufacturing by the SU Butec Division will be rationalised by withdrawal from certain product lines.

Collaboration

20 Collaboration and increased outsourcing of major components are seen as vital to keep BL competitive because they enable the sharing of the technological development workload and enable the company to benefit from the economies of larger scale production. The following arrangements were concluded in 1981 or are currently in their final stages of negotiation:

a) Collaboration with Honda on Triumph Acclaim, launched October 1981.

b) Collaboration with Honda for the joint design and development of a new executive car (LM14/XX) to be produced in Japan and UK and sold worldwide, and involving, perhaps, the manufacture by BL of some parts for Honda's use.

c) Use of Volkswagen gearboxes in LC10 family (all gearboxes are now to be bought from outside suppliers).

d) Use of Vancini Motore (VM) engines in Light Medium Cars and Jaguar products.

e) Perkins/Land Rover development of diesel version of BL's V8 engine.

21 Further collaborative deals being actively explored are:

a) Marketing/distribution collaboration with Honda in Europe.

b) Jaguar/BMW joint sourcing of components.

c) Jaguar/Ford marketing collaboration in Europe.

d) Perkins/Light Medium Cars development of diesel version of BL's '0' series engine.

22 BL have not yet been able to conclude the wide-ranging collaborative agreement with one company (or perhaps two) which we have identified in previous years as carrying the best hopes for the continued future of the volume car business and of removing its dependence on the Government as quickly as possible, since there seems to be little, if any, prospect of an outright purchase of the volume cars part of BL. However, the Official Group considers that BL is continuing to explore collaboration as a priority, and that the current proposals are to be welcomed as a major example of progressive collaboration which initially helps BL towards viability and financial independence from the Government and which holds out a prospect, if not a certainty, of moving on to more wide-ranging collaboration and a permanent solution.

Disposals

23 BL's policy is to dispose of non-mainstream activities. In 1981 Alvis, Prestcold, parts of Aveling Barford, certain trade investments, and properties were sold for a total of £53.1m This compares with £25.5m raised from sales in 1980 and with the £40m which the 1981 Plan projected would be raised in 1981. The company hopes to dispose of the remainder of Aveling Barford as well as Coventry Climax and Leyland South Africa but does not expect proceeds from the sale of these, together with vacant industrial properties, to exceed £25m. A considerable write-down against book asset value has to be expected if the sale of loss-making companies such as Coventry Climax is to be achieved.

Introduction of private capital

24 It is BL's intention to develop the whole business so as to attract private funds into it. To this end, much preparatory work has been done in establishing four separate business activities - Cars Group, Unipart Group, Leyland Group and Land Rover Group - to enable funds to be attracted into those activities which are performing well. These four Groups will be established as separate Companies Act companies on 1 January 1982.

25 As to timing, the 1982 Plan states that "it is planned to seek private sector capital for Land Rover and Unipart - consistent with retention of management control by BL - at the earliest practical opportunity but this is unlikely to be before 1983". The company do not believe that performance of Land Rover and Unipart will be sufficiently strong to enable a partial flotation before 1983 and have been advised that the sale of shares would not be a practical proposition until at least one year's audited results are available, which will not be until early 1983.

26 BL have identified several risks to the achievement of their objective of attracting private capital into Land Rover and Unipart in 1983:

a) failure to reach agreement on the restraint of Japanese light commercial vehicle imports (the risk of this has been removed, at least for 1982, by the SMMT/JAMA agreement which has just been concluded);

b) maintenance of high interest rates, causing further dealer de-stocking of parts;

c) a major setback in the recovery of the Cars Group, affecting demand for parts;

d) an outcome unfavourable to Unipart to the current Monopolies Commission investigation.

Appraisal of risks (Cars, Unipart and Land Rover Groups)

27 In order to identify as precisely as possible the risks attaching to the achievement of profitability by BL, we have drawn a crude division between "internal" and "external" risks - the distinction being between risks that are, or are not, in broad terms susceptible to control by BL. This division can be rather hard to sustain, eg sales volumes may be lower than forecast because of a fall in market size owing to recession rather than any failure in the inherent attractiveness of BL's products. However, it does allow a judgement to be made about future performance.

28 External risks consist of risks arising from the external economic environment in which BL operates, and risks arising from competitors' activity.

a) The economic environment: most important here are world and UK activity rates, the exchange rate, and competitiveness. Although we considered last year that BL's assumptions on activity, exchange rate and inflation were broadly in the centre of the range of possibilities, and, indeed, were slightly more pessimistic than independent forecasts, the outturn was less favourable than forecast in several respects. The economic assumptions underlying BL's new Plan have been considered carefully and our conclusion is that on this occasion these assumptions tend to be slightly more pessimistic than the Treasury forecasts. For example, BL assume a rather slower growth of output and expenditure, and higher earnings and consumer prices. They also forecast a stronger effective exchange rate. However, they seem to have an optimistic view on general input prices and hence costs (but it should be noted that BL see this as an aspect within their control). Also, in the Corporate Plan, interest rates fall more steeply than assumed in the Treasury. A sensitivity analysis of the effect of representative changes in the economic environment on PBIT, cash flow and return on assets employed is in Annex B. This suggests that, on a purely arithmetical basis within this range of forecast economic assumptions, the profit forecast for 1982 could vary from a loss of £30m to a loss of £275m (main forecast is for a loss of £145m). In fact, the worse set of assumptions would require radical corrective action, and a re-assessment of BL's prospects and of its appropriate size, and there would be considerable doubts over the ability of any part of BL to survive. Conversely, the increase in demand implied by the more favourable assumptions would suggest that existing capital expenditure and working capital requirements would be insufficient; this part of the Plan would require revision. As one might expect, forecasts for an individual company such as BL are highly sensitive to changes in both general economic activity and to changes in the market environment.

b) Competitor activity: the risks here arise from three main sources:

i) the first arises from the pricing strategy adopted by overseas manufacturers in the UK, and the extent to which they can benefit from the exchange rate. Whilst the exchange rate has fallen, the pound remains strong against several European currencies and hence some risk still remains.

ii) The second source is the continuing differential in car prices in the UK and Europe. In fact the differential now (at about 25% overall on BL's estimate) is much lower than the 45% which they calculate was reached earlier this year as a direct result of the strength of sterling. BL expect the differential to fall gradually to around 12% by 1986, a trend which they will follow by increasing prices only below the rate of inflation. A markedly more abrupt fall in relative prices than the progressive reduction BL are forecasting would seriously affect their profit forecasts. The risk of a more abrupt fall comes mainly from a decision by importers to reduce their UK prices as a result of adverse public reaction, which might be stimulated further (and hence increase the risk) if enquiries by the Office of Fair Trading or the European Commission were to reveal anti-competitive practices attempting to sustain the differential.

iii) The third risk arises from Japanese activity - both on cars and light commercial vehicles in the UK, and on trucks and four-wheel drive vehicles in export markets. There is still some uncertainty about continuing restraint of Japanese imports and about the alternative (for the Japanese) of manufacture in the UK: BL have assumed (and we accept) that Government-to-Government action would replace the industry talks on both cars and light commercial vehicles if the voluntary restraint agreement fails, and so the risk from this source may now be less serious. As for inward investment, the revised timescale of the proposed Nissan project pushes any effect on BL well outside the Plan period. More serious is the effect of Japanese competition overseas, in particular as the Land Rover expansion programme nears completion and the company's traditional capacity restraint is removed as the new investment programme is completed. BL note that there is no reason to suppose that the Japanese threa abroad will do anything but grow, and have reduced total sales volumes accordingly (compared with the 1981 Plan). Failure to achieve sales volumes - overseas in the case of the Land Rover itself, and in the UK in the case of Freight Rover - remains, however, the biggest single risk for the Land Rover Group.

