cc BUP

SECRET

13

PRIME MINISTER

BL Privatisation

(E(A)(85)3(and 4 Revise))

BACKGROUND

The Government's firmly established policy is to return the various elements of BL to the private sector as opportunity offers. The major achievement so far has been the flotation of Jaguar as an independent company. Meanwhile BL's successive corporate plans have aimed at improving the performance of the company to the point where further major elements could be transferred to the private sector. Following a series of meetings you held in the early summer of 1985, it was agreed

(i) that exploratory discussions with General Motors (GM) on the possible rationalisation of their and BL's van and truck operations should be taken forward to a conclusion;

(ii) that the Austin-Rover Group's (ARG) plans, notably for continuing an extended collaboration with Honda, should be approved; and

(iii) BL would work towards the privatisation of Unipart by the end of 1985.

2. The talks with GM have now been brought to a conclusion, and GM have offered to pay £230 million for Leyland Trucks, Land Rover and Freight Rover, together with a substantial part of the related international operations. Under these arrangements (the 'Salton' proposals) GM would also bear the £42 million redundancy costs arising from the rationalisation

of the present GM (Bedford) van and truck operations and those of LRL (Leyland Trucks, Freight Rover Vans, and Scamell heavy and military trucks. GM would not take over any of that part of BL's current debt which is attributable to the LRL operations.

3. Since last summer work on ARG's collaboration with Honda has gone forward, although the Company's performance in the market has continued to fall short of projections in the Corporate Plan. For 1985 the latest ~~output~~ ? forecast is a small loss before interest and tax, as compared with a profit of over £30 million shown in the 1985 Corporate Plan. There have been comparable, but smaller, deteriorations in profit expectations for the remainder of the current decade. The privatisation of Unipart (the spare part/components operation associated with ARG cars) has been delayed as a result of unforeseen difficulties in consolidating the BL operations with those of Edmunds Walker, a component company acquired in 1984. It is against this background that Ford have expressed interest in the purchase of ARG (including Unipart), so making possible a rationalisation of Ford's UK car operations with those of BL.

MAIN ISSUES

4. The main issues before the Sub-Committee are

(i) whether to approve the GM purchase of the bulk of LRL's operations, on the terms negotiated; and

(ii) whether to ask BL to clarify with Ford the terms on which the latter would be ready to purchase ARG's UK operations (the 'Maverick' proposals).

Salton

5. LRL have made losses of the order of £50 million in each of the last four years, largely on Leyland Trucks, but increasingly on the manufacture of buses; Land Rover and Freight Rover, by contrast, are modestly profitable (the details

are in Annex 1 to E(A)(86)3). Meanwhile GM have been making substantial losses on their Bedford van and truck operations, and some sort of rationalisation to reduce excess capacity is inevitable. Although the provisions of the Treaty of Rome prevent the Government from concluding a legally binding agreement with GM, the Company have offered firm assurances about maintaining high levels of LRL content in their commercial vehicles, and about their plans for the development of Land Rover as a UK-based manufacturer of specialist vehicles to be sold worldwide. Meanwhile the Laird Group have expressed an interest in buying Leyland Bus, to be reationalised with their Metro Cammell Weyman bus manufacturing operation. The debt currently attributable to LRL is about £480 million; after offsetting against this the £230 million to be received from GM, and about £100 million cash currently available to BL out of the Jaguar sale proceeds, the disposal to GM and Laird of LRL's current businesses is likely to require a total debt write-off of about £150 million. In other words the Government will have to repay this amount of outstanding loans to BL.

5. For Leyland Bus the only alternative to rationalisation with Metro Cammell Weyman - at a cost to the Government of £100 million - is likely to be closure, probably at a still higher cost. Ministers will need to take a view on this later, when present discussions have been carried further forward. For the rest, the paper canvasses three alternatives to the Salton proposals:

(i) Finding other purchasers. There is no sign of an alternative purchaser for the truck business, either in the UK or overseas. Land Rover, and possibly Freight Rover, might, however, be saleable to another UK company or a consortium of UK companies.

(ii) Retention of the businesses within BL. The businesses have a doubtful track record, and Leyland Trucks in particular faces severe competition and a continuing outflow of cash. Freight Rover, while currently profitable, will need a large amount to finance model replacement. Land Rover, which is in a relatively better position, will also face heavy capital expenditure around the end of the decade. With the possible exception of Land Rover, all these businesses will continue to face heavy competition and a situation of Chronic over capacity.

to you

(iii) Privatisation of LRL businesses. Separate privatisation, or a management buy out, of Land Rover (perhaps including also including Freight Rover) is a real possibility. (The LRL Chief Executive's letter of 22 January makes the case for a management buy out, not least on the ground that this would be an appropriate recognition of the great efforts made by these companies to improve their situation.) But this would leave the unsaleable rump of Leyland trucks, and the separation of trucks and Land Rover in overseas markets would undoubtedly weaken both.

Below: The Chancellor will reply on your behalf

Maverick.

Note that ARG and Ford would have 44% of the market.

6. The strongest argument for pursuing the Maverick proposals is that they represent the best opportunity the Government are likely to have to privatise ARG during the current decade. With Europe-wide over capacity, and the increasingly strong challenge of the Japanese, Ford's wish to strengthen their position, after the failure of their talks with Fiat, is readily understandable; and Ford are undoubtedly better placed to deploy the financial and other resources which will be needed to upgrade and improve the ARG model range than ARG are themselves. Useful savings could be made in R & D and management costs, and ARG would have access to Ford technology, purchasing power and quality control.

