CHAPTER THIRTEEN

DaimlerChrysler—A Merger Made in Hades

It was supposed to be so right, almost a merger made in heaven, some said at the beginning. Instead, it turned out to be the opposite.

Chrysler was the smallest but since 1994 had been the most efficient U.S. auto producer, the one having the highest profit margin. Now its productivity and innovative strength would be blended with the prestige of Daimler's legendary Mercedes-Benz. Furthermore, during one of its periodic crises Chrysler had sold off its international operations to help raise needed money, and this merger would increase international exposure in a big way and mate it with a rich partner. The instigator, Juergen Schrempp of Daimler, was lauded for his intentions of building a new car company that would have global economies of scale.

Of course, there were two cultures involved, German and American. But in the executive offices, decision making would be shared, with Chrysler's CEO, Robert Eaton, being a co-chairman with Schrempp.

Chrysler management's expectations of equality with its prestigious merger partner were soon dashed. Schrempp, as it turned out, never intended equality. He had flagrantly misrepresented the merger package and quickly got rid of Chrysler top managers. Was this deception unacceptable ethical conduct, or was it rather a hard-nosed negotiating ploy that Chrysler management should have recognized?

In any case, in November 1998 this merger of "equals" was finalized. And the merger was to become a bitter cup.

CHRYSLER BEFORE THE MERGER

During the last several decades, Chrysler had had a checkered history. Some said that Lee Iacocca had performed a miracle at Chrysler. He became president of an almost moribund firm in November 1978. Its condition was so bad that he turned to Washington to bail out the company and obtained federal loan guarantees of $1.5 billion to help it survive. By 1983 Iacocca had brought Chrysler to profitability and then to a strong performance for the next four years. He paid back the entire loan seven years before it was due. Like a phoenix, the reeling number-three automaker had been given new life and respectability. Some said Iacocca should be president of the United States, that his talents were needed in the biggest job of all.

Iacocca turned to other interests in the latter half of the decade, but by 1988, the company was hurting again. To a large extent the new problems reflected capital deprivation: sufficient money had not been invested in new car and truck designs. This lack of funds was the result of the 1987 acquisition of American Motors Corporation (AMC). The crown jewel of this buyout was the Jeep line of sport-utility vehicles, which appealed to younger, more affluent buyers than Chrysler's older, lower-income customers. Still, Chrysler found itself saddled with the substantial inefficiencies that had bedeviled AMC.

An aging Iacocca again turned his full attention back to the car business, now seven years after retiring his company's horrendous bank debt. He staked the company's resources on four high-visibility cars and trucks: a minivan, the Jeep Grand Cherokee, LH sedans, and a full-size pickup. Fearful that the company might not survive until the new models came out, especially if a recession were to occur before then, Iacocca instituted a far-reaching austerity program, which cut $3 billion from the company's $26 billion annual operating costs.

By 1992, the company was riding high. Iacocca retired December 31, 1992, with a job well done. As he said on TV, "When it's your last turn at bat, it sure is nice to hit a home run."[1] Robert Eaton, formerly with GM of Europe, replaced Iacocca as Chrysler chairman.

As it moved to the millennium, Chrysler prospered because of a combination of innovative designs, segment-leading products, and rising sales throughout the auto industry. See Table 13.1 for the sales and net profit statistics of these golden years for Chrysler relative to its two U.S. competitors, General Motors and Ford.

AFTER THE MERGER

Seldom has a merger turned out worse, and so quickly. Perhaps because of morale problems and too much attention given to smoothing relations between Detroit and Stuttgart, the bottom line of Chrysler was wracked. Or maybe the problems at Chrysler had been latent, below the surface, and only needed the disruption of a massive takeover to surface. Or could the problems have been triggered by an unwise dictatorship by the German master?

On November 16, 1998, Daimler-Benz issued an additional $36 billion of its stock to buy Chrysler. This, when added to the $48 billion value of its existing stock brought total market value of DaimlerChrysler to $84 billion. Early in December 2000, barely two years later, the collapsing DaimlerChrysler stock had a market value of only $39 billion, less than Daimler alone was worth before the deal.

[1] Alex Taylor III, "U.S. Cars Come Back," *Fortune,* November 16, 1992, p. 85.

TABLE 13.1 Sales and Profit Comparisons, Big Three U.S. Automakers, 1993–1998 (millions of dollars)

	1993	1994	1995	1996	1997	1998
Ford						
Sales	108,521	128,439	137,137	146,991	153,637	144,416
Net Profit	2,529	5,308	4,139	4,371	6,920	6,579
	2.3%	4.1%	3.0%	3.0%	4.5%	4.5%
GM						
Sales	138,220	154,951	168,829	164,069	173,168	161,315
Net Profit	2,466	5,659	6,933	4,668	5,972	3,662
	1.8%	3.7%	4.1%	2.8%	3.4%	2.3%
Chrysler						
Sales	43,600	52,235	53,195	61,397	61,147	NA
Net Profit	(2,551)	3,713	2,025	3,529	2,805	NA
	(5.9)%	7.1%	3.8%	5.7%	4.6%	

Note: These are total company sales, the bulk of which are autos/trucks. But with nonvehicle diversifications, the sales will be somewhat overstated for autos/trucks.

