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PRIME MINISTER

AUSTIN ROVER

I have written separately about developments at Rover Group on the commercial vehicles front. We must also come to a view on strategic options for Austin Rover (ARG).

Graham Day is the first to acknowledge that ARG's current trading performance shows cause for real concern. He is giving top priority to strengthening the commercial and marketing skills of the company so as to arrest the decline and he is planning to consolidate at around a 14.5% share of the domestic market - in addition to substantial exports - in 1987. He does however remain extremely worried that customer and dealer confidence is very fragile and that, unless the company and the Government work together to restore the position over the next few months, there is a genuine risk of a total collapse of confidence and a spiralling loss of market share which would threaten the Group's survival.

Graham Day will be setting out his detailed strategy for ARG in the 1987 Corporate Plan expected at the end of the year. He has already made clear however that an essential element in any recovery plan would be a deepening of the collaboration with Honda. Following on the Rover 200 and 800, the next phase would be a new collaborative medium car (AR8) to replace the Maestro/Rover 200 for launch in 1989. Graham Day also hopes to negotiate the additional contract build of Honda cars by Austin Rover as is already happening with the Honda Ballade and the Legend (Honda's version of the Rover 800).

With these design and manufacturing tie-ups the futures of the two companies would be increasingly inter-linked. However so long as the collaboration is secured only by limited term contracts relating to individual models, ARG remains at great risk should Honda ever decide to pull out of the relationship in order to pursue an independent future in Europe. Graham Day firmly believes the aim should be to reduce that danger by encouraging Honda to take a minority stake of up to 20% in ARG, and recent contacts between the companies suggest this might be negotiable.

The question for colleagues is whether at this stage we are prepared in principle to accept a Honda minority stake in ARG. Paul Channon and I are strongly of the view that this would be desirable not only because it is a means of underpinning the current collaboration but also because a



SECRET
CMO

Honda shareholding could prove an important element in confidence-building measures for ARG. Clearly it will be necessary to establish the conditions on which Honda would be ready to take on this commitment and these may in turn raise issues which colleagues would separately need to look at - for example that Honda should have our blessing to develop their own assembly operation at Swindon if at any time we wished to encourage an alternative bidder for ARG. The likely timetable of events would also need to be established (there are indications that a Honda shareholding might not actually be triggered until 1988 with the "price" of the holding taking the form of investment in facilities for the new collaborative car).

The immediate requirement however is that Graham Day should have our agreement in principle to explore the ground with Honda so that the possibilities are clear when we come to review the detailed strategy for ARG early in the New Year. Subject to your views, and those of colleagues, I propose that he should be given the go-ahead for this.

Material to the commercial negotiations between the parties is the parlous state of Austin Rover's balance sheet. Clearly action will have to be taken to deal with this problem in due course but no decisions are required now. We shall be able to take a considered look at the options when we review the overall financial projections for the Group in the context of the 1987 Corporate Plan.

Finally, in my separate minute on the question of commercial vehicles, I have suggested the possibility of a pre-emptive statement in December on the talks with DAF and Paccar. Given Graham Day's understandable nervousness about public confidence in the company, I believe we should look seriously at including in that statement a broad supportive statement on the Government's commitment to Austin Rover provided this can be done in a way which does not prejudice our consideration of future options for the company. This would I hope go some way to head off speculation about the future of Austin Rover which would further damage its creditability in the market place.

I am copying this to Willie Whitelaw, Nigel Lawson, Norman Tebbit, Nicholas Ridley and John Wakeham.

GILES SHAW
26/11/86