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Published version deposited in CURVE March 2012

Original citation & hyperlink:

Donnelly, T. and Morris, D. (2002) 'Rover-BMW: study in merger failure' in *Growing the international firm: success in mergers, acquisitions, networks and alliances* (pp: 185-189).

Pittsburgh, Pennsylvania: Carnegie Mellon University Press

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ROVER-BMW: STUDY IN MERGER FAILURE

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Abstract: The last fifteen years have seen a spate of mergers and acquisitions in the international automobile industry as firms have sought to grow, achieve increasing economies of scale, as well as entry into new market segments so that they became full-line producers. The takeover of the ailing British volume producer, Rover, by BMW, the Bavarian producer of upmarket premium saloon and sports models, was part of this movement. Because of its small scale of production, BMW feared possible take-over bids from rival concerns, and so in its drive for increased size, purchased Rover. This paper focuses on the failure of this takeover. It illustrates how BMW strongly overestimated the strength of the Rover brand, not realising how dependent the latter had become on its partner Honda for design and engineering. Within two years of purchasing Rover in 1994, the parent company found itself having to take almost full managerial control of Rover and yet only four years later sold it. BMW's reasons for failure were given as the high level of Sterling, declining brand image, delays in the EU giving approval to a U.K. government aid package and the threat that a weakening Rover posed to BMW's long-term survival.

The focus of this paper is the ill-fated merger between the long established U.K. carmaker, Rover, and BMW of Germany that took place in 1994 and ended a mere six years later. At first the two seemed strange bedfellows. Rover was positioned primarily in the volume market, but did possess Land Rover, one of the world's most prestigious off-road vehicles, whereas BMW operated at the upper end of the market, producing world-class vehicles of excellent quality. This paper explores the reasons for the merger, examines the diversity of problems that hindered its success and tries to establish why in the end, despite years of substantial investment, BMW felt that it had little choice but to sell off its British filial in the hope of securing its own survival.

The fusion of these two entities though needs to be seen in the context of the

general trends in the automobile industry from the late 1980s onwards. It was an era in which globalisation captured the imagination of the industry. Firms tried to achieve a global reach primarily through merger and acquisition as exemplified by the activities of both Ford and General Motors. On the one hand, there was the drive for size and economies of scale; while on the other, it was the means of gaining a position in different market sectors – if only because with the rise of premium brands and segments such as sports utility vehicles and people carriers, it was the cheapest way of market entry. Finally, rationalisation provided a unique opportunity of searching for synergies across models and so helped reduce costs in the drive for competitiveness.

Before examining why BMW purchased Rover, it is wise to look at Rover's chequered history, as that helps to explain the problems the Bavarians encountered in trying to run Rover and was a factor in why ultimately they divested. Rover evolved from a "hotch potch" of mergers within the U.K. car industry that ultimately became British Leyland (BL) in 1968. This group was government inspired and was envisaged as the medium through which British car manufacturers would compete effectively against the American multinationals. Within six years of its birth, BL was all but bankrupt and had to be taken into public ownership. The reasons for this rapid decline need not be debated here. The government, however, commissioned Lord Ryder to investigate the firm's plight and to make strategic recommendations for its future. He found a catalogue of problems ranging from over-capacity, a lack of investment, poor model development to appalling labour relations. Surprisingly, his recommendations did not include plant rationalisation and he advised that the firm remain a full-line producer. The Ryder plan was hopelessly unrealistic and decline continued unabated with market share falling from 33 percent in 1968 to below 20 percent a decade later.

The government then recruited Michael Edwardes from British Oxygen, in a vain attempt to turn the company round. Edwardes embarked on a series of plant closures and massive redundancies, new model development, and on neutering the power of the trades unions. Despite these efforts market decline continued, but Edwardes' lasting legacy was the creation of a partnership with Honda. Under this arrangement, carried on by Edwardes' successor, Graham Day, new models, including the 200/400 series and the Sterling model, which were virtually Honda clones, were produced, but Rover became too dependent on Honda even if the quality of its models improved. Day's main remit, how-

ever, was to return the company to the private sector and it was no surprise when the firm was sold to British Aerospace (BAe) in 1988. The latter, suffering from its own financial difficulties, left BL (now known as Rover) to its own devices and sold the firm to BMW in 1994.

