CC: HMT
DTI
D/Trade
Mr. ...
CO
CPRS
SO

10 DOWNING STREET

bcc: J. Vereker.

From the Private Secretary

17 February 1983

Dear Jonathan,

BL's 1983 CORPORATE PLAN

The Prime Minister held a meeting this morning about BL's 1983 Corporate Plan. The Chancellor of the Exchequer, your Secretary of State and the Secretaries of State for Employment and Trade, the Minister of State, Department of Industry (Mr. Lamont), Sir Robert Armstrong and Mr. Sparrow were also present.

Your Secretary of State said that after prolonged discussion last year the Government had reached agreement with the BL Board on privatisation and the further funding of the business. This agreement was set out in Sir Michael Edwardes' letter to your Secretary of State of 4 August 1982, and had figured in BL's half-year report. Nothing had happened since then which would make it impossible for the Government to deliver its part of the bargain. He recognised, as the Chancellor pointed out in his minute of 7 February, that the Government's agreement to provide up to £150 million equity funding was subject to approval of the 1983 Corporate Plan, and that the need for this funding would have to be demonstrated. He fully intended to scrutinise rigorously the case which BL would put forward for these funds. As he saw it the difference between his position and the Chancellor's was a narrow one: no-one was suggesting that the 1983 Corporate Plan should be rejected. He also proposed that there should be a fundamental review of the Austin Rover group, on the lines of that proposed in paragraph 5 of Mr. Sparrow's minute to the Prime Minister of 14 January. The fact was that Austin Rover was unlikely to generate enough cash to fund the investment for new models. This was the background to the current discussions with Honda, who also saw a partnership as being in their self interest. Recent indications, however, were that the discussions with Honda were not going as well as they had been.

In discussion, it was argued that the 1983 Corporate Plan represented a deterioration on the 1982 Corporate Plan. It was not right to say that BL as a whole was still on the course towards profitability which had been plotted in previous years' Plans. There had been substantial slippage in expenditure in recent years, and it was now clear that a commercial profit would not be made until 1985 at the earliest. This represented a slippage of 12 months from the corresponding forecast in the 1982 Corporate Plan. If this expenditure shortfall had occurred

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elsewhere in the public sector the funds would have been taken back to the Treasury, and could not have been carried forward. There was every reason to believe that BL had again over-estimated the amount of cash they would need to finance the projected activity set out in the Corporate Plan. The assumptions underlying the Plan, which were settled around the middle of 1982, had in important respects proved to be pessimistic: in particular their forecast of the United Kingdom car market this year and the recent exchange rate developments, favourable for BL and unfavourable for their competitors. Against this background it would be wrong to tell BL that they could draw a further £100 million or £150 million as an entitlement. This would merely encourage them in the expectation that they would be able to fund further losses, and to finance further Corporate Plans in which the date of a return to profitability was steadily pushed back into the future. Against this, it was argued that cash control at BL had been tight, so that approved expenditures had been pushed into forward years. The fact was that these sums, including the equity funding of up to £150 million, had been promised to the Board, and there would be considerable public embarrassment if the Government went back on its word. Although the general environment in which BL traded had undoubtedly improved, they faced considerably intensified competition in the United States market, and it was simply not possible to say now that the equity funding would not be needed. The right course would be to approve the 1983 Plan, together with the additional equity funding, but to make it plain that the improvement in trading conditions would be taken into account, along with other factors, in assessing whether the additional equity funding could be drawn down. It should not be forgotten that BL had traded in very difficult circumstances in recent years, and that the Company had achieved a remarkable turn-around in its performance - notwithstanding the very considerable difficulties that still lay ahead.

Summing up the discussion, the Prime Minister said that it was agreed that the 1983 Corporate Plan should be approved, and that BL could be told that such part of the £150 million equity funding envisaged in previous Plans for the period after March 1983 as was not offset by estimated proceeds from the sale of minority interests, would be available to BL, if they could demonstrate, in their changed trading circumstances, that it was needed. A full review of the options open to the Austin Rover group should be undertaken, on the lines set out in Mr. Sparrow's minute. The letter communicating this decision to Sir Austin Bide would need to be drafted with great care, and should be cleared with the Chancellor of the Exchequer. It should be made clear to BL that the Government would look very closely at the 1984 Corporate Plan, in particular to see whether the date for a return to profitability was further set back. The burden of proof, as to the need for the further equity funding, should be placed firmly with BL: the aim was to keep them on a tight rein. Finally, it was not satisfactory that the Company should be able to increase its borrowings against the Varley-Marshall assurances indefinitely and without limit. Ideally, there would be no further increase in exposure; at the very least, a study should be

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produced as soon as possible to consider how the Government's exposure under the Varley-Marshall assurances could be limited or reduced.

I am sending copies of this letter to the Private Secretaries to those present at the meeting, and to Muir Russell (Scottish Office).

Yours sincerely,

Michael Scholar

Jonathan Spencer, Esq.,
Department of Industry.