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Secretary of State for Industry

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*Tell Patrice to call  
the Director, chair in  
my study the  
other day.*

12 November 1982

The Rt Hon Sir Geoffrey Howe QC MP  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
London SW1P 3AG

*One of the weekend  
sees  
Prime Minister (2)*

Dear Chancellor

*No*

*Mr Jenkin is almost  
at the point of proposing  
more public money for  
INMOS.*

INMOS

1 Following the brief discussion we had at our meeting on 25 October I would like to report on the position we have reached as regards the future of INMOS.

2 You will recall that INMOS was set up by our predecessors on the basis of an expectation that £50 million from the NEB, together with £35 million borrowing from the private sector (effectively at Government backed risk) would see the company through to a stage where it would be able to depend wholly on private sector funding. The company decided to develop initially two families of chips, (a 16K static RAM and a 64K dynamic RAM) starting with an R&D pre-production facility in Colorado to be followed up with production facilities here in Newport.

3 The 16K is selling well and INMOS now has 70-80% of the world market within its particular sector. More important for the longer term is the 64K chip which the Newport facility is intended to produce and the family of microprocessors which it is developing. Two recent consultants' reports which have been commissioned by the BTG forecast a considerable revival of growth in the integrated circuit market and indicate that INMOS' products should be capable of being fully competitive. This applies not just to the 64K but also to other products which are in the course of development. The company already has a most impressive list of customers engaged in the computer, telecommunications, defence and consumer electronics field. Amongst the company's top 20 customers are Intel, Westinghouse, Control Data, GE, Matsushita, IBM and Sperry.

4 On the financial side the company has kept reasonably well on target where matters have been within its control - although it has experienced the same sort of production problems with its

*ms 12/11*



*So have other people*

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new products, particularly the 64K, as other semiconductor manufacturers. But in addition it has suffered from a number of factors outside its control, the biggest item being the change in the dollar-sterling exchange rate which has reduced its capacity to borrow by about £8 million since the £35 million borrowing limit was originally set. Other factors include the effects of inflation and the delay of several months in approving the Government's second £25 million. Indeed, these factors largely account for the additional funds which the company now requires.

5 In my judgement, which is supported by merchant banks and outside technical advice, INMOS has performed well against the plans it set itself. This is in contrast to the poor perception of the company in the press and the City.

6 Kenneth Baker and I have made it clear to the BTG in discussions over the last year that future funding should come from outside sources. Although the two consultants' reports which the BTG commissioned were encouraging and should have made it easier to raise private sector money, the BTG have concluded on the basis of advice from merchant banks that there will be a gap in 1983 before they can tap private capital on reasonable terms. This is in large measure because investors have been put off by the adverse publicity which INMOS has tended to attract.

*why?*

*Monks*

7 The BTG therefore sought my authority to increase INMOS' borrowings and to underwrite the raising of £15 million private sector finance next year. Not being ready to recommend this to me, Kenneth Baker asked Jeffrey Sterling to explore the possibility of putting together a private sector package. As I explained when we met on 25 October, his plan was to attract private sector money alongside an equity investment which British Telecom was considering providing for INMOS. BT have a good deal of expertise in this area and George Jefferson has a close personal knowledge of INMOS from his time as a Board member of the NEB. An assessment of INMOS by BT was therefore a worthwhile exercise in its own right.

*No*

8 In considering the case for an investment the British Telecom Board wanted to examine whether INMOS' expertise could make a long term contribution to BT's future business. Mainly as a consequence of the views of two of the outside Board members (Derek Vander Weyer and David Cormie) they have concluded that there was "insufficient synergy with their present mainstream business" to justify support. George Jefferson has made it clear to Jeffrey Sterling that this judgement should not be taken to reflect on BT's views either of INMOS' achievements or its prospects for success or of possible synergy in the longer term. He clearly believes that INMOS should continue and could succeed.



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9 I am disappointed in BT's decision because its readiness to invest in INMOS would have provided the core around which private sector participation could readily have been built. I am therefore proposing to talk with George Jefferson (who I believe shares my disappointment) and if George agrees, with the two outside directors, to explore the thinking behind their decision. I have, on several occasions, both in public and in private, said that privatisation will enable BT plc to develop into a fully integrated I T company ranking with AT& T or IBM. If INMOS succeeds, the capacity to make advanced chips could form an asset of great value to such a company. That is what I believe George saw when he first suggested BT becoming involved (it was his idea, not mine), and I want to know why others do not share that view.