29 Internal risks are those which fall under BL's more or less direct control. These subdivide - for the purposes of this discussion at least - into product-related risks and industrial relations.

a) Four major product-related risks were identified last year: reliability, design, dealer network, and insufficient capital expenditure. These risks remain this year, though offset to some extent by the fact that BL are well into their model replacement programme, that the problem of quality control is being tackled in all areas (and is helped by new models and modern manufacturing facilities), and that increased market share and new models improve dealer morale and profits (though the weakness of the dealer network in Europe remains). A further factor, not identified last year, is BL's continuing determination to keep supplier costs increases below the rate of inflation. However, BL take a relatively optimistic view of supplier costs, and there is a risk that they will not be able to absorb those unanticipated cost increases which they are unable to avoid. Finally, the risk remains that BL may have pruned their total capital expenditure requirements to an excessive extent (without cancelling any major programmes) over the Plan period in their determination to keep cash outflow within the forecasts of last year's Plan. This risk is heightened by the deterioration in forecast profits compared with last year's Plan (see para 11 above).

b) Industrial relations: the Official Group last year identified this risk as substantial. In the event, there were minor disputes (such as the one affecting the Acclaim line in September) but the overall effect on working hours was minimal - 0.55% of working hours were lost in the nine months to September. The most serious outbreak of strike action has occurred over the Cars pay settlement, although only two days of strike action occurred, and more recently over the "tea break" dispute at Longbridge. These two recent disputes illustrate the range of risks under this heading - from major all-out strike over a matter such as pay, through continual minor stoppages of production, to a continued feeling of bitterness at the handling of industrial relations. The risk of a major strike over pay remains real: BL still need to reduce their unit costs to competitive European levels - despite major increases in productivity - and there has been no change in BL's determination to keep actual wage increases below the rate of inflation. There is, however, still potential for earnings increases under the incentive scheme - this has raised average earnings at BL Cars by 13.5% over the past year, and new models will enable total average pay increases to exceed basic pay increases, though perhaps at a lower level than hitherto. However, the Group considers that the threat from the other sorts of dispute - continued minor stoppages and bitterness - could be as serious. The former could lead to a general decline in public and dealer confidence in the company, which would in 1982 not only have an immediate effect on market share but would also weaken the launch platform for the LM10. The latter would prevent the wholehearted cooperation from the workforce which remains essential to BL's recovery and return to viability. The company does, however, emphasise the importance it attaches to adopting a less abrasive industrial relations "style" in the aftermath of the recent pay dispute, and a commitment to greater workforce consultation is written in to the agreement ending that dispute.

30 In summary, the Official Group considers that:

a) The BL main case forecast, although broadly in line with other forecasts, does have some risks particularly relating to costs and prices and to the essential uncertainty associated with forecasting the exchange rate;

b) the risk attaching to competitor activity, and hence market share or margins is serious - in particular the threat from a more rapid than anticipated unwinding of the price differential in the UK market, Japanese imports of light commercial vehicles (despite the prospects for their restraint) and the continuing Japanese competition for Land Rover in third world markets;

c) the risk arising from product related factors remains though is reduced in certain respects (design, dealer confidence, reliability);

d) the most serious risk still attaches to the industrial relations climate, in the Cars Group in particular, and this must remain the greatest threat to the achievement of the forecasts for 1982 at least. On the other hand, the assurance given last year by Sir Michael Edwardes on behalf of his Board remains that the Board would withdraw the Plan if (inter alia) the workforce failed to cooperate in its implementation.

THE LEYLAND GROUP PLAN

Background

31 At the end of 1980, it became apparent that the prospects for the commercial vehicle business (now called the Leyland Group) had deteriorated badly from the company's position of traditional profitability. The UK truck market had collapsed in the second half of 1980, and the Group was forecast to make heavy losses in 1981. The BL Board was not satisfied with the Leyland Group management's response to the situation facing the Group, in particular since there was no realistic hope in their plans of the Leyland Group either meeting short term cash commitments or of restoring the business to viability in the longer term. Specific aspects of the management's planning which were open to question were truck product policy at the light end of the range, use of installed capacity, and collaboration. The BL Board therefore put the 1981 Corporate Plan for the Leyland Group on ice while it brought about a change of leadership for that part of the business. In January 1981, following the departure of Mr David Abell, a new management team took over, under the direction of Mr David Andrews (Executive Vice Chairman of BL). The team had two priorities: to tackle the serious deterioration in the trading position of the UK truck and bus business, and to prepare a revised 1981 Corporate Plan.

32 The new team submitted, in the summer of 1981, a revised Corporate Plan for the Leyland Group. However, the BL Board presented this to the Government only as an operating base for 1981, since the Board continued to have reservations about the future for Leyland Trucks. These reservations were echoed by officials who considered the Plan, particularly in relation to market and market share prospects and to whether the proposals for cost reduction and facility rationalisation were sufficiently radical. Ministers agreed that, while the Plan as presented could be accepted as an operating base for the remainder of 1981, BL should be asked to submit, as part of the 1982 Corporate Plan, the results of a radical review of the alternative courses for the Leyland Group, including a fully-developed study, with operational plans, of:

a) the full range strategy on which the summer 1981 Plan was based (if BL still wished to pursue this);

b) a narrow-range strategy based on contracting out of less profitable sectors; and

c) closure, with disposal of those parts of the business which could be sold.

33 The current Plan, therefore, forms the first concrete set of proposals for the Leyland Group since the 1980 Corporate Plan submitted at the end of 1979, and is the first to address itself fully to the future of the Leyland Group in the changed economic circumstances. The BL Board and the Official Group have therefore paid special attention to the Leyland Group part of the 1982 Plan.

Facilities, models and manufacturing method

34 The Leyland Group Plan proposes a radical realignment of facilities, manpower and manufacturing method to match the current and forecast reduced demand for trucks. The main aim of the Plan is to bring the Group's cost base down to realistic levels in the light of these forecasts. Most of the actions required to achieve this were announced publicly on 20 November 1981 and will take place by the end of 1982; only some, involving collaboration, remain to be settled. The basic strategy underlying the Plan is the retention of a full truck product range - which is seen as vital to protect the dealer and fleet network - and collaboration on or outsourcing of major components.

35 Leyland Trucks will concentrate all its activities onto three sites - the Leyland plant in Lancashire, Albion in Glasgow and Bathgate in West Lothian, with some reduction in the size of the facilities at each plant. The plant at Guy, Wolverhampton, will be closed. For the first years of the Plan, Leyland and Bathgate will both continue to assemble trucks and to manufacture engines; however, by the later years it is planned that Leyland concentrate on truck assembly, and Bathgate on engine assembly with some engines either

completely bought-out or the subject of major collaboration. Albion will from 1982 concentrate on axle manufacture, and all gearboxes will be bought from outside suppliers (mainly ZF of West Germany). The main change is therefore in the level of integration proposed for the future, and the way in which Leyland Trucks proposes to buy into the economies of scale enjoyed by specialist engine and gearbox manufacturers. This seems a logical step for a company the size of Leyland Trucks.

36 There is no major change proposed for Leyland Parts. The only change of note for Leyland Bus concerns its greater freedom from Leyland Trucks, which BL are pursuing in order to ensure that, if Leyland Trucks were to be put into liquidation, the bus manufacturing operations would have an opportunity to continue independently. To this end, parts of the Leyland site are to be transferred to the management of the Bus division. This is a welcome move in management rationalisation and autonomy.

37 Model strategy for Truck and Bus is little changed, because of Leyland's conviction that a full range of models is necessary. They have, however, concentrated on reducing the number of different models and cabs and hence the complexity of manufacture, and have decided to end tractor assembly (Bathgate).