7. But there are strong counter arguments in industrial, employment and political terms. The evolution of the Ford and GM car businesses in Europe shows that these companies have regard to their own interests on a European scale, with the result that Ford and Vauxhall have an adverse balance of trade

in respect of their UK car operations. Although ARG's collaboration with Honda would not be ended overnight, there can be little doubt that it would gradually wither away, to the considerable disadvantage of ARG's future model range. Although the ARG management's estimate that up to a third of their business would be lost as a result of the ending of the collaboration may be an exaggeration, there would certainly be a significant loss. And although Ford have suggested that their take-over of ARG would not be followed by early major plant closures, it must be doubtful whether - given the extent of European over-capacity - all four major plants would continue in operation into the 1990s. Productivity at Ford's UK plant (9 cars per man-year) is well below both ARG's and the European average (both about 14 cars per man-year), so Ford's UK plants might prove distinctly vulnerable in anything beyond the short-term. The suggestion that the gap left by the end of the Honda collaboration (including ARG assembly of Honda models) might be filled by alternative arrangements with Ford's Japanese associate Mazda is speculative; and with Ford's own plants generally under-loaded, the scope for them to divert work from their own European operations into ARG plants does not look very great.

Ford's UK plants must be vulnerable anyway

8. The Department of Trade and Industry assess that sale of ARG to Ford in the course of 1986 might produce £250 million, given that ARG appears to have a medium term profit potentiality of about £50 million a year. With debts attributable to ARG standing at £300-400 million, the net cost to the Government of privatising ARG in this way, in terms of the remaining borrowing which would have to be repaid, would be of the order of £100 million. The alternative is to retain ARG in effective Government ownership, and accept some modest increase in the Government's exposure under the Varley-Marshall assurances so as to make possible necessary capital expenditure, and meanwhile press the company to strain every nerve to fit itself for privatisation - probably by a placement with the institutions in two to three years time.

9. There remains the question of Unipart. The attitude of Ford - that they will only buy ARG if they can get Unipart as well - may call into question the Government's previous intention to pursue separate privatisation. The same considerations would tell in favour of retaining Unipart within ARG in order to make ARG as attractive a prospect as possible for early privatisation on whatever basis.

Letter below

10. Finally, there is the question whether there are any other possibilities which might be explored. We understand that the Chancellor of the Duchy of Lancaster (who is of course unable to attend the meeting) has suggested that it might be possible to take ARG into a European Ford operation which would be independent of the US parent, and which would build a European company better able to compete with the Japanese which would at the same time be more sensitive to UK industrial needs. If the Sub-Committee were to conclude that a straightforward sale of ARG to Ford would not be acceptable, it would be open to the Government to respond to Ford's interest in ARG by suggesting the possibility of an arrangement on the lines indicated by Mr Tebbit. There could, however, be no assurance that Ford's response would be helpful, or that it would be easy by this means to safeguard UK industrial and economic interests in the medium and longer-term, given that the Government would not wish to retain a shareholding indefinitely in a European company.

HANDLING

11. Separate consideration will need to be given to the Salton and Maverick proposals, but at the same time the Sub-Committee's conclusions on each will need to take into account their attitude to the other. You will wish to invite the Secretary of State for Trade and Industry to introduce discussion of the two papers; in view of his recent appointment, he may wish to have the support of his Minister of State, who is the author of the Maverick paper (Mr Brittan is the author of the Salton paper). Thereafter Treasury Ministers will wish to give their view of the privatisation, competition and public sector cash flow

indications of the proposals. The Foreign and Commonwealth Secretary and the Lord President of the Council (both of whom have been specially invited) will wish to comment respectively on the external and political aspects of the proposals; the Department of Employment Ministers will wish to comment particularly on the industrial aspects. I suggest that you should seek to reach a conclusion first on Salton, and then tackle Maverick.

CONCLUSION.

12. You will wish the Sub-Committee to reach conclusions

1. On Salton, whether

(a) to endorse the agreement reached with GM, or

(b) to pursue alternative possibilities, including the separate privatisation of Land Rover/Freight Rover, meanwhile accepting the high risk that Leyland Trucks will have to be kept going as a loss-maker in Government ownership (DTI officials advise that there is little prospect of persuading GM to agree to exclude Land Rover/Freight Rover from the deal);

2. On Maverick, whether

(a) to authorise detailed discussions with Ford on the terms on which they would take over ARG, recognising that the fact of these discussions would be bound to become public knowledge very quickly, or

(b) whether to pursue alternative arrangements with Ford on the lines indicated by the Chancellor of the Duchy of Lancaster, or

(c) whether to accept retention of ARG in Government ownership for the time being, under conditions

designed to maximise the
prospects for its successful
privatisation in two-three years
time.

J B UNWIN
Cabinet Office
27 January, 1986

10 DOWNING STREET

Prime Minister.

GM after Salton would probably end up with about 25% of the UK medium van and truck market.

Ford after Maverick would have 44% of the relevant UK market.

DKW
27/1

From: The Private Secretary

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David Norgrove Esq
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27th January 1986

Dear Mr Norgrove

CABINET E(A) COMMITTEE MEETING 28 JANAURY 1986

Mr King regrets that, provided the Prime Minister is agreeable, he will not be attending the E(A) Committee meeting on 28 January, as he will be in Northern Ireland.

I am copying this letter to Michael Stark in Sir Robert Armstrong's Office.

Yours sincerely

Brian Porter

PP N D WARD