

Corporate Governance and Communications Transparency in the DaimlerChrysler Post-Merger Era

Robert LoBue

Reutlingen University

Abstract. This case study concentrates on comparing the German and U.S. corporate governance systems using the recent experiences of DaimlerChrysler AG and its chairman, Jürgen Schrempp, as reported in the international business press to illuminate differences in investor relations communications practices, in particular. The recent experience of DaimlerChrysler, because of its highly visible role as a “trailblazer” in the U.S. financial markets and due to the difficulties it has encountered, presents an excellent example for analysis of the governance issues inherent in a German-American direct foreign investment situation. Gaining a better understanding of the problems encountered by DaimlerChrysler should allow European business leaders to proactively design their own communications strategy including identifying potential pitfalls for their firms. Without this understanding, European firms could be discouraged from continuing to take advantage of the benefits of international financing and investment available from capital sources in U.S. stock and bond markets and business expansion opportunities in the U.S. product and service markets.

Keywords: corporate governance, investor relations, shareholder lawsuit, DaimlerChrysler, disclosure and transparency, merger of equals, board of directors.

1. The DaimlerChrysler “Merger of Equals”

1.1. Current Situation

In early 2003, the world business press reported on the dramatic financial and operational turnaround of the Chrysler Group of DaimlerChrysler AG under the leadership of German executive Jürgen Schrempp, chairman of DaimlerChrysler.¹ After six consecutive quarters of operating losses totaling about \$3.5 billion, excluding one-time charges, Chrysler announced that it had finally achieved an operating profit in all four quarters of the prior calendar year, totaling over \$1.3 billion. However, the press simultaneously reported that a “Time Bomb” threatened DaimlerChrysler’s future results.² A \$1 billion

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1. Alex Taylor, “Just another sexy sports car? Sure. But it’s also a whole new way of doing business at Chrysler”, *Fortune Europe Edition*, Vol. 147 No. 5, March 17, 2003, pp. 30-33.
 2. Dietmar Hawranek, “Zeitbombe in Delaware”, *Der Spiegel*, 12/2003, pp. 84-86.

lawsuit brought against DaimlerChrysler executives by its third largest shareholder, American “corporate raider” Kirk Kerkorian, Chrysler Corporation’s largest investor from the pre-merger period, was scheduled to come before the U.S. federal court in the state of Delaware.

This situation has been portrayed, as shown below, by the editorial cartoonist of a major newspaper serving the Detroit metropolitan area, home of DaimlerChrysler’s American headquarters at Auburn Hills, Michigan.³ Although the challenge of the Kerkorian caricature on the left side of the cartoon is genuinely playful and humorous in its outlook on the situation, the box on the right forebodingly suggests a serious entrenched incompatibility of German and American business cultures. The efforts of creating a single corporate culture in one of the world’s largest enterprises after years of post-merger integration activities are apparently at risk of being undermined by national allegiances and incompatible styles.



1.2. Expectations and Fall-Out of Merger-Related Events

Following a very turbulent period of at least a dozen years where the company found itself twice on the brink of financial disaster, by the mid-1990’s

3. Mike Thompson, Detroit Free Press, November, 2000.

Chrysler had developed into what many industry watchers considered the most profitably run company in the American automobile industry. Chrysler had invented the minivan concept with its highly successful Dodge Caravan and Plymouth Voyager models in the USA and created the sport utility vehicle (SUV) category with its Jeep division (obtained in its 1980's acquisition of AMC – American Motors Corporation). Chrysler had far less success, however, with its standard family oriented automobile brands, a weakness that still left it vulnerable to acquisition. In 1995, Mr. Kerkorian launched a takeover attempt through his investment firm, Tracinda, which was rebuffed by Chrysler's board of directors and management under the leadership of chairman, Robert Eaton.

