Case Study: DaimlerChrysler

Analysis of Post-Merger Integration and Strategic Position of Daimler AG

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I. Introduction

Amounting to $36 billion deal (Stertz & Vlasic, 2000) the merger of Daimler-Benz and Chrysler in November 1998 was considered the largest trans-Atlantic merger ever. The resulting corporation was equally stunning; DaimlerChrysler was the world’s fifth largest automobile manufacturer with $130 billion business, 442,000 employees (Finkelstein, 2002) and share value which climbed to a high $108.62 a few months after its stock was first traded (Schneider, 2001). Jürgen Schrempp, the Daimler’s CEO, called it a “wedding made in heaven” (Schneider, 2001). In other words, his vision of this new giant in auto industry was a corporation that would take advantage of synergy effects from two complementary merging companies.

However, the honeymoon phase was over after six months. On their closely-watched first quarterly earnings, the numbers were a massive disappointment. Contradict the company’s previous promise, its revenues rose ten percent in the second quarter to $38.5 billion but its profits were the same $1.53 billion (Stertz & Vlasic, 2000). The potential synergy savings between the two companies did not seem to take effect. As the consequence, DaimlerChrysler stock dropped $13 per share in two days, decimating over $10 billion in value (Stertz & Vlasic, 2000).

The subsequent years did not look promising for the merged companies either. The internal turbulence within the company and the disappointing integration profitability, most notably indicated by the declining share price, led to demerger in 2007. This paper attempts to analyze the successes and failures of post-merger integration and determines the significant factors that culminated to the separation of these two automakers. Additionally, the elements of a future strategy for Mercedes, one of Daimler AG automobile divisions, without Chrysler are identified by analyzing its strategic position in 2007.
II. Post-Merger Integration

According to Lasserre (2003) the quality of post-acquisition processes, such as integration framework, transition management and consolidation, is the most important source of success or failure of cross-border M&As. In DaimlerChrysler case, in terms of linear integration framework, the problem began with the vision of the new company. It was a broad strategic intent, and did not drive behavior or new corporate culture which was particularly essential in cross-border integration. And this effect is enhanced in the case of merger between two automakers because automobile is the source of pride and emotionally-charged product of industrialized nations (Schneider, 2001).

As for the change architecture, DaimlerChrysler integration council, automotive and non-automotive integration teams performed successfully. Lead by Schrempp, the sense of urgency and meticulous plans were emphasized and realized early on. It evidenced in its ability to accomplish $1.6 billion of integration benefit, surpassing the forecasted amount by $200 million (Paul, 2008).

However, the architecture for new company presented a challenge. The corporate structure and legal form of DaimlerChrysler were seen to be inclined toward the Daimler side. Furthermore, the abrupt change of direction from preservation to absorption mode following the disappointing first six-month earnings introduced another problem in the case of “merger of equals” as declared pre-merger. These were perceived as domination of Daimler in the new company and created a lot of tension in Auburn Hills, Michigan.

The excellent concord of the two co-chairmen, Robert Eaton and Jürgen Schrempp, played a role in the success of the integration teams. Leadership was established early on, with Schrempp took a more active role. However, in the ensuing phase of transition and consolidation, leadership vacuum existed in Chrysler-side. With Eaton’s withdrawal, Thomas Stallkamp, president of Chrysler, was in charge as the change agent at Auburn Hills. Following Stallkamp’s retirement, anxious of being seen as intrusive,
Schrempp left the lack of leadership and direction clarity for too long. During 1998-2001 periods, Chrysler was neither taken over nor granted equal status (Finkelstein, 2002). The anxiety and non-existent sense of purpose on Chrysler-side were not addressed properly, resulting in the departure of many key talents of the so-called ‘dream-team’ that had led Chrysler to its success in the 1990s (Schneider, 2001).

