CHUKA UNIVERSITY
DEPARTMENT OF BUSINESS ADMINISTRATION
EXAMINATION FOR THE AWARD OF MASTER OF BUSINESS ADMINISTRATION
MBAD 881: STRATEGIC MANAGEMENT
STREAM: MBAD Y1S2
CASE STUDY

Article

How Chrysler marriage failed

By Jim Mateja, Tribune auto reporter (Chicago Tribune)

In the annals of automotive failures, most of the big, splashy mistakes involved individual cars -- Edsel, Pinto or several Cadillac bids to build an entry-level luxury car using a camouflaged Chevy.

Now comes a folly of greater magnitude, one not defined by cars but of a company, DaimlerChrysler. The nine-year, $36 billion "merger" of Chrysler and Daimler-Benz was dissolved Tuesday for a mere $7.4 billion.

Cerberus Capital Management is taking an 80.1 percent stake in the automaker for that amount. In doing so, Cerberus, which promised Monday to restore Chrysler "to the first ranks of the U.S. and global auto industry," will acquire responsibility for the Auburn Hills, Mich.-based company, its assembly lines and its daunting health and retirement liabilities. The deal for Chrysler marks the first time one of the Big Three domestic carmakers will be in the hands of private equity, which is in the midst of an unprecedented buyout binge in industries once thought untouchable only a few years ago.

Daimler will keep 19.9 percent and the hope of finding synergies that still haven't materialized.

"We obviously overestimated the potential of synergies," Dieter Zetsche, chief executive of DaimlerChrysler, said at a news conference Monday at the company's headquarters in Stuttgart, Germany. "I don't know if any amount of due diligence could have given us a better estimation in that regard."

There are those who say the merger, which faced significant cultural differences, was doomed from the start.

"You had two companies from different countries with different languages and different styles come together yet there were no synergies. It was simply an exercise in empire-building by Juergen Schrempp," said Dave Healy, analyst with Burnham Securities, referring to the then-Daimler-Benz chairman and why the merger failed.

"Basically Daimler has now paid Cerberus to take Chrysler off its hands," Healy said.

Monday's deal wasn't the way things were supposed to work out when Chrysler Corp. and Daimler-Benz exchanged vows nine years ago. The plan was for Chrysler to use Daimler parts, components and even vehicle architecture to sharply reduce the cost to produce future vehicles. But problems surfaced when Daimler's Mercedes-Benz luxury division, whose components Chrysler would use, was reluctant to share with its mass-market partner. In the end, all Chrysler got were some steering and suspension components, a transmission and a diesel engine and some purchasing deals.

In return, Daimler had hoped that Chrysler would dramatically increase its footprint in the promised land of auto sales -- North America. But thanks in large part to stiff competition from Asian carmakers, Chrysler fell short.

Kerkorian's role

The real impetus for the merger, however, may have been more elementary. At the time of the deal, billionaire investor Kirk Kerkorian was trying to gain control of the company. Then-Chairman Bob Eaton, determined not to let Chrysler fall into Kerkorian's hands, found Daimler-Benz instead.

Billed as a "merger of equals," the $36 billion deal turned out to be anything but, analysts said. Soon, control of the combined company fell to Daimler Chairman Schrempp.

"Eaton panicked," his predecessor, Lee Iacocca, said recently. "We were making $1 billion a quarter and had $12 billion in cash, and while he said it was a merger of equals, he sold Chrysler to Daimler-Benz, when we should have bought them."

And Daimler was an all-too-willing, if uninformed, partner, analysts said. The company underestimated the competitive forces that would invade the North American car market and take market share from the domestic carmakers.

"Due diligence? Daimler-Benz never did due diligence before it bought Chrysler, never looked into the future to see whether Chrysler could afford to be competitive with the others in the industry," insists George Peterson, president of Global Insight.

Chrysler sales skidded, prompting Daimler to dispatch Zetsche to Detroit in 2000 to turn the Chrysler Group around. Having returned Chrysler to profitability by the time he went back to head the parent in Germany in 2006, Zetsche said Monday that the sale "was a difficult task personally."

With Zetsche at the helm, Chrysler posted a $1.8 billion profit in 2005. But like other domestic carmakers, the company misread the market. With a heavy reliance on trucks and SUVs, skyrocketing fuel prices quickly dampened sales and Chrysler's profit melted into a $1.47 billion loss last year, culminating in Monday's announcement.

"When Zetsche left Chrysler to become chairman of DaimlerChrysler, it shouldn't have been news to him that Chrysler was headed for trouble," Peterson said. "Selling Chrysler Group now takes him off the hook."

Most of Cerberus' investment won't go to DaimlerChrysler, but to bolster Chrysler's auto making operations. Just over $1 billion has been earmarked for its financial-services activities.

"Our approach is fundamentally long term. We don't think about the next quarter. Our capital is patience," said Cerberus chairman John Snow. "We take a longer view. We're prepared to make investments that support management plans."

Pressure to perform

But analysts say that the pressure will be on Chrysler to perform.

"Cerberus' history is to make a 20 percent return on its investments annually. They won't treat Chrysler like a certificate of deposit," said Dave Cole, chairman for Center for Automotive Research.

And that may mean spinning off some of Chrysler's operations.

"They could break Chrysler up and spin off some parts, like its Jeep operations or its mini-van operations. I'm not saying they would, but they could," noted Peterson.

Zetsche insists Cerberus isn't committed to any changes in head count other than the 13,000 workers the automaker already said it needs to shed in three years.

"He says no head counts, but that's today. They still need to get $20 an hour out of the wages and benefits of their workers to be competitive," Healy said.

Cerberus' control, expected to be completed in the third quarter, also possibly opens the door for the return of Wolfgang Bernhard at Chrysler, analysts said.

Though Cerberus says it will retain Tom LaSorda as CEO, the private-equity firm hired Bernhard, who left the job of chief financial officer at Chrysler in 2004, as a consultant on the deal. Bernhard was most recently head of Volkswagen.