Manpower and productivity

38 A major aspect of the drive to reduce costs comes in manpower: 4,100 employees, 25% of the Leyland Trucks workforce, will be made redundant in 1982, and a further 2,600 employees will be transferred to the Bus or Parts divisions as part of the move to make them more independent from the Truck division. These major reductions feed through into productivity gains only slowly because of the continued forecast recession in the truck market in 1982 and the forecast low share for that year, but in 1983 value added per £ labour cost and value added per man are forecast to exceed the 1977 level (at constant prices) and by 1986 to have reached levels competitive with productivity currently achieved by competitors. This increase in productivity, though marked, should be achievable if the realistic forecast sales volumes are achieved, since two-thirds of the productivity gain arises from lower manpower although, as with the rest of BL, productivity is dependent on good industrial relations during the difficult period of restructuring. However, it must be noted that from 1984 to 1986 Leyland Trucks will only equal current levels of productivity in competitors, and may therefore still be "behind" if competitor companies improve their productivity in the interim to any extent.

Sales volumes, market size and market share

39 The UK truck market size fell dramatically in 1980 and 1981, and a major criticism of the two most recent Plans prepared by the Leyland Group has been their assumptions on the recovery of market

size. The current Plan is markedly more cautious in this respect:

(000)	1978	1979	1980	1981	1982	1983	1984	1985	1986
1982 Plan	70	80	61	46	40	52.5	65	70	65
Summer 1981 Plan	70	80	61	46	50	60	75	70	-
Main 1981 Plan	70	80	61	66	72	78	71	65	-

The Group considers that the current profile represents a plausible forecast for the recovery of the truck market: the very low forecast for 1982 is similar to that of the SMMT, the trade association.

40 Also worrying in earlier Plans were UK market share forecasts, and again these have been revised downwards to take account of model availability:

(%)	1978	1979	1980	1981	1982	1983	1984	1985	1986
1982 Plan	19.3	17.3	17.3	16.4	15.8	15.8	19.0	21.1	21.6
Summer 1981 Plan	19.3	17.3	17.3	17.7	18.6	18.5	19.0	21.6	-
Main 1981 Plan	19.3	17.3	17.3	19.2	18.6	18.6	20.1	22.7	-

In market constrast to earlier projections, BL have taken a much more cautious view of their market share in 1982 and 1983. The main reason (other than caution) given by BL for the continued low share in 1983 and the - on the face of it - surprising forecast increase in 1984 is the launch of a new light truck (the high volume end of the range) only at the end of 1983 and the early run-out of part of the existing light truck range in 1982 for emissions standards reasons. It is difficult to assess the effect this new model will have on market share, but we are confident that in other respects the market share projections are now more realistic than hitherto.

41 These projected trends are reflected in the overall sales volumes in this Plan, which (including revised export forecasts) are some 40% below the levels forecast in the main 1981 Plan. Overseas sales volumes are forecast to do little more than remain steady, and if anything there must be an opportunity for increase, rather than a risk of failure, in this forecast. One result of any unexpected increase would be to improve productivity at a faster rate than forecast. However it should be noted that these volumes probably represent the lowest level at which even the revised cost-base of Leyland Trucks can be supported; there is therefore little room for downward revision.

Collaboration

42 Collaboration between volume truck manufacturers has become common practice among European manufacturers over the last few years,

although one of these groupings - Iveco - now seems to be breaking up. Although willing to participate in this general restructuring of the business, Leyland Trucks has not so far concluded any joint venture or more extensive agreement with another truck manufacturer (despite efforts in Europe and the USA). The company has therefore considered other ways in which it can compete with the largest European manufacturers - Daimler-Benz and Iveco, who enjoy much larger volumes. Its response is to concentrate its own resources on vehicle design, development and assembly and turn to collaboration to provide major components at competitive prices.

43 As a result of this policy, Leyland Trucks has decided to purchase all its gearboxes, mainly from the German firm ZF but also from the American-owned Eaton (as opposed to assembling a ZF gearbox at Albion); and to engage in major collaaboration on engines. Of the four existing Leyland Trucks engines, one will be replaced by a bought-in engines, two by collaboration and joint assembly with Cummins and another manufacturer (yet to be identified) and one by a mixture of an existing Leyland engine and a bought-in unit. Negotiations with Cummins are at an advanced stage, with final agreement expected within a few months, and indicate Cummins' confidence in the future for Leyland Trucks; other negotiations are being accelerated. The agreement with Cummins will involve Leyland Trucks manufacturing components for engines assembled elsewhere by Cummins, as well as for those assembled by Leyland at Bathgate; the benefit in economies of scale will be marked.

44 Although it is disappointing that Leyland Trucks have been unable to enter into a joint venture on assembly with another European manufacturer, and thus achieve the necessary economies of scale, the Official Group believes that in the collaboration and purchasing strategy in hand, Leyland Trucks have identified a suitable alternative route which should enable them to benefit from similar economies of scale on the most volume-sensitive and research and development-intensive units. The Group considers that negotiations should proceed with despatch.

Financial forecasts and funding implications

45 This aspect is discussed in general terms in paras 10 to 15 above, in the context of BL as a whole. In more detail, key aspects of the financial projection for the Leyland Group are as follows:

Leyland Group: summary financial projection - £m

	1981	1982	1983	1984	1985	1986
Revenue	735	919	1073	1383	1580	1784
PBIT	(75)	9	58	134	163	189
Extraordinary costs	39	-	3	2	-	-
Total earnings (loss)	(144)	(17)	19	84	110	127
Working capital (increase/(decrease))	(96)	64	16	42	40	41
Capital expenditure	69	57	61	76	55	51
Net cashflow: in/(out)	(84)	(97)	(10)	16	69	93
PBIT/assets employed %	(19)	2	12	26	29	31

It is apparent from these that the 1981 cash outflow has been held down only by the decrease in working capital which has arisen as a result of the drive to reduce inventory to a level commensurate with sales. It is not possible to continue this to the same extent in 1982. In addition, total loss of 1981 is inflated by £39m of provisions for closures which take effect in 1982. The primary reason behind the improved 1982 profit position is the marked improvement in fixed costs, which fall from 25% of sales revenue in 1981 to 18% in 1982 as a result of the radical action on fixed costs noted above (paras 34 to 37).

46 The cost improvements are forecast to feed through in later years to an extent which will offset the worse economic circumstances forecast in this Plan (see Annex B) and will produce greater forecast profit in later years of the Plan than in the main 1981 Plan.

£m better/(worse)

	1981	1982	1983	1984	1985	Total 1981-85
PBIT	(74)	(19)	14	76	84	81
Total earnings	(102)	19	9	69	80	75
Net cashflow	15	(20)	27	17	57	96

47 However, the position of Leyland Trucks is disguised by the various very profitable subsidiary companies in the Leyland Group (Ashok Leyland in India, Leyland South Africa and Parts). Key figures for Leyland Trucks itself are:

Leyland Trucks: summary financial projection - £m

	1981	1982	1983	1984	1985	1986
PBIT	(105)	(54)	(18)	32	41	43
Total earnings	(160)	(63)	(29)	21	32	35
Net cashflow: in/(out)	(40)	(86)	(33)	5	29	40
PBIT/assts employed %	(49.1)	(32.4)	(10.1)	16.9	20.3	21.7

The turnaround in prospects which this shows, while still a formidable task for the management, looks more plausible for Leyland Trucks than might have been thought from the total Leyland Group figures.