The mismanagement in the transition phase also precipitated internal and external communication problems. Schrempp’s confession to German’s Handesblatt which then translated and published at the Financial Times regarding his true intention of the merger sent the company into a major credibility setback. It intensified the uncertainties at Chrysler, ignited outrage in American media and lead to a failure of gaining the goodwill of various stakeholders, particularly in the United States, signified by Kirk Kerkorian $8 billion lawsuit (Schneider, 2001).

Cultural issues also were not resolved directly with a definitive plan. There were some problems concerning national culture differences, notably language which presented a barrier in communication. Surprisingly these did not seem to be the determinant factors in the failure of merger. The more important issues were the differences in corporate governance and cultures.

Daimler-Benz represented the more traditional corporation with tall hierarchical structure in contrast with Chrysler relatively flatter cross-functional structure which posed a problem in decision-making. The differences in compensation package manifested a more serious consequence. The combined salaries of the top 10 executives at Daimler-Benz amounted to $11 million, which was $5 million less than those of Chrysler’s top 5 managers whom also had the stock options they exercised in the aftermath of the merger (Schneider, 2001). Chrysler could not reduce its salaries or bonuses in order to retain its key talents. This issue created difficulties in balancing the compensation for executives in Auburn Hills and those performing the same job in Stuttgart. Additionally, the codetermination concept of corporate governance adopted at Daimler-side where employees and managers are treated equally
and are given equal voting was non-existent in the United States (Carpiaux, 2002). These clashes seemed to sharpen when the dominance of Daimler became apparent, which was perceived in the U.S. as an attempt to impose its thinking on Chrysler (Gulbro, Shonesy, & Valcana, 2007).

Additionally, the nonautomotive business of the old Daimler also posed a challenge for Chrysler side (Stertz & Vlasic, 2000). The lack of experience in these businesses and of business practice in Germany made it difficult for Chrysler executives to grasp some of the decisions by the new company. Schrempp’s bid to take over Nissan Motor Co. added the complications and created a rift between Schrempp and Stallkamp which culminated in Stallkamp’s retirement as mentioned previously.

III. Demerger

There were two key concerns preceding the demerger of DaimlerChrysler in 2007. The first issue was related to the insufficient synergy savings realized from the integration. The opposite brand images of Chrysler and Daimler-Benz and their respective product development philosophies resulted in a fundamental detachment in supply-procurement strategies and factory staffing requirements (Finkelstein, 2002). Due to the differences in brand disposition, distribution and retail sales systems of Daimler and Chrysler were mostly independent (Finkelstein, 2002). Dealers of Mercedes-Benz were disinclined to include Chrysler portfolio in their retail sales and this prevented its market penetration in Europe where Chrysler market share stalled at two percent (Finkelstein, 2002). This bias generated further synergy losses; for instance the loss of potential income generated by vehicles such as the Dodge Neon and the Jeep Grand Cherokee that were sidelined in favor of the less-cost-effective and troubled Mercedes A-Class compact and M-Class SUV (Finkelstein, 2002).

A more serious issue however, was Chrysler’s increasing inefficiency. By spring 2001, its production costs were too high; it introduced too few new products and lost its competitive advantage against Toyota, Honda and Volkswagen (Schneider, 2001). Declining demand in the U.S. market and the
associated overcapacity forced Chrysler to offer product incentives and rebates up to $4,000 per car, deteriorating Chrysler’s profitability further (Schneider, 2001). Meanwhile, the Japanese car imports and increased domestic competition threatened Chrysler’s market share, which was sunk from 16.2% in 1998 to 13.5% in 2001 (Finkelstein, 2002).