Sources: Company public records. NA = Not applicable because of merger with Daimler.

Commentary: After a poor year in 1993—a $2.5 billion loss—Chrysler really bounced back making a profit of $3.7 billion, which was over 7 percent of sales, far above that of its two major competitors. Chrysler continued the strong showing with multibillion-dollar profits from 1994 on. In 1995, its 3.8 percent profit was well above Ford, but slightly less that GM: in 1996 and 1997 its profit margin again was the best. While we do not have specific figures for 1998, we know that it was also a good year. The collapse came in 1999.

Chrysler was bleeding money. During the second half of 2000, Chrysler lost $1.8 billion and went through $5 billion in cash, this at a time when GM and Ford were still doing well.

By 2000 Eaton was long gone, along with nine other top Chrysler executives, including the renowned designer, Thomas Gale. Then in November 2000, Eaton's successor James Holden, a Canadian, the last high-level non-German remaining, was also given the ax. His replacement was a Daimler executive, Deiter Zetsche, 47, a tall German with a walrus mustache. For chief operating officer, Zetsche brought with him Wolfgang Bernhard, 39, an intense young engineer with an MBA from Columbia who was a stickler for cost-cutting. It could have been worse: Zetsche could have brought a big team from Germany, instead of only one other man. Still, indignation surfaced at his putting German executives in top positions of this old American firm—a firm that had played an important part in defeating the Germans in World War II.

Eaton and the rest of the Chrysler hierarchy found to their dismay that this was not a merger of equals, despite Chairman Schrempp's 1998 statements to the contrary, not only to Chrysler's top management but also to the SEC (Securities and Exchange Commission), and the inclusion of the Chrysler name in the corporation name. In reality, Chrysler had become only a division of Daimler. In interviews with the media, Schrempp admitted that subjugation of Chrysler had always been his intention, this a duplicity of no small moment.[2]

Later we will analyze why the merger so quickly proved a disaster.

Jurgen Schrempp

DaimlerChrysler Chairman Jurgen Schrempp, a trim 56, had an untarnished reputation going into the Chrysler merger. He began his career with Mercedes as an apprentice mechanic nearly forty years before, and had moved steadily upward. Now he acknowledged that he faced "outstanding" challenges with Chrysler. But he pointed out, "Five years ago in 1995, Daimler-Benz posted a loss of 6 billion marks ($3 billion). We turned it around in a matter of two years. I think we have the experience and know-how to attend to matters, and if necessary we'll do that at Chrysler . . . Our aim is to be the No. 1 motor company in the world."[3]

Still, there were those who thought he destroyed Chrysler, that "he didn't realize it was the people who counted, not the factories, which were old, or the sales and profits, which could come and go."[4] Schrempp either forced or encouraged key people to leave, and some would say that these departures were of the heart and soul of Chrysler. His duplicity in misleading top Chrysler management and shareholders that this was to be a merger of equals could hardly be viewed as anything but ambitious conniving.

During the merger finalization, it was predicted that Chrysler would earn more than $5 billion in 2000, this being what it earned in 1998. In late 1999, however, Chrysler President James Holden reduced this prediction to only $2.5 billion because of having to spend billions retooling for new model introductions at a time when an economic slowdown seemed to be looming.

The reduced profit expectation coming so soon after the merger was unacceptable to Schrempp, and he pressured Chrysler to pump up earnings for the first half of the year by building 75,000 more cars and trucks than could readily be sold, with these quickly shipped to dealers. (The accepted accounting practice was to consider a car as revenue to Chrysler when it reached a dealer's lot, not when it was sold by the dealer.) As a result, Chrysler was just short of its $2.5 billion target in the first half of 2000.

Not surprisingly, the inventory buildup resulted in showrooms overflowing with old model minivans, just as new models began arriving in August. With car sales in general now slowing because of the economy, Chrysler had to cut prices even on popular minivans, and it was necessary to increase rebates up to $3,000 on the old models. These price cuts destroyed the profitability of Chrysler all the more since the company, in its optimism after record profits in the 1990s, had upgraded its cars

[2] For example, "A Deal for the History Books: The Auto Takeover May Be Remembered for All of the Wrong Reasons," *Newsweek,* December 11, 2000, p. 57.

[3] William J. Holstein, "The Conquest of Chrysler," *U.S. News & World Report,* November 27, 2000, p. 54.

[4] Jerry Flint, "Free Chrysler!" *Forbes,* October 30, 2000, p. 132.

and trucks, expecting to charge more for them. But with competition increasing and car pricing turning deflationary, the price hikes did not hold up, and this and the rebates severely affected profits in the third and fourth quarters. (See the following Information Box for a discussion of rebates.)

