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PRIME MINISTER

FORD/AUSTIN ROVER ("MAVERICK")

The Chairman of Ford of Europe, Mr Bob Lutz, came to see me recently to say that Ford would like to embark on detailed studies with a view to their acquisition of Austin Rover and Unipart. No approach has however been made to BL as Ford first wish to be sure that Government would regard acquisition as a politically acceptable way forward. On Wednesday morning we are to discuss how to respond when we meet on Wednesday.

2. The Ford interest, which has the knowledge and approval of Detroit, is driven by fears of a growing Japanese presence in Europe, whether the result of imports or direct investment, and by a conviction that on existing volumes Ford will be unable to achieve a level of competitiveness necessary to tackle the Japanese head-on. They believe that sooner rather than later the European motor industry will need to restructure in order to mount an effective challenge to the Japanese and that the smaller manufacturers - other than those who have found a particular market niche or who can rely on substantial Government support, will find it increasingly difficult to prosper.

3. This thinking was reflected in Ford's prolonged but unsuccessful talks with Fiat and Mr Lutz acknowledged that ARG was in this sense a second-best solution. Even with acquisition of ARG Ford would still need to collaborate with others. Nevertheless, Ford expect detailed analysis to show that the addition of 500,000 cars to their volume would produce substantial cost savings through the integration of research and development, administration, component manufacture/sourcing and car assembly .

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4. Ford would be willing to negotiate a detailed Memorandum of Understanding with Government to cover their future manufacturing and sourcing intentions. Their aim would be to preserve the Austin Rover marques and distribution capability. They envisage in the early years that the main commonality in vehicles would be in floor-pans and power trains with a fully co-ordinated model range achieved during the 1990s. Product differentiation would be based on the respective strengths of the two companies - for example, Ford believe that, properly planned and supported, there would be a good opportunity over time to develop a premium image for ARG with marques such as Rover and MG. In the interim ARG would benefit from Ford distribution in Europe and the USA.

5. Apart from peripheral activities, Ford do not anticipate significant closures arising from a merger. This aspect would obviously need to be kept under review, particularly at the turn of the decade when rationalisation of the model line-up would begin to take effect. But decisions then would depend entirely on the success or otherwise of the venture in maintaining and hopefully increasing European market share and closure of one of the four UK assembly plants is certainly not part of Ford's current thinking.

6. The Ford approach clearly raises important industrial and commercial issues - the enclosed check-list of potential advantages/disadvantages covers most of the ground. A considered view on the industrial and commercial merits of the proposal can only be reached once detailed studies have been carried out by the two companies, although Ford seem convinced that the outcome both for them and ARG would be substantial and positive. They do not however wish to undertake this work if at the end of the day they are likely to be faced with a political veto. They are therefore seeking a qualified "green light" i.e. an indication of political willingness for the venture to go ahead if the detailed appraisal shows this would benefit the UK; and if Ford's proposals for implementing the merger are judged to be satisfactory.

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7. At a political level, a take-over would leave us open to the charge of having abandoned any prospects of a British-owned volume car producer. Moreover, if the Salton project with GM as well as Maverick proceeds, there will be criticism that we have sold off to US multinationals both mainstream businesses of a company in which the taxpayer has invested a great deal of money; and that the future of these businesses will increasingly be determined not by UK considerations but by multinationals with worldwide operations over whom HMG has little influence. We shall of course be able to mount a respectable defence against such criticisms - not least, in the case of Maverick, by pointing to Ford's impressive UK record in terms of R&D, manufacturing and employment; and, unlike the Salton commercial vehicle venture, the Ford proposal is unlikely to be complicated by the prospect of significant closures in the short-medium term.

8. In my view, however, the central issue revolves around the alternative outlook and privatisation prospects for Austin Rover. The company has unquestionably achieved a noteworthy improvement in performance in recent years. PBIT has moved from a deficit of £112m in 1982 to a forecast profit of just under £10m in 1985; productivity has been raised from 6 to 14 cars per man since 1979; and, while UK market share has not improved as much as had been hoped, ARG has apparently withstood the Vauxhall challenge more successfully than Ford.

9. Nevertheless there is room for another, more pessimistic, school of thought which would argue that ARG is a relatively small company trying to compete in all the main product categories but under severe pressure from the major multinationals. It does not have (nor on its own the opportunity to establish) a specialist image like, for example, BMW. Renewal of the model range, to be completed with XX, has not led to significant changes in market share and with fiercely competitive conditions likely to continue across Europe, and with ARG forced to compromise in its reactions to new emissions standards and related

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incentives, the company will remain highly dependent on the UK domestic market and will find it an increasing struggle to earn the funds necessary to regenerate the business and carry through major new product and component programmes. It is, moreover, worth pointing out that in spite of the improvement that has taken place ARG has consistently fallen short of the more optimistic forecasts that it has put forward. The absence of fresh Government money, and the constraints we have imposed on its commercial borrowings, will not make this any easier to achieve. Moreover, even on its own forecasts, ARG will have a cumulative negative cash flow of £400m by 1990 implying substantial increases in Varley-Marshall exposure.