48 So far as Government funding is concerned, in the 1981 Plan BL provisionally allocated £100m in 1981 and £50m in 1982 for the Leyland Group. The Board and management of BL reserve the right, within the overall Government funding, to re-allocate equity amongst the various business groups as necessary, in particular to provide each group with a satisfactory opening debt:equity position and to allow the introduction of private capital in 1983 to Land Rover and Unipart. However, the radically revised Plan for the Leyland Group does not require funding from Government above the levels already agree

Appraisal of risks

49 As with the other parts of the Plan, these can be divided into internal and external risks. The external risks - the general

economic conjuncture - do not differ in many respects from the analysis on the other Groups (paras 27 to 28 above). A stronger exchange rate would have serious consequences for competitiveness in overseas markets, and BL would be forced either to bear the effect on margins or to lose volume. Volume would also be lost if the UK market size did not recover even to the lower limits BL are forecasting. Probably the greatest area of risk in the Plan is to volume: these are now projected at such a low level that it must be questionable whether the strategy of a full model range could be sustained in the face of lower volumes than are forecast. Although BL does face competition from imports to the UK of commercial vehicles, these are almost exclusively from a European cost base since a voluntary agreement excludes Japanese trucks (other than light commercial vehicles) from the UK market.

50 The main risks to the achievement of the Leyland Group Plan, and in particular to the Leyland Trucks forecast, lie in internal factors. Model strategy is not seen as a great problem since Leyland Trucks is well into its model replacement programme (which will be completed in 1984 with the lightest model) and has achieved a reputation for quality and design with the existing new models in UK and overseas markets. (The reason for the continuing low market share into 1983 is the lack of a light truck model, which will be launched at the end of 1983, rather than a judgement about the attractiveness of other models). The risks in the Official Group's view lie in the scale of the recovery required in Leyland Trucks in physical terms - the fixed and variable cost reductions and the manpower reductions - and in a loss of labour co-operation, though labour relations have never been bad in the commercial vehicles operations.

51 A major question-mark also lies over the quality of middle management and their ability to respond to the challenges of the next two years. The top management of the Leyland Group, and in particular Mr David Andrews, is highly regarded. But the previous senior management, and thus the present middle management, were undoubtedly slow to adjust to the problems created by the severe recession affecting the commercial vehicle market. On the other hand, until this recession, Leyland Trucks had stayed in profit, and the scope for recovery with a coherent and radical reconstruction such as is now in hand should not be under-estimated.

52 In summary, there are major and serious risks to the achievability of the Leyland Trucks part of the Leyland Group Plan, and these focus in particular on the effect of even a small loss of volume, and the extent of the management task.

53 The BL Board have themselves recognised and accepted the element of risk attaching to the achievement of the Leyland Truck forecasts. They have therefore taken two steps:

a) they have allocated a contingency, to be held centrally by BL against non-achievement of the key forecasts, of the following amounts:

£m	1981	1982	1983	1984	1985	1986
PBIT	5	40	38	47	48	45
Asset flow	5	10				
Total cashflow	10	50	38	47	48	45

b) they have identified "benchmarks" against which detailed monitoring of the progress of Leyland Trucks will be measured.

Options

54 BL were asked to evaluate and present a number of options in this year's Corporate Plan: (a) the full range strategy involving maintenance of current facilities, (b) a scaled-down operation based on contracting out of less profitable sectors and (c) closure, with disposal of those parts of the business which could be sold.

55 In the event, although variants of the full range strategy were looked at, BL did not believe that any of these were worthy of serious consideration: the business could not support the cost base. Their present Plan is a version of Option (b), and is only full range in that a full truck model range is retained: engine production is halved and gearbox production halted.

56 BL did explore the possibility of scaling the business down further by withdrawing from the lighter end of the truck market. They concluded, however, that this would be riskier than the option presented in the Corporate Plan because it would involve the fragmentation of the model range with a consequent risk to sales because of the loss of fleet purchasers and a reduction in number of dealers. BL considered that such a reduced business could not produce the same financial benefits as their Plan option and would be far riskier in terms of the pressure on management. They are therefore of the view that this option should only be investigated further if the present Plan failed and consider that at this time liquidation is the only possible alternative to the Corporate Plan which they have presented; we concur in this.

57 The effects of liquidation on BL are assessed, in the light of work done by BL,as follows:

i) Some parts of the business could continue: probably Leyland Bus, Leyland Parts (in a reduced form), Self Changing Gears and most overseas companies.

ii) Adverse effect on Land Rover because of the weakening of joint Land Rover/Leyland Group sales companies overseas, particularly in Africa.

iii) Possible major implications for private funding for the remainder of the BL Group; at least £100m of loan stocks would almost certainly have to be repaid immediately, with the £300m medium term loans (currently under negotiation) also being put in jeopardy. Government guarantees would almost certainly be necessary to provide revised funding arrangements for the remainder of BL.

58 The assessment of the public expenditure and PSBR costs of liquidation is concerned only with the net PSBR costs of liquidation of Leyland Trucks over and above the PSBR cost of supporting the Corporate Plan (which itself involves redundancies etc). In a dissolution some parts of the business could be expected to survive (see para 57(i) above) and the overseas companies should also be disposable. However, this assessment takes no account of the possible proceeds from such disposals; it does, nevertheless, include proceeds from disposal of assets and inventories within Leyland Trucks on a liquidation basis, since, given the present cyclical trough in the European and world truck markets, there is little likelihood of the Bathgate and Albion works, or even of the modern Leyland Assembly Plant, being sold as going concerns.

59 As in the previous years, the Treasury have taken the lead in this assessment, and have used methodology similar to that in previous reports. A more detailed note is at Annex C. The elements of the calculation are:

- numbers made unemployed in Leyland Trucks and in supplier industries;

- rate at which lost jobs are regenerated;

- unemployment and other benefits;

- other (non-labour) closure costs.

These add up to the public expenditure costs of a closure. To get to the full effect on the PSBR we must add:

- Lost tax and NI contributions.

A table showing the effects of a liquidation on the regions most concerned is at Annex D. This shows that unemployment at Bathgate (West Lothian) could rise from the current (November 1981) level of 9423 and 18.9% of the workforce, to 12,435 and 25% and at Leyland (Preston) from 17,559, 11.8% of the workforce, to 23,123, 15.6%.

60 Pulling together all the elements, the closure cost calculation is as follows:

	£m current prices				
	1982/3	1983/4	1984/5	1985/6	Total
Redundancy costs	55	-	-	-	55
Social Security benefits	21	33	28	20	102
Repayment of loans	100	-	-	-	100
Trade creditors	131	-	-	-	131
Other costs	18	6	-	-	24
Trade debtors	(68)	(2)	-	-	(70)
Disposal proceeds: assets	(15)	(14)	(4)	-	(33)
Inventory	(51)	(16)	-	-	(67)
Total public expenditure	191	7	24	20	242
Lost tax revenue) Lost NI revenue)	38	49	42	30	159
Total PSBR costs	229	56	66	50	401

61 By way of comparison, Government funding allocated to the Leyland Group in 1982/3 is £50m. It should be noted, however, that, if it is decided not to fund the Corporate Plan, in addition to the costs in the table above, the Government might have to meet the cost of redundancies envisaged in the Corporate Plan which would otherwise fall to BL's account.

62 The employment, public expenditure and PSBR estimated effects of the Leyland Group closure given above are based on a methodology which is essentially micro-economic in character. This micro-economic approach does not incorporate explicitly all the wider economic effects at the macro-economic level, nor does it take account of possible effects on other objectives of Government policy. The current stance of policy is to secure a lasting reduction in the rate of inflation by control of the money supply. This implies a view about nominal incomes and the level of unemployment which is consistent with the development of the economy as a whole. If these consistent levels of both nominal incomes and unemployment are considered to be unique then any action by the Government to avert unemployment at Leyland and its suppliers must result in an offsetting equal number of unemployed elsewhere in the economy. On this alternative view a strategy to "rescue" the Leyland Group within this overall policy stance would result eventually in no net job gains and no related PSBR effects.

