The Daimler/Chrysler Merger: the involvement of the boards

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In the final stage of the merger negotiations [with Chrysler Corporation], a maximum of 20 to 30 employees were involved.

Jürgen E. Schrempp, former CEO of Daimler-Benz AG, now co-chairman of DaimlerChrysler AG[1] after completing the $40 billion merger with Chrysler in only four months.

On May 7, 1998, at a press conference in London that had been called on very short notice, the CEOs of Daimler-Benz AG and Chrysler Corporation, Jürgen Schrempp and Robert Eaton, announced that their two companies had decided ''to get together in a merger of equals.''

The combined company would have $132 billion in annual revenues; it would be the fifth largest automaker in the world, employing 428,000 people – about one-half in Germany, one-third in North America, and the rest spread across 200 countries around the world. Although it was the largest industrial merger the world had seen to that date, the announcement took most observers by surprise. Negotiations had been conducted under strict secrecy, with only a very limited number of persons from each company involved.

At the London press conference, both CEOs explained the rationale for the merger. In their opinion, both companies were too small on a global scale to prosper in the long-term. This handicap, they felt, could be overcome by joining forces; their product ranges and geographical reach made the two enterprises near perfect partners (*refer to Figures 1 and 2*). At the press conference, the CEOs also publicly announced as one of their guiding principles that this move would be ''a merger of growth; there will be no layoffs.'' They also stressed their determination to increase shareholder value, to obtain $1.4 billion in savings during the first year of the merger, and to complete the integration process within three years.

After the dust of this ''big bang'' had settled, some of the details of the merger's secretive preparation became known. The marriage had indeed had a most interesting courtship.

Mercedes-Benz AG: too small?

After taking over as CEO of Daimler-Benz AG in 1995, Schrempp implemented a number of far-reaching changes. Severe operational inefficiencies, caused by loss-making units acquired since the mid-1980s, had led to the largest corporate financial loss in German history. The company sold or liquidated 12 of its either unprofitable or non-core subsidiaries. Schrempp saw himself as a protagonist for shareholder value, and in response to the loss, he initiated a cultural change program in order to make the employees in Daimler-Benz pay more attention to profitability. One of the arguments for stressing shareholder value was the fact that the shares of Daimler-Benz had been introduced on the New York Stock Exchange in 1993, a first for German industry. To take advantage of this move, the company not only had to publish its results according to US-GAAP, it also had to live up to the

* Research Associate Georg Rädler developed this background note under the supervision of Professors Fred Neubauer and Ulrich Steger as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

expectations of the international investor community with respect to the return on the Daimler-Benz shares. The restructuring efforts paid off, and Daimler-Benz was finally out of the negative news. The rather spectacular turnaround substantially strengthened Schrempp's position in the company and vis-à-vis the board.

Putting the company's house in order was necessary, but it was by no means sufficient. Schrempp saw that further consolidation in the automotive industry was inevitable, in spite of the fact that his company was the most profitable company in the entire industry. He and his colleagues were concerned about the growth limitations of Daimler-Benz's passenger car division with basically one brand, "Mercedes-Benz," in the premium sector (*refer to Figure 3*). The car-making division of Daimler-Benz AG manufactured Mercedes-Benz. The Mercedes-Benz brand was also used for commercial vehicles. In 1997, Schrempp commissioned, in addition to internal strategic studies, a study by an investment bank of ways this weakness might be remedied. The investment bankers suggested Chrysler and Honda Motors as potential complementary partners, particularly on the basis of their product mix and geographic coverage. Since Honda was not considering giving up its independence, Schrempp pushed the idea of joining forces with Chrysler Corporation. Already back in 1995, both firms had evaluated the possibility of establishing a separate company to market cars outside their home markets in Europe and the US. A total of 30-plus taskforces had been evaluating ways to achieve that goal. The proposed joint venture, code-named Q-Star, had stopped before it got off the ground. Neither company could agree on personnel and financial issues. Instead, they had agreed, as Schrempp put it, to "be friends."

Same procedure as every year: contacts at the Detroit Auto Show

When Schrempp went to the North American International Auto Show in Detroit in January 1998, his official reason was to make a speech on the future challenges of the automotive industry.