Schrempp Takes Action

With the huge losses in the second half of 2000, Schrempp sent Zetsche to Detroit with simple instructions: "My orders were to fix the place."[5] On his first day Zetsche fired the head of sales and marketing. Then in two months he developed a three-year turnaround plan. It called for cutting 26,000 jobs (29 percent of the workforce), reducing the cost of parts by 15 percent, and closing six assembly plants. Zetsche projected a breakeven point by 2002 and an operating profit of $2 billion in 2003.[6] This would still be well below the operating profit of Chrysler in 1993–1997, before the merger, as shown in Table 13.1.

His colleague from Stuttgart, Wolfgang Bernhard, organized engineers and procurement specialists into 50 teams to find ways to save money on parts. Suppliers were told to reduce prices by 5 percent as of January 2001, with a further 10 percent reduction over the next two years. Some companies such as Robert Bosch GmbH, the world's second-largest parts maker, and Federal Mogul, said they would not cut prices. Zetsche observed, "If they do not support us to get to the 15 percent, we have to consider that in our future decisions."[7]

INFORMATION BOX

REBATES

A rebate is a promise by a manufacturer to return part of the purchase price directly to the purchaser. The rebate is usually given to consumers, although it can be offered to dealers instead, in the expectation that they will pass some or all of the savings along to consumers.

Obviously, the objective of a rebate is to increase sales by giving purchasers a lower price. But why not simply reduce prices? The rebate is used instead of a regular markdown or price reduction because it is perceived as being less permanent than cutting the list price. This can give more promotional push by emphasizing the savings off the regular price, but only for a limited time. Rebates can be effective in generating short-term business, but they may affect business negatively once they have been lifted.

Do you see any dangers with rebates from the manufacturer's viewpoint? As a consumer, would you prefer a rebate to a price reduction, or does it make any difference?

[5] Alex Taylor III, "Can the Germans Rescue Chrysler?" *Fortune,* April 30, 2001, p. 109.

[6] *Ibid.*

[7] "Daimler Threatens to Drop Some Suppliers," Bloomberg News as reported in *Cleveland Plain Dealer,* February 28, 2001, p. 6-C.

Bernhard also focused attention on improving quality as a way to cut costs. In particular, the four-wheel-drive trucks showed up poorly on quality surveys. The company began rigorously evaluating new models for quality while they were still in the design stage, so that parts or manufacturing processes could be changed before too much money had been committed.

Zetsche began to direct much of his attention to bringing back standout designs that Chrysler had been noted for in the 1990s. Of late, design and engineering efforts, such as the 2001 minivan and the 2002 Ram, seemed more evolutionary than revolutionary, with leadership allowed to slip while Toyota and Honda became stronger competitors.

Despite increased competition, Zetsche had a unique asset that he thought should help his company regain the edge: the prestige and competence of Mercedes-Benz technology. Mercedes previously had feared diluting its premium brand, but now it was directed to share components with Chrysler. New rear-wheel versions of the Chrysler Concorde and 300M coming out in 2004 and 2005, for example, were planned to make use of Mercedes electronics, transmissions, seat frames, and other parts. "If Zetsche can sprinkle some Mercedes magic on the Chrysler brand without damaging the premium status of Mercedes, Chrysler has a shot at doing well in the future."[8]

To his credit, Zetsche worked hard to overcome the anti-German feelings that initially followed his and Bernhard's arrival. To stem the potential brain drain, he persuaded some senior Chrysler executives and technicians to stay. And the drastic cutback of workers and closing of factories before long came to be viewed as necessary cost cutting to keep the company viable. Even UAW President Steve Yokich endorsed these actions: "[Otherwise] I don't think there would be a Chrysler."[9]

Other Problems for Schrempp

Two other major problems confronted Schrempp. In October 2000, despite misgivings by Chrysler executives, he acquired 34 percent of Mitsubishi Motors, with the option to up that to 100 percent after three years. Hardly had the deal been finalized than Mitsubishi admitted it had misled consumers about product quality for decades. It also announced that losses for the last six months had nearly doubled. Schrempp reacted by installing a turnaround expert as chief operating officer at Mitsubishi, accompanied by dozens of Japanese-speaking Daimler executives. All the while the new chief executive, Takashi Sonobe, was quoted as saying that he, not the German team, remained in charge, and that he saw no need for big changes. A contest of wills, this.[10]

DaimlerChrysler's Freightliner, the leading North American heavy-truck maker, was also struggling as the North American market hit one of the steepest slumps in a decade. After an aggressive growth policy that involved acquisitions of other truck makers and a heavy investment in a facility for reconditioning used trucks to

[8] Detroit manufacturing consultant Ron Harbour, as reported in *Fortune*, April 30, 2001, p. 110.

[9] Taylor, p. 107.

