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AUTOMOTIVE INDUSTRY

A potential partner for Chrysler offers lessons in flexibility

Contract manufacturer Magna may hold clues to the future of an industry increasingly forced to outsource production

At Magna Steyr's automobile plant in Graz, Austria, a worker fixes an instrument panel into a black Chrysler Voyager. A robot then applies glue to a windscreen and mounts it on to the minivan's body.

But this is no ordinary car plant: down the line, right after the Voyager, come a Chrysler 300C saloon and a Commander sports utility vehicle produced for Chrysler's jeep brand - completely different vehicles. The same factory also produces X3 small SUVs for BMW, convertibles for General Motors' Saab brand and G-class military-style four-wheel drive vehicles for Mercedes, Chrysler's German sister brand.

With 7,300 employees in Graz, Magna Steyr is the industry's largest contract manufacturer. The business, a unit of Magna International, the Canadian automotive parts and assembly company, produces so many different diesel, convertible, left- and right-hand and other models for the three car groups that its officials cannot give a reliable tally. In one sign of the operation's complexity, more than 1,000 trucks a day pull up to the Graz facility, bringing parts for or taking delivery of the plant's wide array of vehicles.

Yet while BMW and Mercedes are some of the industry's best-known brands, few car buyers have heard of Magna. That may soon change following DaimlerChrysler's recent announcement that it is reviewing all options for Chrysler. Frank Stronach, the Austrian-born chairman and founder of Magna International, has expressed interest in Chrysler. The Canadian company is expected this week to join a private equity group in bidding for the German-American carmaker's unprofitable US unit.

Just what Magna might bring to a transformed or spun-off Chrysler remains unclear, as both companies are declining further comment on the possible sale, which in addition to expressions of interest from at least three buy-out groups has also drawn tentative interest from GM. Although Magna refused requests for interviews with senior managers, the factory may offer some clues on what it might bring to the table should it form part of a bid for Chrysler.

More broadly, the operation also provides a glimpse of one possible future for the competitively squeezed global car industry. Contract manufacturing is already common for such products as DVD players and flat-screen televisions and analysts say it could be applied more widely for cars. With raw-material, labour and other costs rising, manufacturers may increasingly outsource some vehicle assembly to non-branded producers such as Magna.

Europe has other contract car manufacturers: Germany's Wilhelm Karmann makes convertibles for Audi and Mercedes, as well as Chrysler's Crossfire coupe. Valmet Automotive, in Finland, handles all production of Boxster roadsters and Cayman two-seater coupes for Porsche, which is busy with other models.

Car groups turn to non-branded partners such as Magna to make niche vehicles in numbers too small to justify mass production. That *is* the case with the Mercedes G-Class, of which Magna has been the sole manufacturer since 1979. With production last year of just 5,000 units, the vehicles require too much manual labour to assemble competitively in a large automotive plant. With their nimble operations, contract manufacturers also specialise in "peak-shaving" - absorbing excess production demand for brand-name manufacturers.

BMW farmed out all production of its X3 to Magna, beginning in 2003, when it could not find room for the SUV on its'existing production lines. Magna now produces more than 100,000 of them a year. Chrysler makes half a million minivans a year in its plants in St Louis and Windsor, Ontario, but uses Magna Steyr to build right-hand drive and diesel Voyagers, of which the Austrian plant made 27,000 last year. "They outsource the complexity," says Bernd Oberzaucher, Magna Steyr's head of communications.

Contract manufacturing has yet to catch on in the US, apart from a few specialised areas such as the engineering of stretch limousines from ordinary cars. Japan's Toyota and Honda, two of the world's most profitable car companies, do not outsource entire vehicles. But Magna, which has an engineering centre in Detroit and operates a paint shop for Chrysler vehicles in Toledo, Ohio, has expressed interest in opening an assembly plant in America.

One reason the format may have a future is the industry's ever-broadening palette of models. Manufacturers are responding to consumer demand by producing a record number of vehicles covering every possible segment and drive system, including diesel and hybrid petrol-electric cars. Chrysler alone is introducing eight models this year and is in the process of more than tripling its right-wheel-drive offerings and more than quadrupling its diesel models. DaimlerChrysler's US unit is already doing contract manufacturing of a sort with China's Chery Automotive, with which it has a joint venture to produce sub-compact cars.

Chrysler cannot make small cars competitively in America, mostly because of the high pension and healthcare costs eroding its profits. The same margin pressures are pushing other US and European car groups into joint ventures to pool development costs.

Analysts have speculated that Magna, while probably too small to bid for Chrysler on its own, might bring valuable industry knowhow to a consortium including one or more private-equity groups. DaimlerChrysler is already Magna International's largest single customer, accounting for 24 per cent of its 2006 turnover.

The company prides itself on its flexibility, an attribute Chrysler will need to regain competitiveness: when Magna Steyr landed the X3 contract from BMW, it set up the production line in less than two months. Magna's Austrian unit also boasts of having developed the Mila, a "concept" sports car powered by liquefied natural gas, in six months. "They're characterised by very lean management and they are responsive," says Edmund Chew, an editor with Supplier Business, a trade publication. "They have just the kind of guys on board that private equity would need to run Chrysler."

There are reasons for scepticism about Magna's prospects of ending up as even a part-owner of the US marque. It has never handled volume manufacturing on the scale of Chrysler, which sold 2.7m vehicles last year. Nor is it clear how Magna Steyr's non-Chrysler clients would view an equity relationship between their subcontractor and a competitor. Some industry insiders believe that Magna's interest may be purely defensive, driven by concern about the future of its biggest customer. Given Chrysler's billions of dollars of unfunded employee liabilities, it is unclear whether a sale to any investor group, with or without the Canadians, will succeed.

Nonetheless, Magna Steyr foresees a future driven in large part by regulatory pressure and consumer demand for cleaner cars. Launching production of hybrid, clean-diesel or hydrogen-powered cars can be costly at small volumes. Within five years, Magna Steyr hopes to position itself as a big contractor for low-emission vehicles, possibly manufacturing cars for several companies on the same platform. "We see our future as a neutral producer, becoming a supplier of alternative drive systems in the future," says Mr Oberzaucher.

John Reed

Made in Graz: BMWs X3

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