How Daimler, Chrysler Merger Failed

By: Lauren Woods

Automotive records reflect that most of the failures in the industry involved individual vehicles. But at present, a failure of more intense magnitude because it is one defined by a company not just car, has shocked the industry. The news came like a bomb especially for the workers of the ailing American automaker. Even the Stillen cold air intake could not circumvent the heat of the matter.

The nine year mergence of the auto giants has come to a halt through the Cerberus Capital Management's acquisition of an 80.1 percent stake in Chrysler. The New York-based private equity firm promised Monday to restore Chrysler "to the first ranks of the U.S. and global auto industry."

Daimler will keep 19.9 percent stake and find synergies that still have not occurred. "We obviously overestimated the potential of synergies," Dieter Zetsche, the 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."

The acquisition of Chrysler marks the first time one of the Detroit Big Three automakers will be in the hands of a private equity firm. As such, the circumstance has drawn a number of interpretation and analysis. 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, an 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 added.

Originally, 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 averse to contribute to Chrysler. Eventually, all Chrysler got were some steering and suspension components, a transmission and a diesel engine and few packages.

In return, Daimler had hoped that Chrysler would radically raise its standing in the North American auto market. But due to tough competition from Asian automakers, Chrysler fell short. Billed as a "merger of equals," the $36 billion deal turned out to be anything but, analysts said. Shortly, control of the combined company fell to Daimler Chairman Schrempp.

"Eaton panicked," Lee Iacocca, said. "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 underrated 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," stressed George Peterson, the president of Global Insight.

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

With Zetsche at the helm, Chrysler reported a $1.8 billion gain in 2005. But like other Detroit automakers, 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 will not go to Daimler but will be used to bolster Chrysler's operations. Just over $1 billion has been allocated 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."

But analysts said that the pressure will be on the Auburn Hills, Mich.-based automaker 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, the chairman for the 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," said Peterson.

Zetsche noted that Cerberus is not 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 over Chrysler is expected to be completed in the third quarter. Analysts said that the situation could possibly open the door for the return of Wolfgang Bernhard at Chrysler. Though Cerberus said 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 AG.