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# The DaimlerChrysler Merger

## Summary

In the mid-1990s, Chrysler Corporation was the most profitable automotive producer in the world. Buoyed by record light truck, van, and large sedan sales, revenues were at an all-time high. Chrysler had taken a risk in producing vehicles that captured the bold and pioneering American spirit when imports dominated the market – the Dodge Ram, the Jeep Grand Cherokee and the LH Sedan Series. In these vehicles Chrysler found an instant mass appeal, and its U.S. market share climbed to 23% in 1997. As revenues and market share rose, product development costs shrank to 2.8% of revenues - compared with 6% at Ford and 8% at General Motors<sup>1</sup>. Chrysler's integrated design teams and noncompetitive relationships with suppliers kept costs down, while its marketing department scored success after success in gauging consumer tastes.

Chrysler had always fashioned itself the bold and risk-taking underdog. It had brought itself back from the brink of bankruptcy four times since the Second World War, and its boom-bust revenue flow pattern had earned it a "comeback kid" reputation. With \$7.5 billion in cash on hand and a full range of best-selling products, Chrysler finally seemed ready in 1997 to weather the volatile American automotive business cycle on its own – without government bailouts or large-scale R&D cutbacks<sup>2</sup>. Its wealth did not go unnoticed: Investor Kirk Kerkorian, a 13% shareholder, threatened to mount a takeover -- citing "the management's practice of cash hoarding" as his reason<sup>3</sup>.

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<sup>1</sup> Waller, David. Wheels on Fire: The Amazing Inside Story of the DaimlerChrysler Merger. London: Hodder & Stoughton, 2001, p.108.

<sup>2</sup> Vlastic, Bill and Bradley Stertz. Taken for a Ride: How Daimler-Benz Drove off with Chrysler. New York: Harper Collins, 2001, p. 92.

<sup>3</sup> "Kerkorian accuses Chrysler of cash hoarding" *The Detroit News*. Detroit, (4/12/97), Business Section, p. 3.

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In 2001, three years after a "merger of equals" with Daimler-Benz, the outlook is much bleaker. The financial data is sobering: Chrysler Group is on track to hemorrhage \$3 billion this year, its U.S. market share has sunk to 14%, earnings have slid by 20%, and the once-independent company has been fully subordinated to Stuttgart<sup>4</sup>. Its key revenue generators – the minivan, the Jeep SUV, and the supercharged pickup truck – have all come under heavy competition from Toyota, Honda, General Motors and Ford. Chrysler continues to make few passenger cars of note, save the Neon and limited-release Viper and Prowler.

In the words of DaimlerChrysler CEO Jürgen Schrempp, "What happened to the dynamic, can-do cowboy culture I bought?"<sup>5</sup>

## The Rationale for a "Merger of Equals"

On July 17, 1997, Chrysler CEO Bob Eaton walked into the auditorium at company headquarters in Auburn Hills, Michigan, and gave the speech of his life. Instead of reveling in four years of rapid growth, he warned of trouble brewing on the horizon. His urgent oratory, adapted from the nonfiction bestseller *The Perfect Storm*, a tale of three fishermen caught at the confluence of three potent storms off the Canadian coast, warned that a triad of similar factors threatened to sink Chrysler in the coming decade. "I think," Eaton said, "there may be a perfect storm brewing around the industry today. I see a cold front, a nor'easter, and a hurricane converging on us all at once."<sup>6</sup> The cold front was chronic overcapacity, the nor'easter was a retail revolution that empowered buyers, and the hurricane was a wave of environmental concerns that threatened the very existence of the internal combustion engine.

"Read *The Perfect Storm*, and you will learn," Eaton implored the assembled executives, "that when a seventy-two foot boat tries to climb a hundred-foot wave and doesn't make it, it slides back down the face of the wave, out of control . . .and plunges into the trough, stern first. Sometimes the boat bobs back up. Sometimes it doesn't."<sup>7</sup> "In the book, the lesson was

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<sup>4</sup> "DaimlerChrysler AG" Standard & Poors Stock Reports. New York: Standard & Poors, Inc., July 21, 2001.

<sup>5</sup> "Schrempps Fehler" Sueddeutsche Zeitung. Munich, Germany, (12/07/01), page 6.