Besides delivering his speech, Schrempp contacted Robert Eaton, the chairman of Chrysler Corporation. Chrysler was not a stranger to Schrempp. From the previous

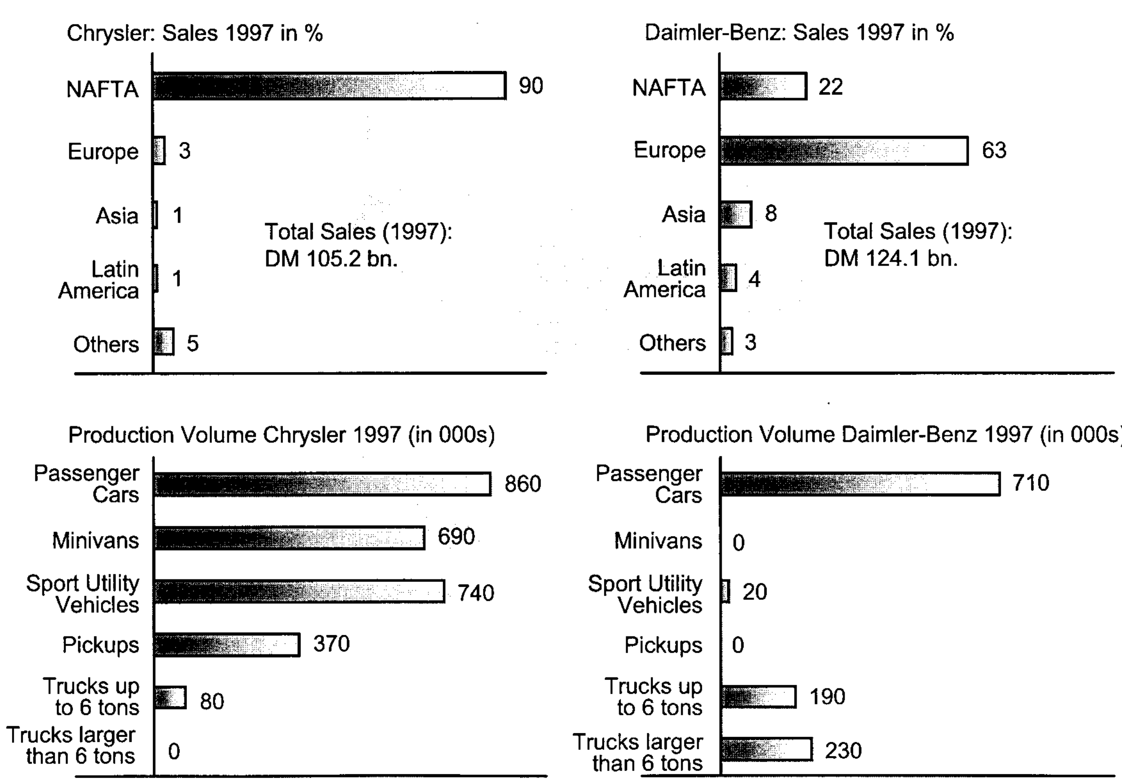

Figure 1. Geographic spread of Chrysler Corporation and Daimler-Benz AG
Source: DaimlerChrysler AG

