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DaimlerChrysler's Jürgen Schrempp — time to backtrack?

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Daimler's Chrysler Problem

By **Christopher Whalen**

After much trepidation, Vivendi Universal has finally bitten the bullet — and decided to sell its Universal Entertainment unit to General Electric. With this step, the unraveling of some of the mega-mergers of the late 1990s and early 2000s boom has started. The question is: Who will be next? Chris Whalen explains why it may well be DaimlerChrysler.

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The prospective agreement by Vivendi Universal to sell its Universal Entertainment unit to NBC, a unit of General Electric Co., provides an abject lesson in how not to run an auction.

Merger mania

Vivendi is selling an asset that it bought too dearly for a price that will bring little joy to the company's shareholders. The sale is about closure, not profit. And about getting rid of an asset that has become a distraction — and a liability.

The real problem facing Daimler in its Chrysler unit is that it represents excess capacity in the U.S. market.

Few things in life are ever certain, but one thing that's pretty sure is that Vivendi's adventure in media and beverage ownership was an enormous financial mistake.

It is a well-accepted fact that most mergers of large companies destroy — rather than create — value for shareholders. The only ones providing

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strong justifications for such ventures are advanced by love-struck managers — as well as the bankers, accountants and lawyers who enable them.

And then there were none?

With the conclusion of the Vivendi saga, the next case that may show the dangers of the global M&A game is the 1998 merger between Chrysler Corp. and Daimler of Germany. The deal appears set to unravel.

Just imagine Daimler's Jürgen Schrempp as Vivendi's ex-chief Jean-Claude Messier — and you get the idea. Recall that six would-be suitors began the auction process for Vivendi Universal, but just two remained when Liberty Media withdrew in August.

More than a merger

The hype that resulted from the value supposedly created by the acquisition of Chrysler was almost as overblown as the claims regarding the prospects of Vivendi as an entertainment company.

Had Chrysler not received a federal bailout — it might have instead been absorbed by perennial #2 Ford.

In May 1998, Schrempp declared: "This is much more than a merger. Today, we are creating the world's leading automotive company for the 21st century."

"We are combining the two most innovative car companies in the world. And I want to add this is the largest and biggest industrial merger ever."

The Chrysler conundrum

Yes, it was a big merger — and Daimler was clearly the buyer. But, five years later, it has turned into a big mess for the Stuttgart automaker. Chrysler is generating more losses — and is continuing to lose market share under sometimes uncertain direction by Daimler managers.

Meanwhile, the financial press is talking about further cost cuts to help get Daimler's Chrysler

unit back into the black – but more than just further job cuts may be required to stop the bleeding.

Toyota's growing lead

There has already been speculation among Wall Street analysts that Daimler might put its U.S. unit through a bankruptcy — primarily in order to restructure its costs.

The great German automaker faces the task of finally liquidating this moribund asset — either through a restructuring or slow liquidation disguised as “cost cutting.”

But after such a radical move, what would be left of Chrysler? The smallest of the “Big Three” U.S. automakers only makes about one quarter of the components that go into its cars.

Chrysler was surpassed in sales during August 2003 by Toyota, which is slowly but surely becoming the third-largest domestic car and truck manufacturer in North America.

Not enough Daimler?

The real problem facing Daimler is that Chrysler represents excess capacity in the U.S. market. In 2003, total U.S. sales could reach 16 million units — but there is enough capacity now to produce 2-3 million more units.

Both Toyota and Nissan are aggressively adding more production facilities, while Ford and Chrysler are down-sizing.

U.S. government to the rescue

In 1980, Ford's then-Chairman Philip Caldwell publicly poured water on an opportunity to acquire Chrysler, a move that would have greatly changed the face of the U.S. auto market.

At the time, Ford was a financial basket case as well, called derisively “Chrysler II.” The opportunity passed. No small part of the

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antipathy to the merger was the break between Henry Ford II and former Ford President Lee Iacocca.

Inc. in North America by the year 2000 — and he is not far from being correct.

Led by Mr. Iacocca, Chrysler was bailed out by the U.S. government in 1981, keeping the company alive another two decades — until it was merged into Daimler. While Mr. Iacocca took many of Ford's best managers with him to Chrysler, the basic business was in shambles. And it never recovered market share or long-term profitability.

Missed opportunities

Had Chrysler not attracted Lee Iacocca from Ford — and thereby received a federal bailout — it might have instead been absorbed by perennial #2 Ford.

Lee Iacocca said in his 1984 autobiography that "a merger between Ford and Chrysler is probably the single most dramatic action that could be taken to strengthen the American automotive industry vis-à-vis the Japanese." The logic here: Reduce capacity — and cost.

Cutting costs

The sad fact is that, five years ago, Mr. Schrempp bought the least competitive auto production capacity in the North American auto market. Over that period, the Daimler brand has gone mass market, registering falling consumer ratings, profitability — and product quality.

Now, the great German automaker faces the task of finally liquidating this moribund asset — either through restructuring or slow liquidation disguised as "cost cutting."

Tough morals to swallow

The moral to this story of another big acquisition gone bad is especially bitter for Daimler. The up-market, luxury automaker bought a down-on-its-luck mass market brand in a bid to bulk-up. It aimed at joining the survivors of the global auto industry.

The industry is engaged

Over the last five years, the Daimler brand has gone mass market, with falling consumer ratings, profitability — and product quality.

in a vicious game of musical chairs that is eventually forcing the weaker brands into a few larger groups.

Twenty years ago, Mr. Iacocca believed it would be GM vs. Japan Inc. in North America by the year 2000 — and he is not far from being right.

Second-rate mistake

As it extricates itself from the Chrysler merger, Daimler might do well to consider the example of Toyota — going up-market, not down. Combining the world's great automotive brand with a second-rate player like Chrysler was a huge strategic error.

Next time the management board of Daimler gets the urge to merge, they would do better to ask one of their automotive cousins in Germany to lunch instead.



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