<sup>6</sup> "Vlasic, Bill and Bradley Stertz" Taken for a Ride: How Daimler-Benz Drove off with Chrysler. New York: Harper Collins, 2001, p. 174.

<sup>7</sup> *Ibid*, p. 175.

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that there's only one way to survive the perfect storm. Don't go there. Be somewhere else," Eaton said. "And don't do it alone"<sup>8</sup>.

Daimler-Benz, meanwhile, was looking for a soul-mate. Despite a booming U.S. economy, its luxury vehicles had captured less than 1% of the American market<sup>9</sup>. Its vehicle production method was particularly labor intensive - requiring nearly twice as many workers per unit produced over Toyota's Lexus division. It recognized that it could benefit from an economy of scale in this capital-intensive industry. With \$2.8 billion in annual profits, remarkable efficiency, low design costs, and an extensive American dealership network, Chrysler appeared to be the perfect match.

On May 7<sup>th</sup>, 1998, Eaton announced that Chrysler would merge with Daimler-Benz. Thanks to a \$37 billion stock-swap deal, the largest trans-Atlantic merger ever, Chrysler would not "do it alone" any longer<sup>10</sup>. Daimler-Benz CEO Jürgen Schrempp hailed the union as "a merger of equals, a merger of growth, and a merger of unprecedented strength"<sup>11</sup>. The new company, with 442,000 employees and a market capitalization approaching \$100 billion, would take advantage of synergy savings in retail sales, purchasing, distribution, product design, and research and development. When he rang the bell at the New York Stock Exchange to inaugurate trading of the new stock, DCX, Eaton predicted, "Within five years, we'll be among the Big Three automotive companies in the world"<sup>12</sup>.

Three years later DaimlerChrysler's market capitalization stands at \$44 billion, roughly equal to the value of Daimler-Benz before the merger<sup>13</sup>. Its stock has been banished from the S&P 500, and Chrysler Group's share value has declined by one-third relative to pre-merger values. Unlike the Mercedes-Benz and Smart Car Division, which posted an operating profit

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<sup>8</sup> Ibid, p. 175.

<sup>9</sup> "Daimler-Benz AG" Standard & Poors Stock Reports. New York: Standard & Poors, Inc., July 21, 1997.

<sup>10</sup> CNN Financial News Broadcast: February 2, 1999. Transcript available at: <http://cnfn.cnn.com/1999/02/01/europe/daimler/>.

<sup>11</sup> Grässlin, Jürgen. Jürgen Schrempp and the Making of an Auto Dynasty. New York: McGraw-Hill, 2000, p. 155.

<sup>12</sup> "Daimler-Chrysler Merger Takes Shape," Detroit Free Press, Detroit (5/8/1998), p. 3.

<sup>13</sup> "DaimlerChrysler AG" Standard & Poors Stock Reports. New York: Standard & Poors, Inc., July 21, 2001.

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of EUR 830 million in Q3 2000, the Chrysler Group has been losing money at an alarming rate. In the same quarter, it lost \$512 million<sup>14</sup>.

## Why the Merger Failed

### Culture Clash:

To the principles involved in the deal, there was no clash of cultures. "There was a remarkable meeting of the minds at the senior management level. They look like us, they talk like us, they're focused on the same things, and their command of English is impeccable. There was definitely no culture clash there."<sup>15</sup>

Although DaimlerChrysler's Post-Merger Integration Team spent several million dollars on cultural sensitivity workshops for its employees on topics such as "Sexual Harassment in the American Workplace" and "German Dining Etiquette," the larger rifts in business practice and management sentiment remain unchanged.

James Holden, Chrysler president from September 1999 through November 2000, described what he saw as the "marrying up, marrying down" phenomenon. "Mercedes [was] universally perceived as the fancy, special brand, while Chrysler, Dodge, Plymouth and Jeep [were] the poorer, blue collar relations"<sup>16</sup>. This fueled an undercurrent of tension, which was amplified by the fact that American workers earned appreciably more than their German counterparts, sometimes four times as much.

The dislike and distrust ran deep, with some Daimler-Benz executives publicly declaring that they "would never drive a Chrysler". "My mother drove a Plymouth, and it barely lasted two-and-a-half years," commented Mercedes-Benz division chief Jürgen Hubbert to the

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<sup>14</sup> "Chrysler Head Ousted in Shakeup," Milwaukee Journal Sentinel, Milwaukee (11/17/00), Business, p. 1.