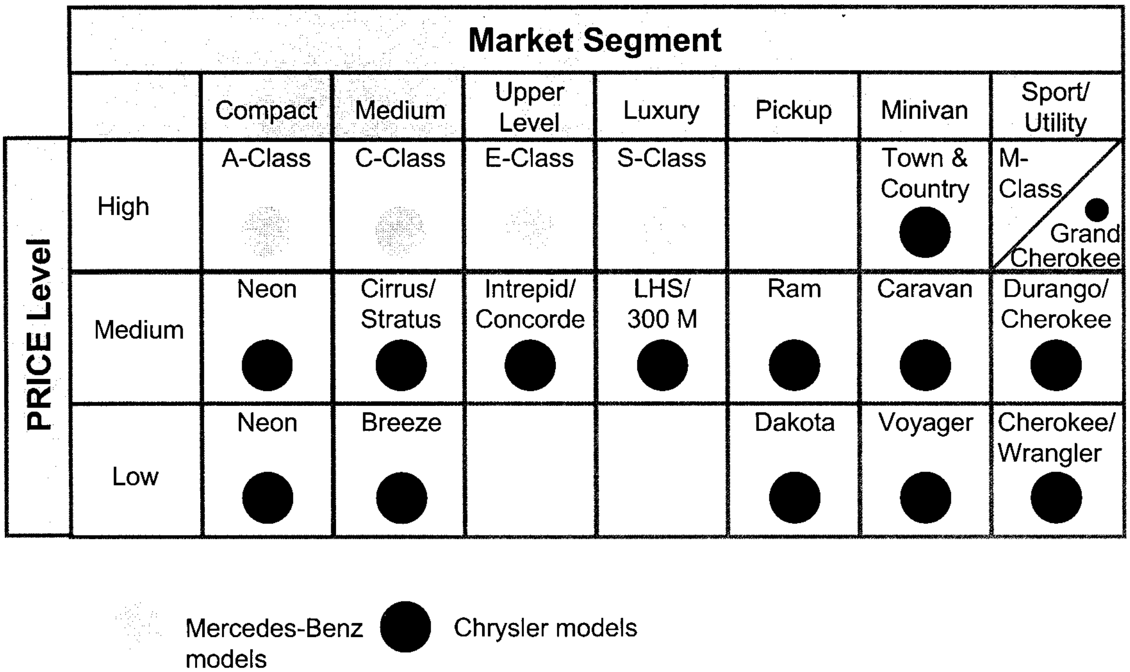

Figure 2. The combined product portfolio of DaimlerChrysler AG
Source: DaimlerChrysler AG

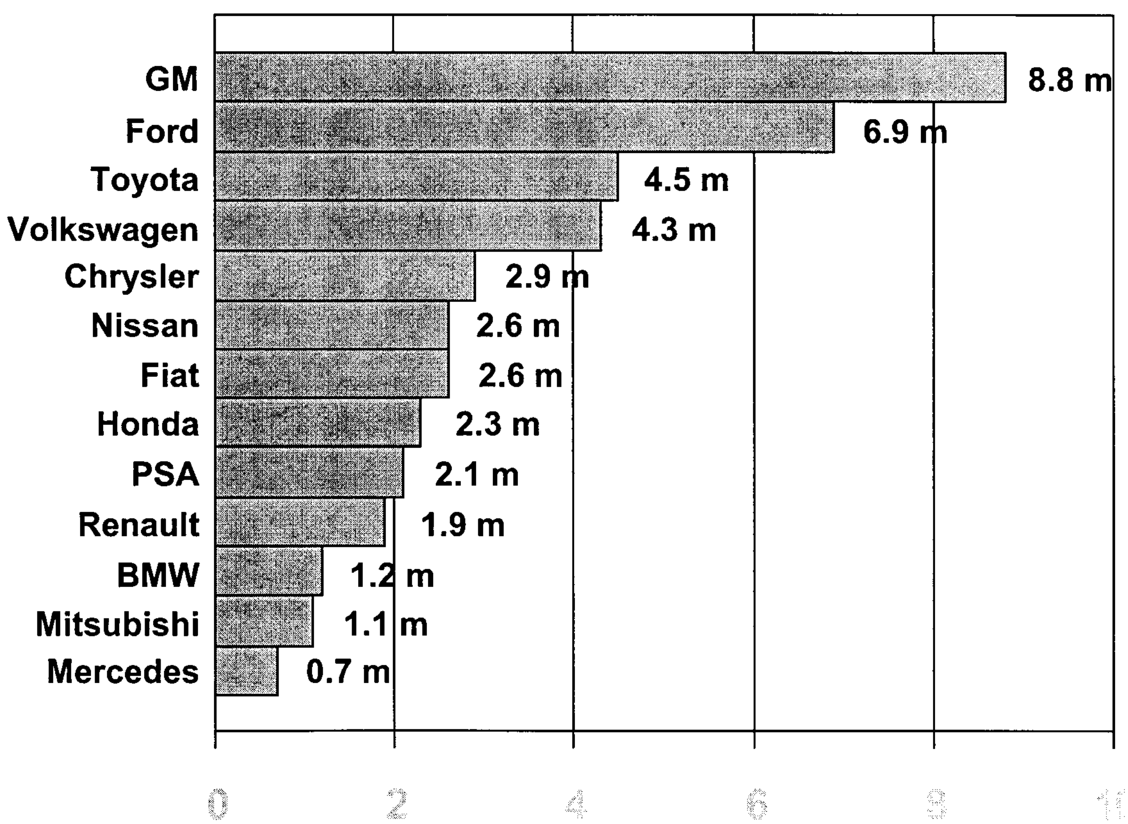

Figure 3. The Global Players in the Automotive Industry 1997 Annual Sales of Passenger Cars (in million units)
Source: Deutsche Bank AG

abortive round of discussions, Schrempp had gotten the clear impression that Chrysler, as the smallest of the ''Big 3'' automakers, also had concerns about its size relative to General Motors and Ford. Schrempp decided he would suggest an outright merger with Chrysler.