CONCLUSIONS: CARS, LAND ROVER AND UNIPART

63 BL's recovery strategies for the Cars, Land Rover and Unipart Groups are essentially unchanged from the 1981 Plan, but have been tightened in response to the worsening economic climate worldwide.

64 Major progress has been made in the physical performance of the Cars Group in 1981. The programme of rationalisation of models and facilities is well on course. Manpower is lower than forecast, and the forecast productivity improvements have been fully achieved. Market share is higher than budgeted. The labour relations position continues, however, to give serious cause for concern; and this remains a major - perhaps the principal - risk to the achievement of the Plan. The revised Plan still shows a return to profit (before interest and tax) in 1983; but the level of forecast profit is lower throughout the period than in the previous Plan, because of more adverse economic conditions forecast throughout the period. Cash outflow, however, is now likely to be held within the budgeted level for 1981, and is forecast to stay as projected in the 1981 Plan throughout the period. On the collaborative front, the widening relationship with Honda (demonstrated most recently by the Letter of Intent on the proposed jointly designed and manufactured executive car, the XX) holds out the best prospect of a long term resolution of the Cars Group problem. We conclude that there is no change in the position or prospects of the Cars Group which would justify a decision not to continue funding the Plan agreed last year for the remainder of the two year period, ie to March 1983. A major labour relations upset could, however, lead to a closure of the Group; and the Board's resolve in this respect remains undiminished, as demonstrated by the recent pay dispute.

65 We are also satisfied that the Plan for the Unipart Group remains on course, though its fortunes remain tied closely to those of the Cars Group until such time as its business in "other makes" parts develops to a much greater proportion of its activities than at present.

66 The Land Rover Group continues to be profitable, but has not had a good year. It is vulnerable to Japanese competition in developing country markets. Its Freight Rover (Sherpa van) Division is particularly vulnerable to Japanese competition in the UK market, and has suffered considerably from this in the past year; though the recent SMMT/JAMA agreement on light commercial vehicles should improve the position in 1982. Restraint on UK imports of Japanese four-wheel drive cehicles will continue, somewhat tightened, in 1982; but this will not help Land Rover overseas where the recent strengthening of the Japanese yen against sterling is the only alleviating factor. Land Rover production facilities will benefit from heavy recent capital investment, though production of major components remains spread over several works; on the other hand, substantial gains in productivity are forecast during the Plan period, linked partly to the fruition of the capital investment

/programme

programme. Our overall judgement is that the Land Rover Group has suffered a deterioration, particularly in profit, in the past year (due more to external rather than internal factors) but is not facing sufficiently severe problems to justify reconsideration of continued Government funding - particularly since it is expected to remain in profit throughout the period.

67 BL as a whole is forecast to make larger losses in the early years of the Plan than was foreseen twelve months ago, mainly because of the performance of the Leyland Group; and the company would be vulnerable to any further deterioration in economic prospects. However no extra Government funding is forecast to be required to carry out the Plan to 1986 (though, as last year, the Plan identifies a need for additional external equity of £150M over the two succeeding financial years) and the judgement of the Board, which we share, is that the deterioration in profitability is not sufficient to undermine seriously the basis of the present funding arrangement agreed between the Government and BL or to diminish the possibilities for attracting private capital into the more profitable groups when circumstances permit. The formation of the four groups, envisaged in last year's Plan, is now implemented; and these will be established as Companies Act companies from the 1st January 1982. This development will not only assist a greater degree of management autonomy and efficiency, but will enhance the opportunities for collaboration and for attracting private capital.

68 We therefore recommend that the Government should approve the 1982 Plans for the Cars, Land Rover and Unipart Groups as a basis for the continued funding required in 1982/83.

CONCLUSIONS ON THE LEYLAND GROUP PLAN

69 After a long period of profitability, the businesses comprising the Leyland Group made a loss in 1980 and will make a larger one in 1981; and in common with other commercial vehicle manufacturers the Group is severely affected by the precipitous fall in the size of the truck market throughout the world, and particularly in the UK (46,000 in 1981 compared with 80,000 in 1979). The Truck Division of the Leyland Group is the main problem area. To meet this situation BL propose a radical revision of the strategy for Leyland Trucks. The Leyland Group Plan proposes a major cut in the manpower of Leyland Trucks in the UK (by 4100, a 25% reduction mainly in 1982); concentration of engine manufacture at Bathgate and vehicle assembly at Leyland (Lancs) instead of a mixture of both at each location; complete cessation of manufacture of two engines and all gearboxes in favour of buying in, and collaborative manufacture of the remaining two engines; closure of the Guy Works at Wolverhampton; and disposal of the tractor business. The Plan envisages, on this basis, a return to profit after interest and tax in 1983 for the Leyland Group as a whole (1984 for Leyland Trucks), and to a positive cash flow in 1984 both for the Group and for Leyland Trucks; and by the end of the Plan period a return to viability which should allow it to raise private sector finance without Government backing.

70 The Plan includes, at Ministers' request, an assessment of the costs of the alternative option of closing Leyland Trucks; other options have been examined but dismissed as more expensive than the restructuring proposed, and commercially barely tenable. Liquidation of the leyland Group is thus presented in the Plan as the only effective alternative. Our assessment is that only a few parts of the Group - within the UK, probably only the bus operation - would survive as going concerns. Closure would have important political and social implications particularly because of the concentrated local effect on unemployment in North West England and Scotland. In contrast with their position on the Cars Group Corporate Plan a year ago, when the BL Board presented the Plan as essentially a matter for judgement of broad national considerations rather than a strictly commercial decision, the Board "believes strongly that it would be wrong to take this course /closing Leyland Trucks/ while a real chance exists of saving the business and that the new Leyland Group management team should be given an opportunity to demonstrate their ability to meet the formidable targets they have set themselves."

71 In terms of public expenditure, endorsement of the Leyland Group Plan involves no increase in the figures agreed and announced by Ministers for BL as a whole in January 1981, in respect of 1981/82 and 1982/83. Approximately £50m out of the £370m agreed for BL for 1982/83 is in respect of Leyland Group's UK activities; and the BL Board are confident that this, together with a central contingency of a further £50m against shortfall in the performance of the Leyland Group against its Plan, can be accommodated without any increase in Government funding in that year. The Leyland Group's projected cash requirements, even including a corresponding contingency in subsequent years, are projected by BL as being containable within

/the

the overall projections for BL which provide for no commitment to Government funding after the end of 1982/83 (though, as last year, the Plan identifies a need for additional external equity of £150m over the two succeeding financial years).

72 The PSBR cost of the closure option depends primarily on the views taken about the effects on unemployment levels and reabsorption rates and on the extent to which the Government would have to redeem parts of BL's borrowings; our calculations suggest that the first year PSBR costs could be about £175M (with a cumulative cost over four years of about £350M) over and above the present allocation for 1982/83.

73 There are substantial risks to the achievement of the Group's Plan, mainly in relation to Leyland Trucks, of which the most serious are:

a) although the new senior management of the Group is highly regarded, there is still a question mark over management quality at middle levels, given the need to handle the major reduction in manpower required in 1982 under the Plan, the major changes in manufacturing facilities and activities, and the need to contain material cost increases to the extent envisaged by the Plan;

b) a lack of cooperation from the workforce (though the record has been historically good);

c) a shortfall in sales volume, market share or price in the UK market: this could arise from a recession more prolonged than BL assume, or from a failure of new models to recover lost market share;

d) the effects of the exchange rate on overseas sales, both in terms of BL's own return and of its competitiveness against other manufacturers.

