

cc/hw

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Confidential

29th March, 1985.

The Rt. Hon. Margaret Thatcher, M.P.,
10, Downing Street,
LONDON S.W.1.

Dear Prime Minister,

Further to our brief discussion last week, I am enclosing my personal views of the Austin Rover Group 1985 Corporate Plan and of the Company's long-term survival prospects. You will see from my comments that I do not feel that ARG can look forward to a financially viable future with the present senior management team.

You should be aware that Robin Mountfield of the D.T.I. has informed Harold Musgrove of his support for the Corporate Plan and of his concern about the cuts proposed by Peter Warry. This comment was presumably made in the context of the civil service review of the B.L. Corporate Plan.

In view of my role as an advisor to ARG and my links with the Department of Trade and Industry I trust my comments will be treated in strictest confidence.

On a separate matter, I should inform you that I have advised two industrial contacts who expressed an interest in the privatization of Land Rover to contact Norman Lamont and John Moore to start the ball rolling.

Developments in manufacturing at Warwick and the University Science Park are proceeding quickly and satisfactorily.

I shall be happy to let you have any further information or explanatory comment should you so wish.

With kind regards,

Yours sincerely,

S.K. Bhattacharyya

PROFESSOR S.K. BHATTACHARYYA

CONFIDENTIAL

SECOND REPORT ON AUSTIN ROVER GROUP

S.K. BHATTACHARYYA
UNIVERSITY OF WARWICK

AUSTIN ROVER GROUP

- 1) Last year the Austin Rover Group (ARG) failed to take 20% of the U.K. car sales market and made a loss of £26.1 m. In the first two months of 1985 the Company has an estimated loss of £7.3 m. This is the depressing background against which I make my comments and proposals below. I should make it clear that my proposals are designed to ensure the survival of ARG as a financially viable entity.

- 2) During the last five years the Company has made great improvements, particularly in the areas of design and manufacture. Labour productivity levels of the 'Metro' are as good as any in Europe and improvements in productivity are still being made across the whole range of cars. Quality has improved substantially over the last three years but further improvements still need to be made especially at the top end of the range.

- 3) During this same period ARG has shed employees, closed factories and introduced major changes in shop floor practice, with the result that the Company is now broadly competitive in variable cost terms. Although manufacturing fixed costs have been reduced, increases in sales are nevertheless required to reduce unit costs to an acceptable level. This has not happened; even with a full model range ARG has not been able to increase sales and therefore the improvement in manufacturing efficiency has not produced the expected financial benefits.

4) Not surprisingly the style of management through this period has been inward looking and fairly brutal. For the future, however, ARG will require management skills of a different kind. We need senior managers with a greater understanding of the new technologies who can think and plan on a global scale and managers, who, whilst being no less forceful and determined, operate in a less autocratic and combative manner. The present style of management is repressive and fails totally to involve and benefit from the specialist staff within the Company.

5) The senior managers at the moment are:

Chairman - H. Musgrove

Managing Director - Operations - A. Barr, responsible for manufacturing and purchasing

Managing Director - Product Development, J.M. Snowdon, responsible for product engineering, design, product planning and business strategy

Director - Sales and Marketing - T. Taylor,

Director - Finance, Planning and Services - P. Reigner

Company Secretary - H. Coles

Personnel Director - A. Curtis - he is not a Board member.

COMMENTS:

a) Snowdon moved to his present post in January, 1985 from Product Planning, Sales and Marketing. He was not successful in sales and marketing. The Product Planning is out of control and he does not possess the relevant

experience to take over a brief which includes product engineering and design. I have said before that responsibility for design and manufacturing ought not to have been separated but notwithstanding this view I do not feel that Snowdon has the necessary qualities or track record to justify his present post.

- b) Taylor was responsible under Snowdon for U.K. sales and the fact that Austin Rover Group penetration of this market is still below 20% speaks for itself.
- c) ARG had a first rate Personnel Director, G. Armstrong, who was largely responsible for the successful handling of wage negotiations and industrial relations over the last four years. He has recently left to become Personnel Director of the Metal Box Company.
- d) In my view neither the Chairman of the Austin Rover Group Holding Board, R. Horrocks, nor Musgrove have the intellectual stature necessary to cope adequately with the demands of their posts. Equally damaging from the Company point of view is their inability to appoint senior staff of the right calibre and this is borne out particularly by the recent appointments of Snowdon and Taylor.
- 6) The fundamental strategic questions for ARG to answer are:
- (i) Is it any longer possible to compete on a world wide basis with a full range of models?

(ii) If ARG retreated from its position as a world scale, full line manufacturer, what range of vehicles could it manufacture economically?