[10] Holstein, "The Conquest of Chrysler."

sustain Freightliner's sale-buyback strategy, demand for new and used heavy trucks plummeted 50 percent, and prices fell sharply. It was expected that Schrempp would install a German national as head of this unit.[11]

PROGNOSIS AT THE TIME

As of mid-2001, many observers were pessimistic of the probabilities of Schrempp resurrecting Chrysler any time soon. In the long term, perhaps; but they questioned whether creditors and shareholders would tolerate a long period of profit drain by Chrysler and low share prices for DaimlerChrysler stock. Rumors were that Deutsche Bank, DaimlerChrysler's largest shareholder, was getting ready to oust Schrempp, and that Chrysler would be broken up into smaller pieces and sold off.[12]

Still, friendly German banks and shareholders might be more patient than Wall Street. DaimlerChrysler was the first German firm to be listed on the New York Stock Exchange, and such a listing subjected Schrempp to the impatience of the international financial markets and their obsession with meeting quarterly earnings expectations. In an age of volatile markets, failure to meet such expectations often resulted in a company's stock price collapsing. This bothered Schrempp: "I don't think [it] is advantageous: focusing on quarterly results. It might well be that because we increase our spending, investment, whatever, for a very good reason, that I might occasionally miss what they [investors] expect from me."[13]

Schrempp would have another worry imperiling his job if Chrysler did not improve soon. The third-largest holder of DaimlerChrysler stock was the Las Vegas takeover tycoon Kirk Kerkorian, a powerful man with a reputation for being easily offended. Rumors held that Schrempp had not made himself available to see Kerkorian, but instead went to his ranch in South Africa.[14]

Chrysler executives, much as they might dislike Schrempp, could be worse off if he should be ousted. Mercedes executives ruled in Stuttgart headquarters, and without Chrysler's main supporter, Schrempp, Chrysler might not receive the resources needed to make a comeback. It might be broken up and sold, or left withering within DaimlerChrysler's empire.[15]

ANALYSIS

This case illustrates the downside of mergers and acquisitions. (We use the terms mergers and acquisitions somewhat similarly, but will consider "merger" as closer to the idea of equals coming together, while "acquisition" suggests a larger firm

[11] Joseph B. White, "Head of Truck Maker Freightliner Is Leaving Post," *Wall Street Journal,* May 25, 2001, p. A4.

[12] "Can the Germans Rescue Chrysler? pp. 106–7.

[13] Holstein, p. 69.

[14] Reported in "A Deal for the History Books," p. 57.

[15] See Robyn Meredith, "Batman and Robin," *Forbes,* March 5, 2001, pp. 67,68; and Jerry Flint, "Free Chrysler," *Forbes,* October 30, 2000, p. 132 for more discussion of these scenarios.

absorbing a smaller one.) The causes of these problems are diverse, although certain commonalities occur time and again.

We will examine the salient factors that led to the collapse of Chrysler soon after the merger under (a) those mainly Daimler's fault, (b) those Chrysler's fault, and (c) the externals that made the situation worse. Then we will examine this whole concept of a "merger of equals." Can there really be a merger of equals?

Daimler's Contribution to the Problem

The Morale Factor

Different cultures are often involved when a merger or acquisition takes place, even among seemingly similar firms. For example, one business culture may be more conservative and the other aggressive and even reckless; one may be formal and the other informal; one culture may insist on standard operating procedures (SOPs) being followed, while the other may be far less restricted; one may be dominated by an accountant or control mentality, which emphasizes cost analysis and rigidity of budgets, and the other by the sales mentality, which seeks maximum sales production and flexibility of operations even if expenses sometimes get out of line. Such differences impede easy assimilation.

This assimilation challenge for divergent corporate cultures becomes all the more difficult when different nationalities are involved—for example, Germanic versus American. National pride, and even prejudice, may complicate the situation.

It is hardly surprising that this mammoth merger of a proud German firm and an American firm with a long heritage should have presented morale problems. Especially with one party misled as to the sharing of leadership, the seeds were laid for extreme resentment. Some of this resentment among rank-and-file workers even went back to World War II.

But there were other obstacles to a smooth melding of the two firms. Daimler had to adjust from being an old-line German firm to becoming a huge international firm confronted with a diversity of cultures. "The German instinct is for hierarchy, order, planning. Daimler executives use Dr. or Prof. on their business cards. Many wear dark three-piece suits. Chrysler, by contrast, was known for a freewheeling creativity."[16]

Chrysler's company culture had been highly successful in the very recent past, as shown in Table 13.1 and in Table 13.2, which presents the gain in market share or competitive position during the 1990s. Its rather unrestrained-by-rules culture seemed to many to be the key to innovative thinking and technical leadership. With the merger it was not only being challenged but repudiated and supplanted by Germans who little appreciated the contributions of designers like Bob Lutz, who came up with products customers wanted that were not engineered at great cost and research. "The daring and imagination of the old Chrysler [is] buried under German management."[17]

[16] Holstein, p. 56.

[17] Flint, p. 132.

TABLE 13.2 Chrysler's Market Share of the Big Three U.S. Automakers, 1991–1998

	Chrysler's Sales Percentage of U.S. Car/Truck Automakers
1991	12.2
1992	13.7
1993	15.0
1994	15.6
1995	14.8
1996	16.5
1997	15.8
1998	NA

Sources: Calculated from publicly reported sales figures; 1998 figures not applicable due to merger in November.