74 On the other hand:

i) the Plan's projections of total market and market share are now realistic and far more cautious than the previous somewhat optimistic Plans for the Group;

ii) the general economic assumptions are also cautious and are broadly acceptable;

iii) the major cost reductions forecast are based on the radical restructuring of manufacturing facilities, the use of collaboration for some engines and the direct purchase of other engines and all gearboxes;

iv) the manpower reductions and manufacturing changes are proportionately somewhat less severe than those already successfully accomplished in the Cars Group, though they are scheduled to take place over a shorter timescale;

v) heavy and medium family of models is well planned and is already available, and plans are well advanced for a new light vehicle which requires relatively small investment;

vi) the company is traditionally profitable and has suffered particularly both in profitability and in productivity from the exceptionally deep cyclical recession in truck demand;

75 Departments differed in their judgement of how strong a prospect the Plan gives of a return to profitability by 1983 or 1984 without the need for any extra Government funding beyond that already provided for. Departments other than the Treasury judged that the prospect was reasonable, though subject to substantial risks; the Treasury, on the other hand, judged that the risks and opportunities were more finely balanced. Taking account of the additional public expenditure and PSBR costs of closure, the recommendation of the Group as a whole is that the Leyland Group Plan should be approved, but on the basis that:

i) the "benchmarks" against which the Plan says the progress of Leyland Trucks will be measured and on the achievement of which decisions will be made on continuing, modifying or abandoning the Plan, should be declared to the Government; and progress against them should be included in the monthly monitoring arrangements for BL as a whole;

ii) continued support of the Plan after the end of 1982/83 will be dependent on that progress and on review in the context of next year's Corporate Plan.

Department of Industry
2 December 1981

ASSESSMENT OF PROFIT SHORTFALL IN 1981

1. BL's total PBIT shortfall, compared to projections in the 1981 Plan, is forecast to be £124m. This note attempts to assess reasons for the shortfall in each of the Groups separately. Throughout this analysis a distinction (necessarily somewhat arbitrary) has been drawn between factors that are susceptible to control by BL ('internal' factors) and those which are not ('external' factors). Quantification of the various factors at work is not a precise science and we would claim only that identification of the factors underlying BL's performance is possible within sufficiently acceptable ranges of confidence to allow a fuller understanding of the strengths and weaknesses of the company.

Cars Group

2. Car Group's forecast outturn is very close to budget - a shortfall of only £4m. This contrasts dramatically with last year's result of a shortfall of £356m against the 1980 Plan. This performance results, however, from a balance of opposing forces. On the negative side the major influence has again been the higher than estimated value of sterling against other major currencies. In particular, BL (in common with other forecasters) expected sterling to fall against European currencies - and Europe is Cars' most important export market - whereas in fact it held steady. This was only partially offset by the unexpected fall against the dollar which provided a stimulus to Jaguar exports. Details of the exchange rate variances are as follows:

Budgeted and actual (forecast) levels of sterling in 1981

	Budget (1981 Plan)	Actual
US $	2.30	2.05
German DM	4.10	4.60
French franc	9.65	11.25
Italian lira	2000	2340
Japanese yen	490	450
Effective Exchange Rate	94	97

3. The effect of these variances on PBIT - taking into account both lower than budgeted margins in the UK in order to remain competitive with foreign manufacturers (pricing effect) and lower than budget revenue from overseas sales (conversion effect) - is shown below:

Effect on PBIT of stronger than expected sterling

	£m
UK pricing	(20)
Foreign currency conversion	(54)
	(74)

4. The other 'external' factor which has had an overall negative impact on PBIT is the worse than expected general economic climate. The higher than expected UK demand for cars (1.447m as against 1.420m) is estimated to have improved PBIT by £11m. However, this has been more than offset by an unexpected shift in demand towards smaller cars on which profit margins are lower: the share of the small car section in the total UK car market has risen from 15.9% in 1979 to 25.9% for the first 9 months of 1981. Finally, high interest rates have continued to exert an adverse influence through dealer de-stocking. The net effect of all these general economic factors is estimated to have been to reduce PBIT by some £9m.

5. The 'internal' performance during the year has, however, been sufficiently impressive virtually to offset the total 'external' negative impact of £(83)m. A higher than expected 1981 UK market share (due largely to Metro's success) - forecast at 19.5% compared with the 1981 Plan projection of 18.5% - is estimated to increase PBIT by some £16m; against this, however, export volumes and margins were below budget. In addition BL have managed substantial improvements in their cost and efficiency performance - including bigger manpower reductions, increases in the productivity of labour, capital and inventories and cost reductions from budget for labour and component purchases. The net effect of these 'internal' factors is to have increased PBIT by £79m, compared to budget, as follows:

Effect on budgeted PBIT 1981: Cars Group

	£m
Higher UK market share	16
Lower export volume	(6)
Cost performance and efficiency improvements	62
Other	9
Total	79

6. The figures for Jaguar are included in the above totals. As noted above, however, the effects of exchange rate movements have been different for Jaguar, which concentrates on the North American rather than the European markets. At the beginning of the year, a strong pound was inhibiting exports to the US and share of the UK market was only 0.3%; losses were running at about £2m per month. A drive to improve quality and reliability and to maintain steadiness of production, together with vigorous marketing and a substantial strengthening of the dollar have resulted in considerable improvements: UK market share was 0.5% in August and September, exports up on last year and the company is now running at approaching breakeven (before interest).

Land Rover Group

7. Although the Land Rover Group continues to be a profitable company, profitability is now only marginal following a very bad year. The Plan forecast for 1981 of £4m PBIT (now revised to £8.3m as a result of improved sales in September) compares with profits of £27m in 1980 and budgeted profits in the 1981 Plan of £33m.

8. The breakdown of the 1981 profit shortfall from budget is given below:

Breakdown of PBIT shortfall from budget: Land Rover Group

	£m
UK vehicle demand	(1)
UK market share	(7)
Export volume	(15)
Pricing	(5)
Currency conversion	(12)
Cost performance and efficiency improvement	10
Other	1
	(29)

9. As with Cars, Land Rover Group suffered as a result of exchange rates being more unfavourable than expected and lower export volumes. These have affected particularly Land Rover Ltd, the manufacturer of the Land Rover and Range Rover four-wheel drive vehicles, which exports about 80% of its output. Land Rover Ltd has also been affected by the strength of Japanese competition in third markets - Japan produced about 50% of worldwide four-wheel drive output in 1980 (cf 20% in 1978) and 90% of their production

is for export. This competition accounts partly for the fall in Land Rover Ltd's worldwide sales from 61,000 (1980) to 54,000 (forecast 1981). The company is, however, expected to hold onto its UK market share.

10. Japanese competition has also affected the performance of Freight Rover Ltd, the other half of the Land Rover Group, which competes in the market for light commercial vehicles of 2-3.5 tonnes GVW with the Sherpa van. Although the company has doubtless suffered from adverse external factors and in particular from Japanese competition, there has also been a serious problem with product - its only product is the Sherpa van and this has had difficulty in competing (for design and quality reasons) against the Ford Transit and Japanese imports. A considerable amount of management attention has consequently been devoted to the problems of Freight Rover in 1981. This is beginning to pay off with better build quality and marketing and market share is currently running at some 10%, as against the 8% forecast for 1981 as a whole.

Unipart Group

11. Unipart's forecast PBIT of £12m is some £12m short of PBIT projected in the 1981 Plan. The poor results are a direct result of the recession, combined with high interest rates, which has led to dealers running down their stocks in order to economise on working capital. Improvements in productivity were able only partially to offset these negative factors:

Breakdown of 1981 PBIT variance from Plan: Unipart Group

	£M
UK part demand *	(9)
Export volume *	(4)
Exchange rate	(1)
Cost performance and efficiency improvement	4
Others	(2)
	(12)

* includes effects of dealer destocking

Leyland Group

12. The Leyland Group's profit shortfall in 1981 is estimated at £74m, although it may be considered rather artificial to compare forecast outturn - a loss before interest and tax of £75m - with the 1981 Plan since that Plan was not endorsed by the BL Board.

