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PRIME MINISTER

We are to discuss on Monday 1 April the progress of BL and the handling of the 1985 Corporate Plan. With the Board committed to privatisation of Unipart this year, and the outcome of the talks with GM expected in May, the immediate questions revolve around Austin Rover.

2 After the significant progress made in earlier years, the 1984 results are a considerable disappointment. There are mitigating factors, notably an extremely hostile trading environment in which most volume car makers have been losing heavily. Nevertheless, conditions throughout Europe are unlikely to improve materially in the short-term and on the basis of the current plan (on which the BL Board have themselves expressed doubts) there are clearly significant risks attached to our continued support of ARG. Moreover, while BL is not seeking more aid, the fact remains that the Plan envisages a large capital investment programme and a significant increase in the Government's liability under Varley Marshall.

3 I therefore agree with the main recommendation of the report of the Official Group that we must look hard at the scope for reducing the Government's exposure to BL provided that in the process we do not so increase the degree of risk to the company



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that the contingent liabilities become a reality. I am not sure that the £250m reduction in ARG capital expenditure, which it is proposed should be the Board's framework, is necessarily an indication of the savings which realistically could be achieved if we are to avoid impairing the company's recovery; but pitching our request at that level will at least ensure that the Board in its mid-year review will take a fundamental look at ARG's essential needs.

4 You should, however, know of developments with Honda which, if they come to fruition, will substantially alter the prospects for ARG and the assumptions on which the current plan is based. In discussion in Tokyo over the past few days, Honda and ARG have drawn up a package of proposals for further co-operation comprising:-

i collaboration on similar lines to the XX, on the development and manufacture of a new model, to replace the Maestro and Rover 200 series;

ii the sub-contract build by ARG at Cowley of various Honda cars, including the Ballade and Civic, with eventual volumes around 80,000 per annum;

iii investment by Honda in a new engine plant at Swindon to supply the Honda versions of the new collaborative car and the sub-contract models under (i) and (ii) above.



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5 These proposals have not yet been put to the BL Board, which meets next week, or to the Honda Board which meets on 5 April. If both Boards given their approval, the intention is that the Honda President, Mr Kume, at the Swindon ground-breaking ceremony on 11 April will announce an "understanding" between the two companies to work for implementation of a programme on the above lines.

6 There is of course no certainty that the package will be agreed but, if successful, this new collaborative programme would represent a very significant deepening of Honda's commitment to working through ARG in its European marketing strategy. It would also have a major effect on the outlook for ARG. Half the ARG model line-up would be based on collaboration with Honda; Honda models would add around 120,000 units per annum to ARG volume; and around 5,000 new jobs would be created. The level of risk involved in our support for ARG would also be substantially reduced.

7 Obviously we shall need to take a close look at the detail of the proposals and in the meantime ensure that no public statement is made which commits the Government. There is nevertheless a good prospect that the BL Board's mid-year review will have a much more encouraging tone than we might otherwise have expected.

8 I must stress the extreme sensitivity of this information. BL believe that, if the news of the proposed collaboration leaks



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before the Honda Board meeting on 5 April, it could prejudice or abort the deal. I should be grateful therefore if the most stringent care could be taken to restrict those who know of the proposed collaboration. I am therefore copying this minute to the Chancellor only.

McCarthy

PP

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29 March 1985

*Approved by the Secretary of State
and signed in his absence.*

Department of Trade & Industry