<sup>15</sup> Interview with Robert Lutz, Former Vice-Chairman, Chrysler, and Exec VP, GM, and current President of the North American Division, Ford, February 23, 2001.

<sup>16</sup> Grässlin, Jürgen. Jürgen Schrempp and the Making of an Auto Dynasty. New York: McGraw-Hill, 2000, p. 162.

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Sueddeutsche Zeitung<sup>17</sup>.irate Chrysler managers responded with jabs of their own. Bob Lutz, then Chrysler vice-chairman, pointed out to the Detroit Free Press that "The Jeep Grand Cherokee earned much higher consumer satisfaction ratings than the Mercedes M-Class"<sup>18</sup>.

With such words flying across public news channels, it seemed quite apparent that culture clash has been eroding the anticipated synergy savings. Much of this clash was intrinsic to a union between two companies which had such different wage structures, corporate hierarchies and values. At a deeper level, the problem was specific to this union: Chrysler and Daimler-Benz's brand images were founded upon diametrically opposite premises. Chrysler's image was one of American excess, and its brand value lay in its assertiveness and risk-taking cowboy aura, all produced within a cost-controlled atmosphere. Mercedes-Benz, in contrast, exuded disciplined German engineering coupled with uncompromising quality. These two sets of brands, were they ever to share platforms or features, would have lost their intrinsic value. Thus the culture clash seemed to exist as much between products as it did among employees.

Distribution and retail sales systems had largely remained separate as well, owing generally to brand bias. Mercedes-Benz dealers, in particular, had proven averse to including Chrysler vehicles in their retail product offerings. The logic had been to protect the sanctity of the Mercedes brand as a hallmark of uncompromising quality. This had certainly hindered the Chrysler Group's market penetration in Europe, where market share remained stagnant at 2%<sup>19</sup>. Potentially profitable vehicles such as the Dodge Neon and the Jeep Grand Cherokee had been sidelined in favor of the less-cost-effective and troubled Mercedes A-Class compact and M-Class SUV, respectively.

The A-Class, a 95 hp, 12 foot long compact with an MSRP of approximately \$20,000, competed in Europe against similar vehicles sold by Opel, Volkswagen, Renault and Fiat for approximately \$9,000-\$16,000. Consumers who ordinarily would have paid a premium for Mercedes' engineering and safety record had been disappointed by the A-Class -- which failed an emergency maneuver test conducted by a Swedish television station in 1999<sup>20</sup>. The

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<sup>17</sup> Oldag, Andreas. "Spiel mit dem Feuer," Sueddeutsche Zeitung, Munich (3/17/2001), p. 12.

<sup>18</sup> "DaimlerChrysler Execs Trade Barbs," Detroit Free Press, Detroit (3/19/2001), p. 5.

<sup>19</sup> "Charges of \$3.9B to Fix Chrysler's Woes". CNN Europe, London, (2/26/01). See article at: <http://europe.cnn.com/2001/BUSINESS/02/26/daimlerchrysler/>

<sup>20</sup> "Vlasic, Bill and Bradley Stertz" Taken for a Ride: How Daimler-Benz Drove off with Chrysler, New York: Harper Collins, 2001, p. 300.

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A-Class appeared both overpriced and under-engineered for the highly competitive European compact market. The Dodge Neon, in contrast, could have competed more effectively in this segment with an approximate price of \$13,000, similar mechanical specifications, and a record of reliability. Brand bias, however, had prevented this scenario from becoming reality.

Differing product development philosophies continued to hamper joint purchasing and manufacturing efforts as well. Daimler-Benz remained committed to its founding credo of "quality at any cost", while Chrysler aimed to produce price-targeted vehicles. This resulted in a fundamental disconnect in supply-procurement tactics and factory staffing requirements. Upon visiting the Jeep factory in Graz, Austria, Hubbert proclaimed: "If we are to produce the M-Class here as well, we will need to create a separate quality control section and double the number of line workers. It simply can't be built to the same specifications as a Jeep<sup>21</sup>". The M-Class was eventually built in Graz, but not without an expensive round of retooling and hiring to meet Hubbert's manufacturing standards.