13. The absolute performance of the Group was severely affected by the collapse in total truck demand in the UK. However, most of this fall in demand had already been anticipated and it is estimated that lower than budget demand accounts only for some £(8)m of the PBIT variance. The Group was also hit by a move in market demand away from the heavier end of the market - where the Group is represented by its newest and most competitive models - and by a high level of dealer destocking, together estimated to reduce PBIT by a further £(7)m. The effects of higher than budgeted exchange rates are estimated as follows:

Exchange rate effect

	£m
UK pricing	(14)
Foreign currency conversion	(8)
Total	(22)

All told, these external factors have therefore reduced PBIT by some £37m.

14. The other half of profit shortfall is due to what can be characterised as internal factors. First, overall market share has declined from 17.3% in 1980 to a forecast 16.4% in 1981. Secondly, there has been a shortfall in export volumes. Both these factors reflect in part the ageing and uncompetitive models at the lighter end of the market. Thirdly, unlike BL Cars and Land Rover, cost performance and efficiency has deteriorated from budget by some £12m. The Group was clearly unable to achieve the volumes necessary to support its cost base and the new emphasis of the 1982 Plan is intended to rectify this problem by severe rationalisation of facilities.

BL'S ECONOMIC ASSUMPTIONS - MAIN CASE AND ALTERNATIVES

BL's Forecast

1. The main elements of the economic forecast used to develop the 1982 Plan are as follows:

THE ECONOMIC FORECAST FOR THE 1982 PLAN - SUMMARY

* Latest forecast

	1980	1981*	1982	1983	1984	1985	1986
% change/year							
GDP (output)	-3	-3	0	1.0	1.5	0.5	0.5
Manufacturing Output	-9	-7	-2	-1	-0.5	-1.0	-0.5
Retail Price Inflation	18	12	11	11	10	9	9
Manufacturing earnings	17.8	12	8.5	11	10	9	9
Material and fuel inflation	12.3	5.0	8.5	11	10	9	9
MLR (%)	16.3	13.5	11	10	9	9	9
Effective UK Competitiveness	117	118	119	120	120	120	120
(1979 = 100)	(increase in index = decline in competitiveness)						
Exchange Rates - Value of £ Sterling							
US ($)	2.33	2.00	2.00	2.00	1.97	1.95	1.93
Germany (DM)	4.23	4.50	4.25	3.95	3.70	3.50	3.30
France (FR)	9.83	10.75	11.35	11.50	11.60	11.70	11.80
Italy (L)	1992	2250	2300	2350	2400	2450	2500
Japan (Yen)	526	440	430	415	405	395	380
Effective Exchange Rate	96.1	94	93	91	89	87	85

2 The UK recovery is forecast to be very slow with manufacturing output falling throughout the Plan period. This forecast, and the forecast of world economic activity in general, are somewhat lower than those used in the 1981 Plan.

3 For currency, the average strength of sterling is forecast to be lower than in the 1981 Plan, but the average conceals important differences - the pound is forecast to be decidely weaker against the US dollar and Yen than in the 1981 Plan, but stronger against the main European countries.

4 For UK competitiveness (currency and relative inflation combined) the UK is not forecast to recover to any significant extent over the period, and will continue to be in a much worse position than in 1979.

Assessment

5 The BL forecast differs from the Treasury outlook in several important respects. On the general level of activity, BL are relatively pessimistic: for example GDP and consumer expenditure are projected to grow more slowly than in the Treasury forecast. BL also forecast a stronger effective sterling exchange rate. On the other hand, BL are relatively optimistic about the outlook for earnings and particularly for raw material costs; they also show a fairly sharp decline in interest rates (itself probably not wholly consistent with their/ rate forecast). Overall, BL's economic assumptions forecast seem reasonably central.

/exchange

Alternative Cases

6 In recognition of the uncertain economic outlook, BL have prepared assessments not only on the "main" case but in outline on two alternatives, characterised as the "high sterling" and "low sterling" cases. Besides exchange rates, these cases incorporate changes in UK economic growth (hence market size and BL sales volumes) and UK inflation rates (hence changes in costs and revenue).

7 BL note that the effects of changes in these factors are complex and take place over a considerable period. It is therefore impossible to be sure that the evaluation of these alternative cases shows a true outcome. If they arose, they might also require changes to 'physical' plans (products, manufacturing etc). The estimated effects on revenue, cost and working capital levels are included, in the summary figures below, but BL have made no

attempt to reflect any modifications which may have to be made to physical plans. Volumes have however been modified to reflect changes in the size of the UK market.

ALTERNATIVE ECONOMIC CASES SUMMARY OF FINANCIAL IMPLICATIONS

High Sterling Case		1982	1983	1984	1985	1986
UK Price Inflation	(%)	9.5	8.5	7	7	6
Effective Exchange Rate Index		102	104	103	102	102
PBIT	£M	(275)	(273)	(252)	(254)	(233)
Cashflow	£M	(657)	(555)	(511)	(505)	(482)
Return on Assets Employed	(%)	(17)	(15)	(13)	(13)	(11)
Low Sterling Case						
UK Price Inflation	(%)	14	11	10	10	10
Effective Exchange Rate Index		83	82	81	78	75
PBIT	£M	(30)	262	368	546	632
Cashflow	£M	(472)	(135)	29	255	323
Return on Assets Employed	(%)	(2)	14	17	24	26
Memo:						
1982 Corporate Plan - Main Case						
UK Price Inflation	(%)	11	11	10	9	9
Effective Exchange Rate Index		93	91	89	87	85
PBIT	£M	(145)	27	188	271	357
Cashflow	£M	(557)	(305)	(111)	30	88
Return on Assets Employed	(%)	(9)	1	9	13	16

8 BL comment that the low sterling case would probably make it economic to commence selling in countries which do not offer a sufficient profit margin at present. This might be accompanied by the need for capital investment in more production capacity and/or new products. The high sterling case would probably trigger further retrenchment and plant closures. There would be considerable doubts over the ability of any part of BL to survive under the high sterling case.

LEYLAND TRUCKS: EFFECTS OF CLOSURE

Introduction

1. This note attempts to identify the additional public expenditure and PSBR costs which would result from a decision to close down Leyland Trucks i.e. those costs which are over and above the cost of implementing the rationalisation of Leyland Trucks envisaged in the Corporate Plan. It should be stressed that it is only possible to indicate the order of magnitude of such costs.

2. A decision not to fund the Leyland Group Corporate Plan would require a number of decisions to be taken about the mechanics of closure and the allocation of costs between Government and BL. For the purposes of this exercise, the general working assumption has been that Government would meet the costs of, for example, redundancies and trade creditors but also benefit from any proceeds from trade debtors and sale of Leyland Trucks' inventory and capital assets.

Employment

3. On the evidence of the Leyland Group's Corporate Plan, closure of Leyland Trucks would involve the loss of 9,500 jobs at BL, over and above those already provided for in the Plan. Employment losses in supplier firms are very difficult to estimate, mainly because the fundamental rationalisation of Leyland Trucks under the new Plan will imply new supplier relationships to those we have had in previous such analyses. In particular, the outsourcing of gearboxes and two of the engines will mean that under the new Plan the ratio between supplier employment dependent on Leyland Trucks and Leyland Trucks employment will be higher than in the past. We have estimated employment losses in supplier firms at around 15,500. However, not all of the Leyland Truck output will be lost to the UK. It is believed on the basis of current market share information that about one-third of Leyland Truck's output would be replaced with other UK-based production, so there would be offsetting employment gains in rival UK assemblers and suppliers. These offsetting employment gains are estimated at 8,000, although it is recognised that because of below capacity working in the industry all of these employment 'gains' are unlikely to materialise immediately.