(iii) If ARG continued as a full line manufacturer could this be done more cheaply?

In my view it does not make sense for a company of the size of Austin Rover Group to contemplate the design and manufacture of a full range of models. Nor do I feel it is wise to attempt to provide a large number of derivatives and variations within a single model range. The basic strategy which I feel Austin Rover Group should adopt would require the company to build four models each having a limited number of derivatives and to consolidate its technological advances and concentrate its efforts on sales and marketing.

PRODUCT PLAN

7) With regard to the Product Plan I suggest that the following proposals would reduce the proposed capital expenditure envisaged in the 1985 Corporate Plan by £640 m. and also offer a more realistic way forward. (Financial detail in Appendix I).

(i) As suggested under paragraph 6 above the model range should be reduced to four with few derivatives and greater commonality between models. The present

plan bears no relation to market realities and cannot be justified on technological grounds. I know of no other motor manufacturer which can support such a wide range of variants and derivatives on the basis of such a low sales volume. (Some details of the extraordinary range and scale of existing variants is shown in Appendix II).

- (ii) The Product Plan assumes an average model life of 6-7 years. Successful competitors such as Volvo, Saab, Mercedes and BMW have a much longer floor pan life and I would suggest that ARG should extend their model life by 'face lifts' and 'reskinning'. Acceptance of this strategy would enable major expenditure on the next generation of models to be deferred by up to two years.
- (iii) The current 'A' series engine (up to 1.3 litre) is outdated and cannot be updated in order to satisfy emission regulations. ARG plan to develop a completely new engine with an estimated cost of £121 m. In my view this is not necessary. Honda produce a reliable engine in this range which satisfies emission regulations and which ARG should consider buying. Similarly a new gearbox which is planned for 1989 should be abandoned in favour of the VW gear box which is currently used in some of the models in the lower range. ARG's engines above the 1.3 litre range are quite satisfactory.

- (iv) Capital expenditure in the plan is based on a sales volume exceeding 750,000. If this were reduced to a more realistic level of 500,000 coupled with double shifting the expenditure plan could be cut significantly.

SALES AND MARKETING

- 8) (i) Sales is a disaster area. The low level of sales in 1984 has been excused on the grounds that models were unavailable because of industrial problems. This is not correct. Appendix III shows that the stock levels at the end of November, 1984 and December, 1984 (the period of the ARG strikes) were more than adequate to satisfy the market demand.
- (ii) Sales planning leaves much to be desired. It was a mistake to make Germany the prime European target in 1984. It will be an even greater mistake to assume that the launch of the XX in the U.S.A. in Autumn 1987 will repeat Jaguar's success. The timing of the proposed ARG launch is most inappropriate since it follows the launch of the Honda version of the XX by twelve months. Moreover, Honda have a good distribution and dealership network in the U.S.A. whilst ARG as yet has none.

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(iii) Sales figures for January and February, 1985 appear to be within the Company's target. I believe these figures have been contrived and do not represent the true picture. Furthermore, current internal sales estimates fall far short of those presented in the 1985 Corporate Plan. (See Appendix IV).

(iv) Responsibility for poor sales performance and planning must rest firmly with the Chairman and M. Snowden.

Conclusion

9) The conclusion which must be drawn from the above comments is that whilst great advances have been made in the design and manufacturing functions, these have not been paralleled in other aspects of the ARG organisation. We have a product plan which is designed principally to maximise Government funding, a sales and marketing force which clearly has not measured up to the task and a senior, Board level, management which, with the exception of A. Barr, is devoid of ideas and talent.

It is this latter factor which is the principal reason behind ARG's continuing difficulties. At a recent meeting of senior staff, the Chairman, H. Musgrove, said in reply to a question about privatization, "As long as we are not making an enormous loss 'She' cannot touch us". This

illustrates the defensive and short sighted approach which I feel is all too often at the root of ARG's problems. If ARG is to be 'turned around' it needs an immediate change of senior management. Messrs. Horrocks, Musgrove, Snowdon and Taylor should be replaced by managers who have a wider commercial experience but who, most importantly, must be people of a much higher intellectual calibre.

POST SCRIPT

I have just learned that Honda has responded to the offer by ARG to allow them to utilize spare capacity to assemble their own vehicles in the U.K. Whilst this will obviously provide ARG with additional short term income it will in the long run prove to be a poor deal. Honda will now be able to assemble in Europe without the usual heavy capital investment and without contributing more to the 'collaboration' with ARG than a rental payment. I suspect that ARG will use this agreement as the basis of a claim for further capital funding from Government. A better long term deal for ARG would have been an agreement under which Honda would manufacture the 1.3 engine in the U.K. and supply ARG in return for the use of their assembly facilities.

