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PRIME MINISTER 9 May 1984

## BRITISH LEYLAND - THE RESIDUAL CORPORATE PLAN

The Corporate Plans of Austin-Rover, Unipart and Land Rover have now been dropped from E(A)'s discussion on 10 May, with the result that substantive issues now have to be dealt with by post. This is quite deplorable. We are talking here of businesses with sales exceeding £2 billion, using assets of nearly £1 billion, and having a high public profile. And we have had the plans for six months. Your earlier hopes for a crisper response from Government to the state industries have gone unheeded. We urge you to take a firmer line.

### 1. AUSTIN ROVER GROUP HOLDINGS

Performance is beginning to look more respectable, especially as regards labour productivity.

| £ million | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|
| Sales | 1799 | 2155 | 2690 | 3040 | 3320 | 3660 |
| Profit After Interest | (18) | (21) | (4) | (4) | 28 | 30 |
| Cash Flow | (95) | (123) | (72) | (41) | (25) | (31) |
| Year End Assets | 550 | 654 | 722 | 759 | 812 | 873 |
| Capital Expenditure | 112 | 173 | 167 | 181 | 216 | 242 |
| Cars per man/year* | 12.0 | 12.6 | 14.3 | 14.6 | 15.3 | 16.2 |

* In 1981 8.0, and in 1982 9.5.

But it is too early to say that ARGH have finally turned the corner:

- trading cash flow remains unsatisfactory, because capital expenditure still handsomely exceeds profitability;
- the plan is lightweight on its assessment of what moves the competition will make. Although the product planning is now much sharper than it was, UK companies too often assume that competitors will stand still while we catch up;
- the forecast results are acutely sensitive to ARGH's share of the UK market, which, since it is so competitively contested, cannot be taken for granted.

Despite improving performance, the BL Board is not pressing for privatisation or even for equity based forms of collaboration. Why? We suspect that DTI sponsor too comfortable a life in the public sector. Improved cash flow would bring privatisation closer. We judge that BL should be made to feel the discomfort of pressure towards privatisation. Lower capital expenditure would help. It not only conserves cash, but improves profitability by reducing depreciation and interest charges. Why not, for instance outsource or collaborate on engines and gearboxes?

We recommend:

i. that BL look again at ARGH's capital expenditure requirements, with a view to improving nett cash flow by around £200 million over the period 1984-87.

(You do not have to accept that lower capital expenditure means fewer new models and therefore uncompetitiveness. What about good old-fashioned economies and new-fashioned collaboration?)

ii. that DTI ask BL to spell out, within six months, what more needs to be done to make ARGH fit for privatisation in 1987.

## 2. UNIPART

The performance of Unipart as a freestanding entity is acceptable from Government's point of view:

| £ million | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|
| Sales | 338 | 352 | 319 | 336 | 354 | 373 |
| Profit After Interest | 17 | 18 | 24 | 28 | 33 | 39 |
| Cash Flow | 3 | 28 | 14 | 21 | 26 | 31 |
| Year End Assets | 140 | 112 | 100 | 107 | 114 | 122 |

The key questions are:

(i) whether and when Unipart should be privatised separately;

(ii) whether Unipart should be authorised to acquire Edmunds Walker, for not more than £20 million, in order to gain access to the non-franchised trade in spare parts.

Privatising Unipart separately would not be difficult. Subject to completing its contractual negotiations with BL's product companies, it could bring in about £100 million, and could be sold during the first half of 1985.

But the bulk of Unipart's profits are derived from Austin Rover, of which it is essentially the spare parts operation. No other motor manufacturer in the world handles his spare parts through a third party company because the profitability of spares is too great to surrender. The motor industry will be astonished if Government wishes this upon Austin Rover.

There is commercial logic in Unipart's wish to acquire Edmunds Walker, although that same logic points to a price well below £20 million. But politically, we cannot have a state enterprise taking over a (failing) private sector subsidiary.

E(A) should decide firstly if Unipart is to be sold separately, and secondly if it should acquire Edmunds Walker - not the other way about.

If Unipart is to be sold separately, we support the DTI view that the acquisition of Edmunds Walker must be irrevocably coupled with a commitment to privatise. We would regard a minority holding by Austin Rover in Unipart as acceptable, but not essential.

If Unipart is to stay with Austin Rover, it must drop the Edmunds Walker ambition.

3. LAND ROVER

This is a business which failed to see:

(i) the pace at which Japanese competitors were establishing all wheel drive knowhow and economies of scale in low-cost sectors, ready for an assault upon Land Rover's premium sector;

(ii) difficulties building up in its traditional (and now debt-ridden) markets, especially in Africa.

If we look further back into history, Land Rover shows just how dangerous it can be to use good businesses to cross subsidise bad ones in the same corporation.

The recent results, and the new plan, run as follows:

| £ million | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|
| Sales | 359 | 461 | 562 | 612 | 654 | 698 |
| Profit After Interest | (42)* | (7) | 18 | 39 | 45 | 50 |
| Cash Flow | (25) | (26) | (5) | 45 | 36 | 35 |
| Year End Assets | 193 | 212 | 235 | 229 | 238 | 253 |

* Including £20 million reorganisation costs.

The plan looks so much better than recent history because the current management is now vigorously reducing its costs, principally by pruning its spider's web of plants back to one key factory at Solihull. The product range is also going through major improvements, which have been well received.

But all this will not put right LR's market problems. This business now badly needs a buyer or a partner who can provide both the financial strength to pull LR back into the profitable premium-price vehicle maker it ought to be, and the distribution network to give LR access to markets which it cannot quickly build up on its own. Land Rover is a "niche" business which needs something bigger and more solid to sit on.

We reject BL's persistent assertion that it should be possible - and is preferable - to privatise Land Rover with Leyland Trucks on the grounds that Land Rover is "icing on the cake". Some icing and some cake!

We agree with DTI's urging that Land Rover should prepare - quickly - a paper setting out how Land Rover could be privatised as a single entity. The options are not numerous. We suggest a maximum of 3 months.

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