Also in 1995, representatives from Daimler-Benz AG, headquartered in Stuttgart, Germany, whose new chairman was Mr. Schrempp, met with Chrysler to explore the possibility of a merger between the two companies. Daimler-Benz, like Chrysler, enjoyed one of the industry's highest rates of profitability stemming from its worldwide reputation of excellence in engineering and production of its high quality mid-size and full-size Mercedes-Benz luxury sedans. Daimler-Benz was planning for the introduction of a new line of more affordable family sedans, the 'A' series, and for a new mini category concept, the 'smart' car, in Europe. In anticipation of the widely predicted consolidation of automobile industry competitors worldwide,⁴ Mr. Schrempp became concerned about Daimler-Benz' limited future if it could not achieve substantially greater economies of scale.

In the same year, the Private Securities Litigation Reform Act of 1995 was enacted. The legislation was a major corporate governance event in the USA, amending both the Securities Act of 1933 and the Securities Exchange Act of 1934. The new law intends to protect executives by providing a "safe harbor" to those who make "forward-looking statements" about impending transactions from frivolous lawsuits based solely on the fact that future results differ from expectations set by those statements. It encourages company managers like Mr. Schrempp to be open in disclosures and to favor transparency when discussing material events, such as impending mergers, by defending them from having their own honest and forthright statements from being used later against them maliciously in court.

Following three years of off-and-on meetings spanning from preliminary discussions through detailed negotiations, in 1998, Mr. Schrempp and Mr. Eaton announced their intention to merge their businesses through an exchange of stock. They promoted this monumental event as the largest

4. Ralf P. Brammer, "Erfahrungen mit Investor Relations eines internationalen Konzerns am Beispiel der DaimlerChrysler AG", *Die Praxis der Investor Relations*, Klaus Rainer Kirchhoff and Manfred Piwinger eds. – Neuwied, Kriftel: Luchterhand, 2000, p. 256. In 1960 there were 42 automobile manufacturers worldwide, by 1998 there were only 17, with signs of further consolidation coming.

merger transaction of two organizations in industrial history,⁵ with the main strategic vision of becoming no less than the largest player and the clear leader in innovation in the worldwide automotive sector. To illustrate the total size of the proposed merged entity and relative sizes of the two companies, the following pre-tax pro forma statement of income (profit and loss) has been summarized from information that was presented in the merger prospectus.

DAIMLERCHRYSLER AG
UNAUDITED PRO FORMA STATEMENT OF INCOME
For the Year Ended December 31, 1997
(in millions)

		<u>Historical</u>			Pro Forma	Pro Forma	
		<u>Daimler-Benz</u>	<u>Chrysler</u>		<u>Combined</u>	<u>Combined</u>	
Revenues.....	DM	124,050	DM	105,205	DM	229,255	\$ 127,131
Cost of sales		<u>(98,943)</u>		<u>(84,879)</u>		<u>(183,822)</u>	<u>(101,936)</u>
Gross margin		25,107		20,326		45,433	25,195
Selling/admin/other expenses		(17,433)		(9,703)		(27,136)	(15,048)
Research and development		(5,663)		(2,972)		(8,635)	(4,788)
Other/financial income...		2,238		251		2,489	1,380
Income before income taxes....		<u>4,249</u>		<u>7,902</u>		<u>12,151</u>	<u>6,739</u>

Notes: Currencies are DM = German Marks and \$ = U.S. Dollars. Pooling of interests assumed.
Source: Chrysler Corporation Proxy Statement/DaimlerChrysler AG Prospectus, 1998, p.110.

In April, 1998 the law on control and transparency in business (known as the “KonTraG”⁶) was enacted in Germany, supplementing previously introduced related legal initiatives including the German Stock Corporation Act, German Securities Trading Act, German Commercial Code, German Antitrust Act, and the German Banking Act. The German Panel on Corporate

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5. “The Merger of Daimler-Benz and Chrysler”, http://www.daimlerchrysler.com/investor/merger/merger_e.htm, 1998, p. 1.
 6. “Control and transparency in business (KonTraG): Corporate governance reform in Germany”, www.bmj.bund.de/misc/e_kont.htm, 1998, pp. 1-5.