The initial meeting between Schrempp and Eaton in January 1998 lasted 17 minutes, and Eaton promised to let Schrempp know within a few weeks his reaction to the idea of a full-fledged merger. Adds a source close to Schrempp:

> Eaton was obviously well-prepared. He had done similar studies as Schrempp, and he knew that although Chrysler was highly profitable, it was still too small and too domestic compared to its competitors. They did not have to convince each other anymore–the writing was on the wall.

''The deal these guys pulled off was on nobody's radar screen before the news broke.''

Only a few days after their initial meeting, Eaton called Schrempp and expressed his interest in further talks about the possible merger. As he was afraid of leaks – ''we were worried that if word leaked before most of the details were worked out, it might have fallen apart'' – Schrempp initially informed only two executives about the talks: Dr. Eckhard Cordes, the member of the management board who was responsible for corporate development and directly managed businesses and Dr. Rüdiger Grube, senior vice-president of corporate strategy and planning (a close associate of Cordes). At that point, Schrempp, Cordes and Grube were the only three who knew about the intended deal at Daimler-Benz. As the talks continued, secrecy became an obsession. Soon afterwards, Cordes became the key dealmaker behind the merger.

On February 12, 1998, the first meeting between Schrempp, Cordes, Eaton and Gary C. Valade, CFO of Chrysler, took place. The discussion focused on the state of the industry as well as possible synergies that might result from combining the companies. Potential economies of scale were discovered in R&D, purchasing and manufacturing.

At the same time, Ford also approached the Stuttgart-based company regarding a closer co-operation. On February 13 and 14, 1998, Cordes, Jürgen Hubbert, management board member and head of Mercedes-Benz passenger cars, and Dr. Dieter Zetsche, management board member for sales and distribution, flew to London where they were confronted with the idea of a possible merger. Ford was actively trying to expand its share of the premium market, and Alex Trotman, Ford's CEO, later visited Schrempp in Stuttgart to disclose that the proposed merger could no longer be pursued due to the veto of the Ford family. At this point, the merger talks with Chrysler were quite far along.

External advisors enter early

On February 17 and 18, the representatives of Daimler-Benz and Chrysler met again. This time, Daimler-Benz was represented by Cordes and Grube and representatives of Goldman Sachs, the investment bank. Chrysler was represented by Valade, Thomas P. Capo (vice-president and treasurer) and William J. O'Brian (general counsel of Chrysler). Credit Suisse First Boston (CSFB) acted as financial advisor to Chrysler. In addition, corporate lawyers were involved.

In these discussions, the representatives of Daimler-Benz stated that:

> ...it was important to Daimler-Benz that any potential transaction maximize value for its stockholders, that it be tax-free to Daimler-Benz's German stockholders and tax efficient for DaimlerChrysler AG and that the surviving entity of any combination be a German stock corporation. (DaimlerChrysler AG prospectus, page 47.)

Chrysler stated its strategy in a similar fashion:

> ...it was important to Chrysler that any potential transaction maximize value for its stockholders, that it be tax-free to Chrysler's US stockholders and tax efficient to DaimlerChrysler AG, that it have the post-merger governance structure of a ''merger-of-equals'' [this was essential for saving tax on goodwill]. (DaimlerChrysler AG prospectus, page 47.)

During these meetings, various tax, corporate and management issues were discussed.

The Geneva Auto Show in early March 1998 was a good opportunity for the chief executives of both companies to meet again. During the meeting at a restaurant in neighboring Lausanne (secrecy was still a major issue), Schrempp and Eaton, accompanied once again by Cordes and Valade, looked at corporate governance and organizational structures. In order to avoid massive tax bills, it soon became very clear that locating the merged company in Germany was the only option for Chrysler's American stockholders and Daimler-Benz's German stockholders.