Chrysler continued losses nearly halved DaimlerChrysler net profit in 2000 (Carpiaux, 2002). By spring 2001, DaimlerChrysler stock price stagnated around $50 per share, meaning that the company was worth less than Daimler alone had been pre-merger; and this dire situation was made worse when Standard & Poor banished its stock from their S&P 500 (Finkelstein, 2002). Unlike the Mercedes-Benz and Smart Car divisions, which posted an operating profit of €830 million in Q3 2000 (Finkelstein, 2002), Chrysler’s profitability did not improve despite the subsequent restructuring efforts. Daimler recognized its declining stock price as a threat to its profitability and ultimately might expose Daimler to the possibility of a hostile takeover. Below is the overview of DaimlerChrysler/Daimler stock performance from 2000-2009:

*Figure 1. Daimler AG Stock Performance (OnVista Group)*
Closing year-end 2006 with €46.80 per share (Paul, 2008), a re-assessment of the business environment and a new strategic direction were of imminent importance for Daimler. Taking the external and internal factors of Daimler in 2007 into consideration, the SWOT analysis can be described as follows:

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Brand strength</td>
<td>• Declining stock price</td>
</tr>
<tr>
<td>• Engineering and R&amp;D Capabilities</td>
<td>• Dented image and credibility</td>
</tr>
<tr>
<td>• Capital Resource</td>
<td>• Chrysler’s turnaround difficulties</td>
</tr>
</tbody>
</table>

**Opportunities**
- Changing consumer’s buying habit: fuel-efficient, green technology
- Traditional core segment: Germany and Western Europe
- Interested party to buy Chrysler’s share
- Exploit engineering and R&D capabilities to develop fuel-efficient cars
- Reinforce brand strength and reputation by refocusing business on core segments
- Improve reputation and profitability by unloading Chrysler
- Unloading Chrysler to focus all resources to exploit fuel-efficient version for core segments

**Threats**
- Sluggish U.S. economy and increasing oil price
- Increasing competition in SUV and truck segments
- Vulnerability to takeover by competitors
- Loss of market share to Audi and BMW
- Use capital resource to eliminate acquisition risk
- Use Brand Strength and Engineering capabilities to regain market share
- Unload Chrysler to eliminate risk from sluggish US economy
- Focus to regain market share in core segment and minimize risk from increased competition in SUV

*Table 1. SWOT Analysis*
One of Daimler’s strengths is the brand value of its Mercedes-Benz cars which are associated with disciplined German engineering coupled with uncompromising quality consumers pay the premium for. Its superior engineering and R&D capabilities are indicated by the R&D costs for passenger cars, which pre-merger in 1997 amounted to 5.75% of its revenue (own calculation, based on (DaimlerBenz AG, 1997)). Capital resources available from Mercedes-Benz, Smart Car and non-automotive divisions are also identified as one of its strength with regard to its next strategic method. The weaknesses of Daimler are summarized from the two key issues described in previous paragraphs.

Rising oil price in 2007 led to a changing buying habit by consumers; they demand smaller and fuel-efficient cars. Increased environmental concerns also heightened the need for cars with green technology. The sluggish U.S. economy in 2007, combined with its automobile industry’s high volatility, compelled Daimler to reassess its priority in terms of growth. Positive economic growth in Germany and Western Europe compared to negative growth in the U.S. presented an opportunity to re-focus on Daimler’s traditional core segment (Daimler-AG, 2007); Europe represented 60.2% of Daimler’s total automobile revenues in pre-merger 1997 (DaimlerBenz AG, 1997).

From the analysis summarized in Table 1, adding the bids by Magna and Cerberus to buy Chrysler’s share as opportunity and loss of market share in traditional core segment to Audi and BMW as a threat, there are two points stand out for Daimler: unload Chrysler and re-focus on its traditional core segment. Market reacted positively, exhibited by the sharp increase of Daimler’s stock price following the demerger announcement, which settled at $95.63 per share at New York Stock Exchange and €66.50 per share at Frankfurt DAX by year-end 2007 (Paul, 2008). This sharp increase in its share price is quite impressive in comparison to its main competitor, BMW AG; the share price of the latter remained relatively constant in 2006-2007 period\(^1\).