BMW had been seeking a partner for some time. Its scale of production was small and felt it was under threat from possible predatory take-over bids. To avoid these, it felt it needed to grow and achieve greater scale of production by moving into the volume market. Superficially, Rover appeared a good bet. Its products did not compete against BMW's own offerings and swift acquisition brought with it a doubling of BMW's European market share to six percent. Rover was a low-cost operation and it offered penetration of the small car market, front wheel-drive technology, the excellent K series engine, Rover's Japanese 'know how' and, of course, control of Land Rover. The downside was that Rover's volume models were aging and it had become too dependent on Honda for both design and engineering and, perhaps more importantly, BMW vastly overestimated the strength of Rover as a brand.

BMW's initial approach to Rover was positive. It promised to invest £500 million per annum in Rover from 1994 until 2000. Equally, it intended to continue with Rover's U.K. suppliers as long as price and quality were appropriate. Finally, it expressed the hope that Honda would continue to work with Rover, but the Japanese would have none of it and terminated their relationship with their British partner almost immediately. Initially, BMW left Rover to operate under its existing U.K. management and while in 1994-5, 54 percent of annual output of circa 500,000 units were being exported, there were reports that all was not well. BMW became anxious about rising costs, poor scheduling, appalling build quality, falling market share and a growing weakening of brand image. The Bavarians felt that they had little choice but to take a more interventionist approach.

As an initial step Walter Hasselkus was appointed chairman. Work began on a new engine plant, a commitment was given on building a new Mini and £750 million of new investment was earmarked for Land Rover. Rover's crucial weakness though lay in the volume side. The 200/400 and 800 series were 'leftovers' from the Honda era, while the Mini was no more than a collector's item. However, no new models were scheduled before 2002 and BMW/Rover's problem was how to bridge the gap between then and 2002, especially when

the plants were operating at only 62 percent of capacity on average, with obvious consequences on costs.

Between 1998 and 2000 matters deteriorated. Market share fell below 10 percent; exports were hit by the high value of the pound Sterling with productivity remaining stubbornly poor. These factors led to BMW asking for redundancies and embarking on an almost total reform of work practices to boost productivity, and at the same time announcing its intention to source more components from cheaper outlets in Europe. It would be unfair to blame Rover for all BMW's problems. At home it was encountering intense market competition and the Quandt family was becoming anxious about the survival of the parent company, arguing that Rover's weakness jeopardised BMW as a whole and so feared a possible take-over bid. The outcome was that Chairman Pichetsreider resigned as did Hasselkus, with Joachim Milburg becoming chairman. As for Rover, there was a renewed commitment to a new Mini, continuation with producing the new Rover 75, but only face-lifts for the 200/400 series.

In 2000 the denouement eventually came and parts of Rover were sold. The Phoenix group bought Longbridge and Ford purchased Land Rover. BMW retained the Cowley plant and title hold to the new Mini.

The reasons given for the sale were the high value of Sterling; the failure of the EU to approve the requested financial aid package offered by the U.K. government; accumulating losses; and the growing weakness of the Rover brand. All of these were claimed to pose a threat to BMW itself, but what of BMW's own culpability in this whole debacle? BMW's biggest failure was its underestimation of Rover's weaknesses prior to take-over. For more than two decades Rover had been a company in serious decline with a history of repeated model and market failure, both of which had weakened the brand significantly. Moreover, in sections of the British press it was seen as swallowing public funds that might have been better spent elsewhere and which did nothing to enhance its public image. On merging, contrary to the best canons of merger behaviour, BMW did not seem to have any concerted plan of development for its subsidiary, only intervening after two years when it replaced Rover's top management team. It had seriously overestimated the quality of Rover management, not realising just how much the company had become dependent on Honda. Equally serious was the failure to develop new models, apart from the Rover 75. The inherited models were already becoming dated at the time of take-over

in comparison with those from rival concerns. Finally, blaming the high level of Sterling might speak volumes for BMW's ability to handle exchange rates. After all, for years German carmakers survived and prospered with a high Deutschmark, but then they produced cars people wanted to buy.

Further information:

The above paper emanates from research on the international automotive industry conducted at the Motor Industry Observatory at Coventry University Business School, Coventry, U.K. The Observatory concentrates primarily on manufacturers and assemblers and covers topics such as mergers, acquisitions, etc. Work is currently ongoing on the U.K., French, and Chinese auto industries; supply chain management; global branding; and on Ford's Premier Automotive Group.

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