## **Mismanagement:**

In autumn 2000, DaimlerChrysler CEO Jürgen Schrempp let it be known to the world - via the German financial daily *Handelsblatt* - that he had always intended Chrysler Group to be a mere subsidiary of DaimlerChrysler. "The Merger of Equals statement was necessary in order to earn the support of Chrysler's workers and the American public, but it was never reality"<sup>22</sup>. This statement was relayed to the English-speaking world by the *Financial Times* the day after the original news broke in Germany.

To be sure, it was apparent from Day One that Daimler-Benz was the majority shareholder in the conglomerate. It controlled the majority of seats on the Supervisory Board; yet the DaimlerChrysler name and two parallel management structures under co-CEOs at separate headquarters lent credence to the "merger of equals" notion.

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<sup>21</sup> Grässlin, Jürgen. Jürgen Schrempp and the Making of an Auto Dynasty. New York: McGraw-Hill, 2000, p. 217.

<sup>22</sup> "DaimlerChrysler will seine Autos günstiger verkaufen," Handelsblatt. Frankfurt, Germany, (10/30/00), p. 3.

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This much, however, is clear: Jürgen Schrempp and Bob Eaton did not follow a coordinated course of action in determining Chrysler's fate. During 1998-2001, Chrysler was neither taken over nor granted equal status. It floated in a no man's land in between. The managers who had built Chrysler's "cowboy bravado" were no more. Some remained on staff, feeling withdrawn, ineffective and eclipsed by the Germans in Stuttgart. Others left for a more promising future at G.M. or Ford. The American dynamism faded under subtle German pressure, but the Germans were not strong enough to impose their own managers. According to a Daimler-Benz executive, "Eaton went weeks without speaking with Jürgen [Schrempp]. He preferred to maintain lower-level contact. . . Jürgen, meanwhile, was afraid of being labeled a takeover artist. He left Chrysler alone for too long".

Why? According to one well-placed senior executive at Chrysler, "Jurgen Schremp looked at Chrysler's past success and told himself there is no point in trying to smash these two companies together. Some stuff was pulled together but they said operationally let's let the Chrysler guys continue to run it because they have done a great job in the past. What they didn't take into account was that immediately prior to the consummation of the merger or shortly thereafter, enough of the key members of that former Chrysler management team left. They saw the forest but they didn't realize that removing four or five key trees was going to radically change the eco system in that forest. It was a misjudgment."<sup>23</sup>

As a result, Chrysler sat in apathy, waiting for Daimler's next move - a move which came too late -- eleven months after Eaton's retirement -- when Schrempp installed a German management team on November 17, 2000. During that interval, Chrysler bled cash.

After the merger, many people in Auburn Hills observed that co-CEO Bob Eaton appeared withdrawn, detached, and somewhat dispassionate about the company he continued to run. Even Schrempp encouraged him to "act like a co-chairman and step up to the podium..." to no avail. Two valuable vice-presidents, engineer Chris Theodore and manufacturing specialist Shamel Rushwin, left for jobs at Ford<sup>24</sup>. According to then-president Peter Stallkamp, Eaton "had really checked-out about a year before he left. . . The managers feared for their careers, and in the absence of assurance, they assumed the worst. There were a good eighteen months when we were being hollowed out from the core by the Germans' inaction and our own paralysis<sup>25</sup>".

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<sup>23</sup> Interview with Robert Lutz, Former Vice-Chairman, Chrysler, and Exec VP, GM, and current President of the North American Division, Ford, February 23, 2001.

<sup>24</sup> "Two U.S. Executives Leave DaimlerChrysler," USA Today, (3/1/1999). Money Section, p.2.

<sup>25</sup> CNBC Financial News. Television Interview. January 9, 2001.

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During the period 1998-2000, the Honda Odyssey came to rival the Dodge Caravan, the Toyota Tundra threatened the Dodge Ram, and SUVs from GM, Ford, Nissan and Toyota attacked Jeep's market share. Chrysler responded with little innovations, and competitive price reductions only began in Q2 2001. Its traditional dominance in the SUV and light truck market had been challenged, and it had not adequately responded. While Chrysler's management languished, the market continued to function, and the industry left Chrysler in the dust.

Synergy savings are only achieved when two companies can produce and distribute their wares more efficiently than when they were apart. Owing to culture clash and a poorly integrated management structure, DaimlerChrysler is unable to accomplish what its forbears took for granted three years ago: profitable automotive production.