At this point a limited number of small working teams were established. They worked intensively on the key issues during March 1998. These teams were supervised by Cordes and Valade.

Involvement of the boards

According to the classical corporate governance doctrine, the board has the ultimate responsibility for the company. The approval of the boards of both companies to a step as massive as the merger was therefore eventually necessary.

The way both CEOs managed the timetable of the approval process and the degree of involvement of their respective boards shed an interesting light on the corporate governance practices in the US and in Germany. (*Refer to Figure 4 for the different timelines according to which both companies proceeded in getting the approval of the merger plans from the appropriate bodies. Note: Please keep using Figure 4 as a reference while reading the following paragraphs.*)

The involvement of the Chrysler board

Before looking into the details of the involvement of the Chrysler board in the merger decision, a few general remarks on US corporate governance practices are appropriate.

As a typical US corporation, Chrysler had been run by a so-called ''unitary board.'' This meant that the Chrysler board was composed of executive and non-executive board members. In the case of Chrysler, Robert Eaton and Robert A. Lutz were the executive directors; in addition, there were ten non-executive directors on the board. Members came from industry and finance, and many of the companies they came from represented ''household names'' in US business (*refer to Figure 5 for a list of board members*). As is typical for many US companies, the position of the chairman of the board and the chief executive was held by the same person: Robert Eaton.

US board members are elected by the shareholders annually; they can be re-elected until they reach the age of 70, typically the retirement age for board members.

In a litigious society like America, it should come as no surprise that US board members are under substantial threat of law suits by

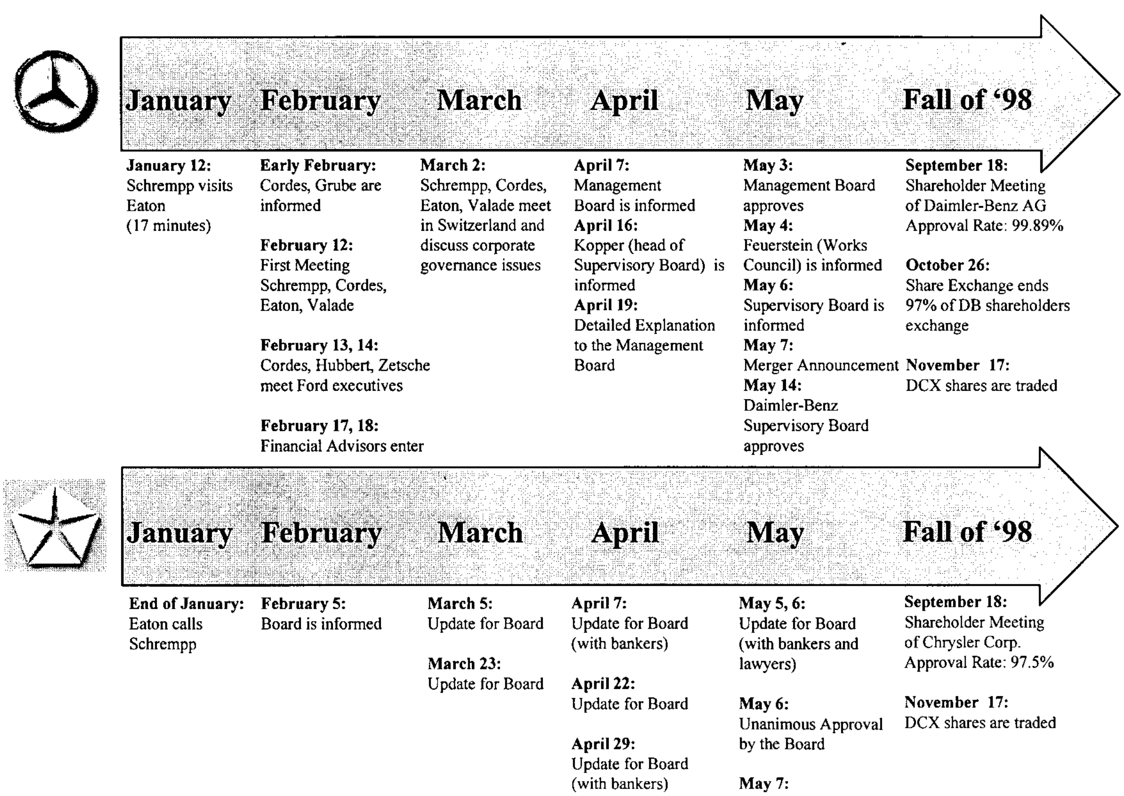

Figure 4. Timeline of the DCX Merger in 1998
Source: DaimlerChrysler AG Prospectus, Company Sources

CHRYSLERBOAR

Mrs. Lilyan Affinito (1982)
Former President of Maxxam Group Inc.