March, 1985

APPENDIX I

AUSTIN ROVER GROUP CORPORATE PLAN(1985)

CAPITAL EXPENDITURE

LEGEND

AR5	-	Rover 200 replacement
AR6	-	Metro replacement (4Dr)
AR7	-	Maestro replacement
AR16	-	New car Montego Varient
AR17	-	Montego Replacement
XX	-	Rover 3500 replacement Honda collaboration
LM10	-	Maestro
LM11	-	Montego

ADDRESSEE ONLY

AUSTIN ROVER GROUP

1985 CORPORATE PLAN

CAPITAL EXPENDITURE - £m

PRODUCT	1983	1984	1985	1986	1987	1988	1989	1990	1991	TOTAL
METRO 85 MY	1.0	8.2	0.4	-	-	-	-	-	-	9.6
METRO 5 DOOR	9.8	5.8	0.5	-	-	-	-	-	-	16.1
METRO 86 MY	-	-	3.9	6.8	6.2	-	-	-	-	16.9
ROVER 200 FACELIFT	-	-	-	10.0	10.0	5.0	-	-	-	25.0
ACCLAIM & RESOURCING	16.4	20.0	0.9	-	-	-	-	-	-	37.3
LM10/11 VAN/ESTATE	74.0	42.0	1.9	-	-	-	-	-	-	117.9
LM10/11 CAPACITY INCR	0.3	5.0	0.1	-	-	-	-	-	-	5.4
XX - INCL. GEARBOX	2.1	22.0	82.9	12.1	10.9	-	-	-	-	130.0
XX NAS	-	-	-	2.5	2.5	-	-	-	-	5.0
XX COUPE	-	-	1.0	9.0	6.0	-	-	-	-	16.0
XX FACELIFT 1991	-	-	-	-	-	-	3.3	21.5	24.5	49.3
LM10 FACELIFT SPR 87	-	-	1.7	17.0	8.0	5.0	-	-	-	31.9
LM11 FACELIFT SPR 87	-	-	3.5	8.5	3.0	-	-	-	-	15.0
AR5 SPR 91	-	-	-	-	-	-	-	21.3	49.7	71.0
AR6 SPR 89	-	-	-	10.0	3.0	51.6	65.7	11.5	-	162.5
AR7 AUT 90	-	-	-	-	-	15.9	26.5	41.6	38.6	122.6
AR16 MID 88	-	-	-	3.4	3.8	26.2	16.8	-	-	73.2
AR17 AUT 89	-	-	-	-	-	10.4	26.5	25.4	3.9	66.2
AR16/17 FACELIFT 93	-	-	-	-	-	-	-	-	37.6	37.6
ENGINE'O' DIESEL	-	7.0	5.0	3.9	-	-	-	-	-	12.9
'K' SERIES	-	-	-	5.0	11.0	37.0	15.0	13.3	-	121.3
'S' SERIES	-	-	-	5.0	11.8	3.2	-	-	-	30.0
V6	-	-	-	-	-	3.9	24.0	14.1	-	42.0
FUEL INJECTION	-	0.5	2.5	2.2	-	-	-	-	-	5.2
SMALL CAR GEARBOX	-	-	-	11.5	15.7	23.0	9.0	13.3	-	72.5
OTHER PRODUCT	5.7	4.5	3.2	3.6	4.6	4.5	5.2	19.0	23.2	75.5
TOTAL PRODUCT	109.3	115.0	109.5	127.5	170.4	185.7	192.0	181.0	177.5	1367.9
NON PRODUCT										
FUELS ELEC ASSY/TEST	-	-	1.5	1.0	-	-	-	1.5	1.0	5.0
ROBOTICS	0.7	3.2	3.9	6.2	6.6	7.0	7.6	8.1	8.6	53.9
FORGE REFURBISH	-	0.8	1.7	1.5	2.0	-	-	-	-	6.0
STREAMLINING	0.8	-	-	-	-	-	-	-	-	0.8
ENGINEERING TEST CELLS	4.4	3.8	10.1	7.3	4.4	7.1	8.1	10.5	14.0	74.7
CIE	4.4	4.0	7.7	4.8	4.0	4.0	4.0	4.0	4.0	41.1
PRESSES	-	-	-	1.0	9.3	9.8	10.6	9.8	10.6	51.1
TOOLRM MODERNISATION	0.9	1.0	6.3	6.5	5.4	5.8	4.0	9.2	14.8	53.6
VENDOR TOOLING	0.9	1.5	1.6	1.7	1.8	1.9	2.0	2.1	2.2	15.7
PLANT PROJECTS	8.0	10.2	13.7	13.7	4.5	7.0	12.0	12.0	15.5	96.6
OTHER	1.3	10.3	10.4	8.8	1.6	1.7	1.7	1.8	1.8	39.4
TOTAL NON PRODUCT	21.2	40.0	58.9	52.5	39.6	44.3	50.0	59.0	72.5	437.9
TOTAL PLAN	130.4	155.0	168.4	180.0	210.0	230.0	242.0	240.0	250.0	1805.8
MEMO 1984 PLAN	115.4	180.0	170.7	189.4	227.6	255.5	267.5	236.4	241.1	1883.6
VARIANCE 85 B/(W)	(15.0)	25.0	2.3	9.4	17.6	25.5	25.5	(3.6)	(8.9)	
CUM	(15.0)	10.0	12.3	21.7	39.3	64.8	90.3	86.7	77.8	77.8