4. It is assumed that a policy decision not to fund Leyland Trucks further would be taken before the end of 1981. BL say that "in practice it is considered that at best the close-down could not be spread over more than 4-6 months". It is therefore assumed that the job loss at BL occurs on (or is spread either side of) 1 April 1982. The further job losses and offsetting gains in rival firms and suppliers would take place throughout 1982-3; a mean effective date of 1 October 1982 is assumed.

5. In summary, the job loss in 1982-3 is assumed to be as follows:

Job losses:	in Leyland Trucks	9,500
	in suppliers	15,500
		25,000
Less offsetting job gains in UK assemblers and suppliers		8,000
Net job loss		17,000

6. It is accepted that a major closure leads to a net increase in unemployment above what would otherwise have been projected nationally. This impact diminishes as the economy returns to equilibrium and unemployment resources are re-absorbed. A major issue in analyses such as this is the speed at which re-absorption takes place. Given the Government's overall macro-economic policy stance as expressed in the MTFS, a closure of Leyland Trucks should not lead to any permanent change in aggregate national unemployment in the medium to longer term. A continuing loss of jobs at Leyland Trucks is probably already implicit in the MTFS; on this view an immediate closure has its main effect in producing a sharp change in the time-profile of unemployment. The speed of adjustment when seen in this light is primarily an empirical issue, but one on which almost no evidence exists to conclude how markets might react to a shock of this nature.

7. There would certainly be a transitional increase in unemployment until markets had time to adjust. But there is wide range of view about how long this transitional period might last. Arguably, it might be short, since the effects on the labour market - for instance in reducing the pressures for wage increases - might quite soon lead to new employment opportunities. On the

other hand, in the case of a closure of BL Cars, it was felt to be only prudent to assume that the net re-absorption rate would be rather slower: 0% in the first two years, 25% in the third year and 50% in the fourth year. In the present case it is already assumed that there is an identifiable level (8,000 jobs) of re-employment within the same industry in Year 1. The question arises whether there should be any additional assumptions made which might point to a faster re-absorption rate that in the Cars case. It is noted that previous exercises have assumed that a Leyland Group closure would be followed by a faster level of re-absorption, but weight must also be given to the view that re-absorption will be slow because of the highly localised effects of closure and because current underemployment in the UK truck industry will enable UK truck manufacturers to increase production (to take up some of Leyland's market share) without a commensurate increase in employment.

8. On balance, it seems sensible to retain the Cars case assumptions: on this basis, the net increase in unemployment would be as follows:

At 31 March	1983	1984	1985	1986
Number	17,000	17,000	13,500	9,500

Redundancy Payments

9. It has been assumed that about 90% of Leyland Truck's employees (ie about 8,550) would be eligible for redundancy payment: this eligibility assumption is based on information provided by BL. The average redundancy payments have been calculated on the basis of BL's standard closure terms which take into account such factors as length of service, level of skill, bonuses for smooth run down of production etc. On this basis, an average redundancy payment of £5850 has been assumed, reflecting the high proportion of skilled labour in the industry and the fact that many employees have been long-serving. This figure includes the contribution from the State Redundancy Fund. The total cost of these redundancies would therefore be about £50 million.

10. In addition, there would be a cost to the State Redundancy Fund from job losses in supplier firms. Assuming 60% eligibility, which is the national figure for the engineering industry, this cost would be nearly £5m.

Social security benefits, lost tax and NI receipts

11. On the basis of the above assumptions about the net employment effects, the following calculations of financial implications have been made:

£m	1982/3	1983/4	1984/5	1985/6
Social security payments	21	33	28	20
Loss of tax revenue Loss of NI revenue	38	49	42	30

Other (non-labour) costs

12. These include:

- the need to repay about £130m of trade credit;
- the probability that about £100m of loans and loan stock will have to be repaid; it may be possible for BL to refinance this debt but we regard this as unlikely given the extent of existing private sector exposure to BL.

13. It has been assumed that the risk to BL's £300 million medium term loans would not have any public expenditure implications. Negotiations on these loans are continuing. It is difficult to assess in advance what effect the closure of Leyland Trucks would have on these negotiations. BL could present the closure as a necessary commercial decision which would substantially improve the outlook for the company as a whole. Furthermore, closure would not alter the security provided by the Government's public statement of its obligations with regard to BL's debts and, in as far as trade creditors of Leyland Trucks were paid, would strengthen it. It should be noted, however, that the banks may be sufficiently unnerved to request a formal Government guarantee.

14. The calculation of costs takes into account miscellaneous costs such as those arising from warranty obligations. These 'other costs' total £24m over the four years 1982/3 to 1985/6.

Summary

15. On the basis of the above assumptions the total financial effect on Government is calculated as follows:

	1982/83	1983/84	1984/85	1985/86	Total
Redundancy costs	55	-	-	-	55
Social security benefits	21	33	28	20	102
Repayment of loans	100	-	-	-	100
Trade creditors	131	-	-	-	131
Other Costs	18	6	-	-	24
Trade debtors	(68)	(2)	-	-	(70)
Disposal proceeds: assets	(15)	(14)	(4)	-	(33)
inventory	(51)	(16)	-	-	(67)
Total Public Expenditure	191	7	24	20	242
Lost tax revenue) Lost NI revenue)	38	49	42	30	159
Total PSBR costs	229	56	66	50	401

Note: Although included above as a cost in 1982/83, it should be noted that trade creditors may require payment in 1981/82.

+ See next page

16. Closure of Leyland Trucks would also have the following further implications for Government funding:

a. Closure would enable the saving of up to £50m of the Government funding currently projected for Leyland Group in 1982, but against this has to be set the costs of redundancies assumed in the Corporate Plan, which would fall to Leyland Group's account if the Corporate Plan were funded. On the basis of the working assumptions used for the above calculations, the cost of these redundancies could amount to around £25m in 1982/83.

b. On the basis of projections in the Leyland Trucks Plan there would be a beneficial cash impact on BL as a whole in the early years of the Plan, but a detrimental effect in later years, since Leyland Trucks is forecast to recover to a positive cashflow. BL quantify the effect as follows:

Beneficial (Detrimental) effect on BL cashflow of closure of Leyland Trucks

1982	1983	1984	1985	1986	(£m)
89	35	(5)	(28)	(40)	

However, the beneficial effects would be offset and detrimental effects compounded to some extent by the worse-than-Plan performance of Leyland Parts and the adverse effects on other parts of BL consequent upon a closure of Leyland Trucks.

CONFIDENTIAL

PLANT	TTWA	UNEMPLOYMENT NOVEMBER 81		EMPLOYABLE POPULATION	CORPORATE PLAN JOB LOSS	UNEMPLOYMENT FOLLOWING CORPORATE PLANT (1)		LIQUIDATION GROSS JOB LOSS	UNEMPLOYMENT FOLLOWING LIQUIDATION (1)		1982 AA STATUS
		NO	%			NO	%		NO	%	
BATHGATE	BATHGATE	9,423	18.9	49,714	1,365	10,515	21.2	3,765	12,435	25.0	DA
ALBION	GLASGOW	94,564	16.0	592,914	140	94,676	16.0	1,840	96,036	16.2	SDA
LEYLAND	PRESTON	17,559	11.8	148,371	1,855	19,043	12.8	6,955	23,123	15.6	- (NOW IA)
GUY	WOLVERHAMPTON	24,101	16.5	146,271	740	24,693	16.9	740	24,693	16.9	-

(1) Assumes 80% registration of those made redundant

CONFIDENTIAL

ANNEX D