Additional Board Seats:
Caterpillar Inc., Jostens Inc., Kmart Corporation

Mr. James D. Aljian (1996)
Executive of Tracinda Corporation

Additional Board Seats:
MGM Grand Inc., Metro-Goldwyn-Mayer Inc.

Mr. Robert E. Allen (1994)
Retired Chairman of the Board and CEO of AT&T

Additional Board Seats:
Bristol-Myers Squibb Co., Pepsico Inc.

Mr. Joseph Califano, Jr. (1981)
Chairman & President of the National Center on Addiction and Substance Abuse at Columbia University
Additional Board Seats:
Authentic Fitness Corporation, Automatic Data Processing Inc., Health Plan Services Inc., Kmart Corporation, Travelers Group Inc., Warnaco Inc.

Mr. Robert J. Eaton (1992)
Chairman of the Board and CEO of Chrysler Corporation

Additional Board Seats:
International Paper Company

Mr. Earl G. Graves (1990)
Chairman and CEO of Earl G. Graves

Additional Board Seats:
AMR Corp., Aetna Life & Casualty Company, Federated Department Stores, Rohm & Haas Corporation

Mr. Kent Kresa (1989)
Chairman, President and CEO of Northrop Grumman Corp.,

Additional Board Seats:
Atlantic Richfield Company

Mr. Robert J. Lanigan
Retired Chairman of the Board & CEO of Owens-Illinois Inc.
Additional Board Seats:
Owens-Illinois Inc., Barry Wehmiller Co., The Dun & Bradstreet Corp., Sonat Inc., Transocean Offshore Inc., Cognizant Corp.

Mr. Robert A. Lutz (1986)
Vice Chairman of Chrysler Corporation

Additional Board Seats:
Ascom Holdings AG, Silicon Graphics Inc., Northrop Grumman Corp.

Mr. Peter A. Magowan (1986)
President & Managing General Partner of San Francisco Giants, former Chairman & CEO of Safeway Inc.

Additional Board Seats:
Caterpillar Inc.

Mr. John B. Neff (1996)
Retired from Wellington Management Company

Additional Board Seats:
General Accident Insurance, Greenwich Associates

Mr. Lynton R. Wilson (1994)
Chairman & CEO of BCE Inc.
Additional Board Seats:
Chrysler Canada Ltd., Bell Canada, Bell Canada International Inc., BCE Mobile Commun., Bell-Northern Research Ltd., Northern Telecom Lim., CAE Inc., Tate&Lyle Plc, Teleglobe Inc.

Figure 5. Board Members of Chrysler Corporation (1998)
(year in brackets indicates when the person joined the Chrysler Board)
Source: Chrysler Corporation, Annual Letter to Shareholders 1998

shareholders for any wrong-doings on a board. As a result, they are usually particularly careful in handling the business of the board they are on and maintain strict confidentiality. A breach of confidentiality or a leak of business information will trigger much more severe sanctions on the American board member than in any other country.

Boards in the United States meet rather frequently. In 1997, the Chrysler board held 15 meetings (down from 18 in 1996); this indicates that the board was rather close to what was going on in the company. This closeness is not unusual for US companies. One of the reasons for this closeness is that for the last decade or two, many US corporations have been under great performance pressure from their shareholders, whether institutional investors or individual shareholders. Both categories of investors play a role in Chrysler's case.

For quite some time, a ''thorn in the thigh'' of Chrysler has been Kirk Kerkorian, a self-made American billionaire. Kerkorian regularly puts the company under tremendous financial pressure, and at one point, he even embarked on a bitter takeover battle. In April of 1995, with the help of Lee Iacocca, the former Chrysler chairman, Kerkorian attempted to take over Chrysler in a $23 billion bid. He later withdrew his bid, but increased his stake to 13.6% of equity. Moreover, Kerkorian has constantly fought to increase the maximum limit of equity a Chrysler shareholder can hold – first to 15% and later to 20%. Eaton was strongly opposed to this and publicly accused Tracinda, Kerkorian's investment company, of trying to obtain ''creeping control.'' James D. Alijian, an executive of Tracinda Corporation, represented the views of Kerkorian on the Chrysler board.