Commentary: The improvement in Chrysler performance in the middle and late 1990s is clearly evident. Market-share improvement of even 0.05 percent translates into a gain in competitive position. And here we see a gain of more than 4.0 percent in 1996 and 3.6 percent in 1997. You can see how Chrysler's improving performance in the latter years of the 1990s would be attractive to Daimler.

Schrempp's Major Blunder

A miscalculation by Schrempp little more than a year after the merger was to have drastic consequences. His order to produce and ship 75,000 more older-model vehicles than could reasonably be sold before the new models came out, thus beefing up sales and profits for the first half of the year, resulted in huge imbalances of inventories in the last half and destroyed year-2000 results as well as the early months of 2001. This overproduction was the trigger that brought Chrysler its huge losses and even jeopardized the soundness of Schrempp's acquisition decision.

Chrysler's Contribution

One could argue that Chrysler had grown fat and inefficient after its years of success in the last half of the 1990s, that it was on the verge of a drastic decline in profits even if Daimler had not come on the scene to stir things up. By 1999 Chrysler showrooms were saddled with aging models, including the important minivans that were in their fifth year. While still the leader in minivan sales, Chrysler was losing market share to competitors with newer models, including the Honda Odyssey.

The prosperity of Chrysler in the mid-1990s may have reflected not so much inspired management as a combination of good luck factors: innovative designs and segment-leading products, yes, but also rising sales throughout the auto industry and a groundswell of demand for high-profit minivans and pickup trucks. Maybe the success of those years paved the way for the disaster that came shortly after

Daimler took over. The great demand for vehicles like the Ram pickup truck, Jeep Grand Cherokee, and Dodge Durango brought a heady confidence that these good times would continue. Accordingly, Chrysler projected market share to increase to 20 percent by 2005, far above anything ever attained before. (You can see from Table 13.2 that reaching a 20 percent market share was not very close.) So Chrysler spent heavily on refurbishing plants and buying new equipment. It went from having the fewest workers per point of market share in 1996 to the most by 1999. It was spending money extravagantly, and its entrepreneurial culture was operating unchecked. "The company lost its purpose and lost its direction," the former chief engineer Francois Castaing said.[18]

The uncontrolled entrepreneurial culture led to poor communication and coordination, with each team buying its own components, such as platforms and parts for the different cars, thus not taking advantage of economies of scale. For example, the Durango and the Jeep had different windshield wipers, and Chrysler's five teams specified three different kinds of corrosion protection for the rolled steel used to reinforce plastic bumper surfaces.[19]

Other lapses of good judgment included continuing production of old-model minivans as it was switching production to the new one, thus flooding the market. This yielding to the pressure of Schrempp, as we have seen earlier, was a major factor in the disastrous 2000 results. Could Chrysler executives have protested more vigorously? The practice of the old management to introduce new models in batches rather than spreading them over several years brought a feast or famine situation: very good years, and rather bad years in between.

External Factors

Certainly the merger was consummated at a time when the auto industry, and the economy in general, was on the threshhold of a downturn. Chrysler apparently miscalculated such an eventuality, spending heavily for costlier models just before demand turned down, and its brands were not strong enough to command higher premiums from customers. By early 2001, Chrysler was outspending all other major automakers on rebates and other incentives.

Chrysler also seemed oblivious to the threat of competitors during its golden years. Despite heavy use of incentives, Chrysler lost market share for the first three months of 2001: a 14.2 percent market share vs. 15.1 percent for the same three months in 2000.

CAN THERE REALLY BE A MERGER OF EQUALS?

In reality there is seldom a merger of equals. Unless the two parties actually recapitalize themselves with new stock—and this is seldom done—there is always an acquirer and an acquiree. Even if both parties to the merger have equal seats on

[18] As quoted in "Can the Germans Rescue Chrysler?" p. 109.

[19] *Ibid.*

the board of directors, still the acquiring firm and its executives are more dominant. Even if the name of the new combined firm is completely changed, this does not assure a merger of equals. For example, in a well-publicized merger "of equals" in 2000 between Bell Atlantic and GTE, the name *Verizon* was created. But no one was fooled: Bell Atlantic was in charge. Furthermore, there can be no true merger of equals if one firm owns more of the consolidated stock (usually reflecting its larger size) than the other, and this is almost always the case. Daimler was certainly the larger firm in this merger, having paid $36 billion for Chrysler while its own shares just before the merger had a market value of about $48 billion.