10 If on reconsideration BT changes its mind (it has, of course, to be their decision - no one else's) then the way ahead for INMOS looks reasonably hopeful. If not, then I believe we face some difficult decisions. Without BT I do not believe it will be possible to raise private sector money this year. This is the view of BTG and their advisers and my advisers as well. Without the prospect of further money now, it will not be possible for INMOS to reverse the damaging decision the Directors had to take to halt production at Newport in order to conserve cash. The factory there is otherwise on schedule but until it is in full production, there is simply no on-going business which could be continued even in the event of a forced sale. Without further money, therefore, the investment which the taxpayer has made in order to secure an independent capacity to develop and manufacture high performance chips in this country, will be lost. INMOS' Colorado Springs operation could probably be sold and thereby limit the direct loss of public funds but little of technological importance would survive in this country. This would also expose us to the criticism that we had let go an important technical development in South Wales after arguing with INMOS that it should locate its facility there.

No 11 The obvious question therefore is whether it is worth risking more public funds. There might be two reasons for doing so; because the company has a prospect of success and of moving into private ownership and/or because the technology on which it is engaged is of strategic national importance.

12 On the first point, I acknowledge that to support INMOS would continue to be a high risk. But to have go as far as it has, INMOS has made considerable achievements, as all the outside consultants have concluded, and we now have several independent views from Hill Samuel, Lazards and Smith Barney as well as from my own Industrial Development Unit and Jeffery Sterling, that it should be possible to raise private sector finance in 1983 and that the facility which is required now is purely bridging finance. Furthermore, not to continue support INMOS at this



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point when the Newport facility is ready to go into volume production and have the US technology transferred to it is like trying to sell a house before putting the roof on. Even if we were to judge in a year's time that INMOS could not succeed, it would still almost certainly have been worth investing the additional sums needed now to bring the one significant UK asset to the point where it could be disposed of as a going concern.

13 On the second point I have become increasingly aware of the strategic importance of having an independent capacity to design, develop and manufacture those electronic components which are critical to our future IT industry. This is especially so for the high density chips on which INMOS is concentrating, and its VLSI products in the future. There is an increasingly restrictive environment in world trade, particularly where the export of technology is concerned. This is apparent in our experiences with Japan where for reasons that are entirely commercial, our companies are finding difficulty purchasing innovative components. At the same time we have all been recently made aware of restrictions for defence reasons on exports from the US of critical components and manufacturing know-how and equipment. In addition to our experience with the US over the gas pipeline, there are increasing restrictions through COCOM which affect our trade; the US is now refusing to allow sales of aircraft to certain markets when particular US chips have been incorporated (we discussed the Nimrod sales to Iraq a few days ago). I do not believe, therefore, that we can count on relying on the free use of imported chips from the US and Japan for incorporation in other electronic equipment and we should certainly be putting our exports at risk if we were to do so. It is also worth stressing, in case there is a view that other UK manufacturers could fill the gap left by INMOS, that INMOS' facilities are ahead of anything which exists in GEC, Ferranti or Plessey (although their product ranges are also important for Britain).

*Ask GEC to purchase it. They have looked at it before.*

14 I believe, therefore, that however strongly we have all argued that INMOS must survive within its approved limits, it simply does not make sense to abandon INMOS. If it is to have a chance of success, it needs not just finance but to be seen to enjoy the confidence of its investors and their determination to give it the best chance of succeeding. It is against this background that I would like to discuss with you the best way forward after I have had a final word from George Jefferson and if it becomes clear that the BT proposal is not a runner.

15 I am sending a copy of this letter to the Prime Minister, other members of E Committee, George Younger, Nicholas Edwards, Sir Robert Armstrong and John Sparrow.

*Give me a total account of what INMOS have done with the money how many jobs have been created and where not*

*Yours sincerely*  
*David Saunders*

PP PATRICK JENKIN  
(Approved by the Secretary of State and signed in his absence)



c.c. Mr. Vereker

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IND POL.

10 DOWNING STREET

BF

*From the Private Secretary*

15 November, 1982.

INMOS

The Prime Minister has seen a copy of your Secretary of State's letter of 12 November to the Chancellor of the Exchequer about the future of INMOS.

The Prime Minister is far from persuaded that there should be any move on the Government's part from the view that INMOS must survive within its approved limit, without any further help from public funds. She does not believe that there are special reasons in INMOS' situation - for example, the inflation and exchange rate reasons mentioned in paragraph 4 of your Secretary of State's letter - which might justify any such move. Mrs. Thatcher is not aware of adverse publicity for INMOS which would deter private sector money, and she has enquired why, if INMOS' facilities are ahead of anything which exists in GEC, Ferranti or Plessey, GEC do not purchase the company. Finally, the Prime Minister has asked for a full account of what INMOS have done with the public funds they have so far had; how many jobs have been created, and where.

BF

I am sending copies of this letter to the Private Secretaries to the other members of E Committee, George Younger, Nicholas Edwards, Sir Robert Armstrong and John Sparrow.

M. C. SCHOLAR

Jonathan Spencer, Esq.,  
Department of Industry.

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