PROPOSED CAPITAL EXPENDITURE REDUCTION FROM THE PLAN

Modification and reduction in product range, realistic sales volume, and if necessary double shifting.

£m

A. PRODUCT

1.	Merge AR5 and AR7	80
2.	Postpone AR7 by two years	70
3.	Merge AR16 and AR17	70
4.	Out source smaller car gearbox	72
5.	AR6 modification (Reskin Metro, adjust floor plan and redesign front end)	80
6.	Out source small car engine K. series	121
7.	Scrap V6 engine	42

B. NON PRODUCT

a)	Engineering test cells	25
b)	Presses	20
c)	Tool room	20
d)	Plant projects	50
e)	Others	<u>20</u>

TOTAL SAVING 640

AUSTIN ROVER GROUP CORPORATE PLANCAPITAL EXPENDITUREREVISED COST VARIANTS

<u>£m</u>	<u>AR5</u>	<u>AR6</u>	<u>AR7</u>	<u>AR16</u>	<u>AR17</u>	<u>'K' Engine</u>	<u>'S' Engine</u>	<u>Small Trans</u>
Corporate Plan	71.0	162.5	122.6	73.2	66.2	121.3	30.0	72.5
Latest Cost Indications February 1985	98.7	176.4	198.1	148.4	126.4	161.5	40.6	118.5
Costs (0)/ U CP	(27.7)	(13.9)	(75.5)	(75.2)	(60.2)	(40.2)	(10.6)	(46.0)

NOTE

Capital expenditure overshoots.

APPENDIX II

APPENDIX II

MODEL VARIANTS

	<u>AR XX</u> (planned)	<u>AR XX</u> (proposed)	<u>Honda XX</u>	<u>Rover</u> <u>3500</u>	<u>Montego</u>	<u>Maestro</u>
<u>PARTS</u>						
Fascia	384	148	160	128	134	134
Door Pads	110	84	16	68	128	134
Front Seats	92	70	24	34	44	44
Centre Console	50	25	8	33	6	6
Post Finishers	74	50	24	22	66	28
Rear Seats	38	19	4	18	37	31
Str. Wheel	18	14	4	16	11	10
Headlining	10	4	4	4	8	8
Carpet	8	6	4	30	36	40
P. Bodies	149	98	20	40	62	71
Bumpers	53	35	12	3	8	8
P. Units	62	34	4	33	14	14

APPENDIX III

APPENDIX III

SOURCE - FVF U.K. STOCKS

<u>Model</u>	<u>End Nov. '84</u>	<u>End Dec. '84</u>	<u>Months Stock End Nov. '84</u>
Mini	2735	3245	2.6
Metro Old	2109	1310	
Metro 3Dr	10700	10010	
Metro 5Dr	6730	11175	
Total Metro	21638	26950	2.7
Rover 200	7779	10379	3.0
Maestro	7673	10770	2.1
Montego SAL	14618	17395	3.3
Montego EST	615	1869	
Total Montego	15233	19264	
Rover	3219	3362	
Others	225	111	
TOTAL A.R.	58502	74081	
Metro Van	1120	1384	2.2
Maestro Van	1695	2571	1.7
Ital Van	925	1039	
TOTAL A.R.	3740	4994	

Budgeted Stock Levels - 2.5

APPENDIX IV

COMPARISON OF CORPORATE PLAN AND "INTERNAL" PLAN UPDATESALES VOLUMES

(000's)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
1985 Corporate Plan	532.6	518.4	585.3	639.7	684.5	746.3
Most Likely (Internal Plan)	432.8	423.3	460.1	488.5	515.1	543.8
(Under) Corporate Plan	(99.8)	(95.1)	(125.2)	(151.2)	(169.4)	(202.5)
U.K. Content	(76.5)	(61.9)	(69.4)	(85.4)	(86.0)	(93.5)