How important is this merger of equals to the executives of acquired firms? Apparently to many it is not of major consequence as long as they get a good price for their stake, or as long as they believe the acquiring firm will honor their importance. Occasionally a merger negotiation will fall apart over the issue of who will be in charge. Take the example of Lucent and Alcatel of France, two of the world's biggest makers of communications equipment: At the last minute on May 29, 2001, Henry B. Schacht, chairman of Lucent, called off the merger talks. "It started to feel more like an acquisition than a merger," one of the Lucent participants explained. They could not accept the probability that Alcatel would be in charge.[20]

UPDATE TO 2007–2008

At the beginning of 2002, Chrysler reported it had lost a staggering $2 billion in 2001, and this brought a new wave of criticism of the merger—after all, it was four years after the deal. For the first years after the merger, Mercedes closely guarded its parts and designs for fear of eroding the Mercedes mystique. Now headquarters in Stuttgart, Germany, finally began forcing its far-flung operations to begin working together. In spring 2003, Chrysler introduced two models that reflected more German engineering: the Pacifica, a cross between a station wagon and a SUV; and the Crossfire, a sleek sports car. Waiting in the wings were a LX sedan and a SUV called the Magnum. Headquarters also began bringing engineers from its Mitsubishi subsidiary to Stuttgart in order to integrate some ideas for smaller cars.[21]

By 2004, nearly seven years after the merger, Chrysler was on an upswing, with its profits and market share growing because of improvements in quality and design, and drastic cost-cutting. Not the least of the contributors to the turnaround was a hot new car, the 300C. (The Pacifica introduced in 2003 had been a dud, partly because it was priced too high.) The new car was not only distinctive but significantly cheaper than equivalent competitive models. For example, a well-equipped version sold for $36,000, while a similarly powered BMW retailed at $60,000. Chrysler gave a 300C to Snoop Dogg, in return for a promise he'd include the car in a musical video, and with crowds being pulled into dealerships, Chrysler's market

[20] For more details, see Seth Schiesel, New York Times, reported in *Cleveland Plain Dealer,* June 3, 2001, p. 1-H.

[21] Neal E Boudette, "At Daimler Chrysler, a New Push to Make Its Units Work Together," *Wall Street Journal,* March 12, 2003, pp. A1 and A15.

share inched up to 13 percent from 12.7 percent a year earlier, this at a time when both Ford and GM were losing market share.

Alas, now that Chrysler was making money, Mercedes-Benz was faltering, with serious quality problems. Back in 1998 at the merger, Mercedes was the world's No. 1 luxury brand. Now it had slipped to the fifth largest. This reversal of fortune—whenever one part of the empire turns a corner, another part stumbles—raised doubt about the belief that vast size brings huge economies of scale. Jurgen Schrempp's global vision inspired other auto industry tie-ups, such as Ford's acquisition of Land Rover and Volvo, and GM's stake in Fiat, which also have had mixed results.

The see-sawing performance continued into 2006, now with Chrysler struggling to clear out a large inventory of unsold vehicles, while Mercedes seemed to have rebounded and recovered from its quality problems.[22] By the end of 2006, the situation was worsening as Chrysler recorded a $1.5 billion loss for the third quarter, joining GM and Ford in posting whopping losses. The U.S. auto industry was on the ropes as Tokyo-based Honda reported a profit. Chrysler's losses were blamed on falling sales of large sport utility vehicles, and also on the highest labor costs among the Big Three, thanks to the UAW rejecting similar concessions to those given to Ford and GM. Rumors surfaced that Chrysler might be put up for sale by parent DaimlerChrysler.[23]

A Last Stand?

In August 2007 private equity firm Cerberus Capital Management bought Chrysler for $7.4 billion. Most of the money went into Chrysler, not Daimler. The complex transaction resulted in only a $680 million cash outflow for Daimler, whose acquisition of Chrysler in 1998 was valued at $36 billion. Now, with the benefit of hindsight, the monumental acquisition mistake by Daimler can truly be recognized—not a blunder of hundreds of millions of dollars, but of billions.

The bargain price that Cerberus struck posed a rather optimistic prognosis for Chrysler. Former Treasury Secretary John Snow, Cerberus chairman, said: "There's a sense at Cerberus that U.S. manufacturing in general, and the auto industry in particular, continue to have a bright future, not only in America, but in the global economy." Others viewed saving Chrysler as a matter of national pride.[24]

Three days after closing the deal, Cerberus installed Robert Nardelli, a controversial former CEO of Home Depot, as Chrysler's chief executive. He was known for his dictatorial manner and huge pay package at Home Depot, but it paid off for Home Depot until the housing industry collapsed. At Chrysler, he would have challenges aplenty to occupy him. But he will also have one huge advantage he did not have at Home Depot. As a private company—Cerberus may take Chrysler public some day if Nardelli can rejuvenate it—major decisions that once took months to

[22] Stephen Power and Neal E. Boudetter, "Slide in Mercedes Performance Dent's Chrysler's Recent Revival," *Wall Street Journal,* February 9, 2005, pp. A1 and A6; and Steven Power, "DaimlerChrysler, VW Profits Rise, but Challenges Persist in the U.S.," *Wall Street Journal,* July 28, 2006, p. A2.

[23] Rick Popely, "Crisis at Chrysler after News of $1.5 Billion Loss," *Chicago Tribune,* as reported in *Cleveland Plain Dealer,* October 26, 2006, p. C3.

[24] Joann Muller, "Chrysler's Last Stand," *Forbes,* November 26, 2007, pp. 169–180.

make can now be made in minutes. Long-term decisions are now possible that would have been difficult to justify in an environment where stockholders punish companies for missing earnings projections by even a penny a share.