\(^1\) See appendix for BMW Stock Performance
IV. Daimler AG Future Strategy

The demerger returned Daimler (Daimler AG post-demmerger) to its prior position. The analysis of Daimler AG strategic options is focused on its luxury vehicles segment. Competitive advantage as one of the bases of strategic choice in this segment is determined using VRIO model which is illustrated as follows:

<table>
<thead>
<tr>
<th>Resource</th>
<th>Valuable?</th>
<th>Rare?</th>
<th>Costly to imitate?</th>
<th>Exploited by the organization?</th>
<th>Competitive Implication</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advanced Patents</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>✓</td>
</tr>
<tr>
<td>Established customer base</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Partly</td>
<td>✗</td>
</tr>
<tr>
<td>High reputation</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>✓</td>
</tr>
<tr>
<td>Powerful brand</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>✓</td>
</tr>
<tr>
<td>Advanced R&amp;D skills</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>✗</td>
</tr>
<tr>
<td>Efficient production skills</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>✗</td>
</tr>
</tbody>
</table>

*Table 2. VRIO Model*

The advanced patents, high reputation and powerful brand are identified as intangible resources that give sustainable competitive advantage and therefore difficult and relatively costly for competitors to imitate.

The subsequent analysis on strategic directions is based on the Ansoff matrix and three options are identified: market penetration using existing products in current market, product development in
existing market and market development using existing products. As mentioned previously, Daimler AG unique resources and core competences enable the company to sustain and improve its competitive advantage in quality which is one of the key determinants for increasing market share (Johnson & Scholes, 1999). Daimler’s expertise in environmental-friendly automobiles also gives it an edge compared to muscle, gas-guzzling cars.

Product development is driven by innovation, in which Daimler AG is also best-known for. Fit-driven innovation based on changing consumer needs necessitates R&D efforts and creativity to develop alternative drive systems such as hybrid drive, fuel-cell drive, and the so-called DIESOTTO engines (Daimler-AG, 2007). Daimler AG’s innovation is also stretch-driven exhibited by its vehicles market success in terms of quality, customer satisfaction, customer perception and product appeal which it plans to utilize in order to continue growing in its traditional core segments and seize new market opportunities particularly in emerging markets (Daimler-AG, 2007). Table 3 summarizes the strategic directions of Daimler AG:
Table 3. Daimler AG Strategic Directions

<table>
<thead>
<tr>
<th></th>
<th>Environment</th>
<th>Capability</th>
<th>Expectations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Penetration</td>
<td>Gain Market share for advantages</td>
<td>Exploit superior resources &amp; competences</td>
<td>Better returns at low exploiting risk by current strategies</td>
</tr>
<tr>
<td>Product development</td>
<td>Adapt cars to changed demands due to increasing gas prices</td>
<td>Exploit R&amp;D</td>
<td>Better Returns at medium risk by exploiting current strengths or market knowledge</td>
</tr>
<tr>
<td>Market development</td>
<td>Concentrate more on emerging not yet saturated markets in e.g. in Asia</td>
<td>Exploit current products</td>
<td></td>
</tr>
</tbody>
</table>

To accomplish its strategic direction, Daimler AG opts for the internal growth and develops its strategies around its own resource base and competences; this strategy is particularly suitable for its luxury vehicles which are highly technical (Johnson & Scholes, 1999). Plus, by choosing to grow organically, Daimler AG can spread the high development costs favorably and realistically and reduce disturbance to its other activities.

V. Conclusion

Cross-border M&As are one of the poorly understood phenomena in business world (Schneider, 2001). The internal turbulences of two merged companies increase significantly in the case of a merger between two automakers (Schneider, 2001) as exhibited by DaimlerChrysler. Corporate culture clash between the two companies with different business management and production philosophies were not
managed properly. The boom in highly volatile automobile industry in the U.S. led Daimler-Benz to overestimate the potential of the merger which ultimately resulted in their separation in 2007. It appeared to be the right decision for Daimler AG, as it managed to boost its credibility and profitability reflected in its share price right after the demerger. Internal growth also seemed to be the most viable option for Daimler AG in 2007. Further study is required to determine the growth and profitability of Daimler AG by pursuing this strategy with more recent data, particularly in light of recent recession.
Bibliography


Appendix

Figure 2. BMW AG Stock Performance (OnVista Group)