The Chrysler Corporation not only experienced the increasing influence of Kerkorian, but also that of other financial intermediaries. Mutual funds have become very popular in the US, and with them, the power of fund managers has grown substantially. The influence of the financial side has led to changes in the dividend policy in a number of companies, also in Chrysler. In order to raise the earnings per share, Chrysler started a share buy-back program. Between 1995 and 1997, Chrysler spent $5.2 billion on repurchasing roughly 22% of outstanding stock. As a result, the shareholders had higher quarterly earnings per share. In 1997, the dividend yield on common stock reached 4.5%, equivalent to three times the average for Standard & Poor (S&P) stocks. The top management continued to stress the importance of the interest of shareholders more heavily, and information dissemination to shareholders was considered one of the best in America. As Eaton stated, ''Chrysler is one of the most shareholder-friendly companies in America.''

Eaton contacted his board of directors about the merger talks with Daimler-Benz roughly a week after confirming his interest to Schrempp.

Thereafter, the Chrysler board was regularly updated on the progress of the merger talks on March 5 and 23 and on April 7, 22 and 29 (*refer to the timeline in Figure 4*). The April 7 meeting was of particular relevance: at this meeting, it was decided that Daimler-Chrysler would be incorporated in Germany.

After another update on May 5 and 6 – the investment bankers and the lawyers attended this meeting as well – the Chrysler board unanimously approved the merger plans. This meant the green light for the merger from the US side – provided the Chrysler shareholders would also agree.

The involvement of the Daimler-Benz boards

Exactly as in Anglo-Saxon corporations, in German stock companies the ultimate fountain of power is the shareholders meeting. Major differences in the governance systems of both countries occur at the board level. German corporations are governed by a two-tier board system, consisting of the board of management (''Vorstand'') and the supervisory board (''Aufsichtsrat''). No overlapping board membership is allowed.

The management board is responsible for running day-to-day operations of the company. Corporations with a paid-in capital of more than $3 million require at least two members on the board of management. The contracts for members of the management board usually run up to five years.

The supervisory board was originally conceived as an institution that was essentially supposed to appoint and control management. As a consequence, members of the supervisory board are not allowed to take part in the actual running of the business. This rule, however, is not without exceptions. The company may, for instance, stipulate in its bylaws that the supervisory board has the right and duty to approve certain categories of management decisions with far-reaching consequences. Typically they are – among others – major acquisitions (of subsidiaries, for instance). In this context, a particular legal ''wrinkle'' is of importance: If the board of management decides on a matter that would require the approval of the supervisory board, but fails to secure that approval, then the decision is, in principle, legally binding. The board of management has, however, violated its duty vis-à-vis the supervisory board (and has to bear the responsibility for this step). Obviously a board of management will not behave in this way, as such a violation would ruin the relationship with the supervisory board and jeopardize any reappointment of the management board members. Nevertheless, the possibility exists.

In line with this somewhat laid-back, control-oriented view of the role of the traditional German supervisory board, this group normally meets only four times a year. Daimler-Benz normally met five times per year, though in 1998, it held eleven meetings.

One additional important feature of the German board system has to be mentioned here: According to the German Co-Determination Act/Law of 1976, half of the members of the supervisory board are elected by the shareholders and half of them represent the employees. Members of the supervisory board for the capital side are elected for five years by the shareholders at their annual meeting. All employee representatives are voted in by employees. The law stipulates a carefully balanced split among the representatives for blue and white collar employees of the firm, and it also requires one representative of senior management who is not a board member. As a special twist, the Co-Determination Act also requires that in corporations above a certain size, at least three employee representatives be delegated to the supervisory board by the union. (In the case of Daimler-Benz, there were actually three union representatives on the board.)

The possible danger of a paralyzing situation on a German board due to the fifty-fifty parity between the representatives of the employees and of the capital side is overcome with the help of the ''casting vote'' (double vote) of the chairman (who, by the way, always comes from the capital side). It can be used to break a stalemate, should it occur.