Nardelli quickly toughened Chrysler's quality standards, making senior engineers responsible and hiring a "chief customer officer," an industry first, to monitor quality assurance and be an advocate for the buyer. Under Daimler, cost-cutting was the emphasis, perhaps to not upstage Mercedes cars. Nardelli pounced on cheap-looking Chrysler vehicles with tacky plastic interiors. "It's an earth-shattering moment in time. We don't do expensive things," noted one Chrysler engineer.[25]

Invitation to Make Your Own Analysis and Conclusions

Could the early problems of the merger have been avoided? What are your recommendations?

WHAT WE CAN LEARN

Was the Flagrant Deception That This Would Be a Merger of Equals Unethical?

Outright deception and lies would seem the essence of unethical behavior, and perhaps illegal as well. It is when it comes to deceiving consumers. But in the hard negotiating climate of a merger, is a less truthful and trusting stance more the norm? Should we define ethical standards differently than when the hapless consumer is involved?

The situation is indeed different. The consumer is substantially disadvantaged before the greater product knowledge of the seller, and can easily be deceived by false claims. In a business-to-business situation, one would think that information would be shared equally, unless some fraud was involved. And even this should be uncovered if a careful audit was made before the transaction was finalized.

But verbal promises of sharing the administration? Even if written, such promises may be difficult to enforce. What does a "merger of equals" really mean: Is it "a genuine business model, or is it a takeover cloaked in the high-toned language of amity?" as Robert Bruner of University of Virginia's Darden Graduate Business School phrases it.[26]

Chrysler's top managers should have suspected that their position might be temporary. After all, there is precedence for top-management displacement in mega-"mergers of equals": for example, David Coulter of Bank of America, and John Reed of Citigroup, due to political infighting and disappointed expectations.

[25] *Ibid.,* p. 176.

[26] Robert F. Bruner, "A Merger of Equals?" *Wall Street Journal,* January 20, 2004, p. B2.

Mergers Are No Panacea

For years in recurrent cycles of exuberance and caution, businesses have tried to solve the problem of growth with mergers and acquisitions. What you didn't have you could acquire faster and better than developing it yourself, so the reasoning went. The term *synergy* became widely used, especially in the 1980s to tout the great benefit and advantages of such mergers and acquisitions. (The following Information Box describes this concept of synergy.)

Wall Street dealmakers, investment bankers, and lawyers reap the bonanza from merger activities, but many of these mergers do not work out as well as expected, and some are even outright disasters.

We have seen the cultural conflict in the DaimlerChrysler merger. But this is just one of the things that can go wrong. Many acquisition seekers are so eager to get the target company because it has strength in market share or access to strategic technologies, or because it will make their firm so much bigger in its industry (with all the prestige of large size for the executives involved) that they

INFORMATION BOX

SYNERGY

Synergy results from creating a whole that is greater than the sum of its parts, and thus can accomplish more than the total of individual contributions. In an acquisition, synergy occurs if the two firms, when combined, are more efficient, productive, and profitable than they were as separate operations before the merger. Sometimes this is referred to as $2 + 2 = 5$.

How can such synergy occur? If duplication of efforts can be eliminated, if operations can be streamlined, if economies of scale are possible, if specialization can be enhanced, if greater financial, technical, and managerial resources can be tapped or new markets made possible—then a synergistic situation is likely to occur. Such an expanded operation should be a stronger force in the marketplace than the individual single units that existed before.

The concept of synergy is the rationale for mergers and acquisitions. But sometimes combining causes the reverse, negative synergy, where the consequences are worse than the sum of individual efforts. If friction arises between the entities, if organizational missions are incompatible, if the new organizational climate creates fearful, resentful, and frustrated employees, then synergy is unlikely, at least in the short- and intermediate term. Furthermore, if because of sheer optimism or an uncontrolled acquisitive drive, more is paid for the acquisition than it is really worth, then we have a grand blunder. With hindsight, that was the case with the Chrysler acquisition, in addition to the culture problem. With the price that Cerberus paid for a wounded Chrysler, it is highly unlikely that the private equity firm paid too much.

Do you think a typical committee or group has more synergy than the same individuals working alone? Why or why not?

are prepared to pay well, and often too much. Funds for such borrowing are usually readily available, heavy debt has income tax advantages, and profits may be distributed among fewer shares so that return on equity is enhanced. But all too often the best of the acquired human assets are soon sending out résumés to prospective new employers, and the assimilation and effective consolidation of the two enterprises may be years away. Furthermore, acquiring companies may be left with mountains of debt from over-ambitious mergers and acquisitions, thus greatly increasing the overhead to cover with revenues before profits can be realized.

Cultural Differences Should Be Considered in Mergers and Acquisitions

Cultural differences in perceptions, customs, ways of doing things, and prejudices often are not given enough heed. The acquiring firm expects to bulldoze its culture on the acquired firm (despite how this may affect pride and willingness to cooperate). As we saw with the Daimler merger with Chrysler—in reality a merger of unequals—arrogance and resentments were enduring.