10. Even with the benefits of the Honda collaboration, a "go it alone" policy for ARG under this scenario would be highly risky. The prospects of a public sale this decade would be remote and the likelihood of requests for further Government funding, or at least higher borrowings, would be very high. The prospects of a sale to another manufacturer could in due course be considered but Honda have shown no interest (even if we were to regard them as acceptable owners of ARG) and it is hard to identify others in Europe or elsewhere who would be interested in acquisition and in retaining a strong UK manufacturing presence.

11. I believe therefore that, although it raises some very difficult questions for us, the Ford approach offers the only realistic early opportunity for achieving our privatisation objectives. If the studies show the venture has industrial and commercial logic, we shall again have to tackle the question of ARG debt which Ford are not prepared to inherit. It is not possible to speculate usefully on the size of the problem but, if it is to be kept manageable, there is obviously a strong argument for solving the question of LRL debt in the context of the SALTON talks as I have separately proposed.

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12. If we do decide to pursue the Ford interest, the BL Board will need to be persuaded to follow this through seriously and quickly. To help in the presentation, if we go down this route, I would propose to tell the Board that we would be willing to consider alongside the Ford proposal any reasonable alternative routes to ARG privatisation which they might care to put forward; and for this purpose they should also assume that Government would be ready in principle to consider special treatment of the outstanding debt. This would I think be helpful in our relationships with the Board and would enable us at the end of the day justifiably to claim that we had examined all reasonable alternatives to the Ford option.

13. But before any of this arises we have to face up to the fundamental, essentially political questions: Are we prepared to contemplate sale to Ford at all, with the almost certain necessity of providing what will be depicted as a dowry to go with it? Or do we prefer to follow the course of keeping ARG going at present in the hope of some other privatisation, but in the knowledge its viability is at best questionable? The industrial logic favours the former course.

14. I am copying this minute to the Chancellor of the Exchequer.

L. B.

L B

2 December 1985

DEPARTMENT OF TRADE AND INDUSTRY

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ANNEX A

FORD/ARG : ADVANTAGES/DISADVANTAGES

FOR GOVERNMENT

PROS

- early privatisation, providing a long-term solution for ARG and an end both to Varley-Marshall contingent liabilities and to the potential need for further Government funding of ARG;
- maintenance of a domestic base for the UK components industry if commitments made on local content;
- greater prospect of retaining UK technological base, likely to weaken in ARG and Ford under alternative strategies;
- secures major Ford commitment to the UK as alternative to Ford (US) preference for a deal with the Japanese;
- offers more robust possibilities for UK car exports.

CONS

- abandons any prospect of a UK-owned volume car manufacturer;
- Ford undertakings on manufacture etc will protect the short-medium term position. But longer-term these will have less force and decisions will be those of a foreign multinational with world-wide options. Limited HMG influence;
- concentration of Ford activity in the UK increases UK vulnerability in any future Ford Europe rationalisation. Closure of one of the four British assembly plants at the end of the decade a distinct possibility;
- Ford ownership of ARG may prompt Honda to press for its own assembly plant at Swindon, raising difficult questions for HMG;
- individual ARG and Ford market shares may be difficult to sustain in a combined operation and lead to increased import penetration;
- raises question of write-off of outstanding ARG debt;
- reduced competition in the UK market (MMC considerations).



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FOR ARG

PROS

- access to Ford's financial strength enabling higher levels of benefits from the pooling of R&D resources with those of Ford and less reliance on overseas, particularly Japanese, technology and products;
- investment than would be possible under Government funding constraints;
- access to management strengths of Ford;
- access to Ford's US and European distribution network raising throughput, lowering unit costs and increasing profitability;
- economies of scale on major components;
- beneficial links with Honda might still be retained;
- better able to cope with new European emissions legislation.

CONS

- strategy will be dictated from outside the UK by a foreign multinational;
- short-medium term, increased production from association with Ford may be offset by loss of sub-contract/collaborative build for Honda;
- ARG productivity and industrial relations performance may be 'infected' by Ford's relative lack of progress at Dagenham and Halewood;
- production volumes may not be sustained unless product differentiation policy is successfully implemented and accepted in the market place;

FOR FORD

PROS

- an immediate increase in UK/European market share;
- opportunity to deflect Ford (US) from basing strategy on a partnership with the Japanese;
- higher volumes produce economies of scale throughout the combined operation, particularly in relation to the design and production of major components;



- potential to secure substantial reduction in combined fixed overheads in particular through closure of one of the four UK assembly plants.
- particular synergy in engines where ARG well-placed to specialise in small engines with Ford strong in medium;
- increased sales of ARG product through Ford's European dealership generating revenue and profit on distribution and manufacturing activity; creation of potential premium Ford marque in Europe and USA;

CONS

- the merger would produce substantial but not overpowering economies of scale and further links with a major European manufacturer (and/or collaboration with Japan) may still prove necessary;
- Ford control over ARG may induce Honda to 'go it alone' at Swindon creating a new, highly efficient UK competitor;
- the considerable risks inherent in any major rationalisation merging managements, facilities, products, components and industrial relations structures;
- the combined market share may be significantly less than anticipated.

VEHICLES DIVISION

November 1985