Should the acquiring company express its dominance quickly, or should it try to be as soothing as possible? Morale will probably not be savaged in a soothing takeover, but there can be serious problems with this approach also. Permitting an acquisition to continue operating with little control can be a disaster waiting to happen, especially if the acquisition is a foreign firm.

How Much Can You Trust?

Both parties to a merger negotiation may express a commitment to equality. But such lip service may prove a facade. Even if executive positions are as evenly balanced as possible, one person may be a more dominant personality than the other, perhaps by dint of bigger stock ownership. Consequently, the merger of equals becomes in name only, with any equal standing of the acquired firm existing only at the convenience of the acquirer.

The Danger of Cannibalization

Cannibalization occurs when a new product takes away sales from an existing product. This is likely to occur whenever a new product is introduced, but flooding the market with the old product just before a new model introduction, as Daimler pressured Chrysler to do, is asking for problems. DaimlerChrysler found that it took both massive rebates of the old models as well as substantial price reductions of the new ones to move the inventory—all this destructive to profitability. The same scenario has confronted computer makers and other firms at the cutting edge of new technology. When do you let go the old model without jeopardizing lost sales in the interim?

We do not advocate stopping production of the older model when the new model is first announced. But it seems judicious to reduce production in the months after the announcement. Then the newer, technologically advanced model should command a higher price than the older version. DaimlerChrysler's problems in 2000 were aggravated by the fact that the new models were not so much technologically superior as provided with expensive options that some buyers found not worth the extra money.

Let us not denigrate the desirability of cannibalizing. As products are improved, they should be brought to the marketplace as soon as possible, and not held back because there may be some cannibalization. The temptation to hold back is there, especially when the new product may have a lower profit margin than the product it is supplanting, perhaps because of competition and higher costs. Invariably, the firm that restrains an innovation because of fear of cannibalizing a high-profit product winds up making the arena attractive for competitors to gain an advantage. *Fear of cannibalization should not impede innovation.*

CONSIDER

Can you think of other learning insights?

QUESTIONS

1. Do you think Schrempp was wise to replace the top Chrysler executives? Why or why not?
2. How could Chrysler boss Robert Eaton have been so naive as to permit himself to be ousted from power in a negotiation that he actively campaigned for and accepted? Do you see any way he might have protected his position in the merger?
3. How specifically can a firm protect itself from the extreme risks of cannibalization?
4. Do you think the culture problems could have been largely avoided in this merger? How?
5. Dieter Zetsche was sent from Stuttgart headquarters to fix all-American Chrysler after the disastrous year 2000. On his first day in Detroit, he fired the head of sales and marketing. Discuss the advisability of such a quick action, considering as many ramifications and justifications as possible.
6. Evaluate the desirability of rebates rather than regular markdowns or price cuts.
7. Do you personally think the use of Mercedes parts in Chrysler vehicles would diminish the prestige of the Mercedes brand? Would it help Chrysler that much?
8. Do you think good times can ever be lasting in the auto industry? Why or why not?

HANDS-ON EXERCISES

1. You are one of Chrysler's biggest suppliers of certain parts. You are shocked at the decree by the new management of Chrysler that you must cut your prices by 5 percent immediately, and another 10 percent within two years. What do you do now? Discuss and evaluate as many courses of action as you can. You can make some assumptions, but spell them out specifically.
2. Place yourself in the position of Robert Eaton, CEO of Chrysler before the merger, and now "co-chairman" with Jurgen Schrempp. You have just been told that your services are no longer needed, that the co-chairman position has been abolished. What do you do at this point? Try to be specific and support your recommendations.
3. You are Steve Yokich, president of the United Auto Workers. You had initially endorsed the plans of Dieter Zetsche to cut costs severely, this including laying off 26,000 workers and closing six plants. You had been convinced that such downsizing was necessary to save Chrysler. Now many of your union members are storming about such arbitrary cuts. They are castigating you for supporting these plans, and you may be ousted. Discuss your actions.

TEAM DEBATE EXERCISES

1. In this case we have the great controversy of German top executives replacing American ones. Debate the desirability of such replacing versus keeping most of the American incumbents. I would suggest dividing up into two groups, with one being as persuasive as possible in arguing for bringing in fresh blood from German headquarters, and the other strongly contesting this. Be prepared to attack your opponents' arguments, and defend your own.
2. Debate the ethics of the flagrant deception by Daimler of this being a "merger of equals."

YOUR ASSESSMENT OF THE LATEST DEVELOPMENTS

Do you think Chrysler can again be a viable entity in the U.S. auto industry? Nardelli had a reputation for alienating employees at Home Depot. Do you think this will be a serious problem in his Chrysler tenure?

INVITATION TO RESEARCH

What is the situation with Chrysler today? Is Nardelli still chief executive? Have the Big Three U.S. automakers been able to counter the great inroads of Honda and Toyota? How does the future look for the U.S. firms? What ever happened to Jurgen Schrempp? To Deiter Zetsche? To Wolfgang Bernhard?