Besides the workers' representation on the supervisory board, a second channel of co-determination exists in Germany at the management level, namely the system of works councils. Some observers feel that for practical matters the influence of the employees through the works council is much more effective than through supervisory board representation. The chairmen of works councils typically wield great influence and are accordingly courted by management; they are also frequently elected to the supervisory board as employee representatives. This is also true in the case of Daimler-Benz, where the chairman of the works council, Karl Feuerstein, is not only a member of the Daimler-Benz supervisory board, but in accordance with German law, also its vice chairman.

In order to make the works council system effective, large companies have to provide fully paid absences for some of the council members. This gives the council the ability to play its role vis-à-vis management effectively and to discuss human resources issues. Moreover, some management measures have to be approved by the works councils, such as output-related pay rates, pay structures, hiring and change of pay. If management and works councils disagree, management can either change its proposal or take it first to an arbitration court and then to the labor court. Although all of this may sound rather stringent to an outsider, 76% of German managers believe that works councils are more flexible than unions.

(*The two ''benches'' on the Daimler-Benz supervisory board – the representatives of capital on the one side and employee representatives on the other – are shown in Figure 6*.)

Back to the Daimler-Chrysler merger

On the Daimler-Benz side, the merger talks were also thought to be progressing well. The sequence of steps to get other key parts of the corporation involved in the decision making process differed, however, markedly from Chrysler's approach (*refer to the timeline in Figure 4*).

Key dates in the decision making process of Daimler-Benz follow.

On Tuesday, April 7, the management board of Daimler-Benz held its regular weekly meeting. At this gathering, Schrempp, as the head of this board, together with Cordes, informed their colleagues of what had happened during the past few months. No formal decision on the merger was, however, made by the board of management at that point. Moreover, Schrempp explained that he had seen a study evaluating the success of attempted mergers. This study revealed that total secrecy was necessary for ensuring successful mergers.

On April 16, Hilmar Kopper, the chairman of the supervisory board of Deutsche Bank AG (the largest equity holder of Daimler-Benz, with a stake of 22%), in his role as chairman of the Daimler-Benz supervisory board, was officially informed by Schrempp about the possible merger.

Although no details are known to the public, it can be safely assumed that Schrempp had revealed general considerations of such a merger much earlier to Kopper. As one aid to Schrempp put it:

> Schrempp and Kopper have a special relationship. Kopper's role as head of the supervisory board is very different from that of the other members. Kopper and Schrempp meet about twice a month in Frankfurt, and Schrempp has open discussions with Kopper.

On May 4, Schrempp met with Feuerstein to inform him about the merger. Since Daimler-Benz and Chrysler promised that the merger would not lead to any job losses (and since the logic of the merger made sense to him), Feuerstein agreed to the plans.

With the leading figures of both benches on the Daimler-Benz supervisory board ''in the boat,'' Schrempp did not have to expect much opposition from the rank and file board members.

After Kopper was informed, Schrempp and Cordes set up a second meeting about the merger for the management board on April 19. After this extensive second round of discussions, the board of management met again and unanimously approved the merger – on May 3.

The merger was announced on May 7 with the proviso that the supervisory board and the shareholders of Daimler-Benz must agree.

On May 6, the same day the Wall Street Journal reported on a potential merger between Daimler and Chrysler, the supervisory board met in Stuttgart and was informed of the deal. This meeting did not include a vote, but rather a discussion of the reasons behind the move. The actual vote took place on May 14, 1998 – a week after the deal had been announced. One member of the Daimler-Benz supervisory board remembered:

> You cannot tell a story like this to 20 people. This is different from the US situation. A typical US board consists of 7–8 members and their liability is by far higher than in Germany. If you only whisper something about a deal of this magnitude, you are dead!

CAPITAL SIDE

Mr. Hilmar Kopper
Chairman of the Supervisory Board of Daimler-Benz AG

Additional Board Seats:
Deutsche Bank AG (Chairman), Mannesmann AG (Chairman), Bayer AG, Akzo Nobel NV, Solvay SA, Unilever, Xerox USA

Dr. h.c. Martin Kohlhaussen
Chairman of the Management Board of Commerzbank AG

Additional Board Seats:
GKN Automotive International GmbH (Chairman), Bayer AG, Bertelsmann AG, Hochtief AG, Karstadt AG, Schering AG, Winterthur Swiss Insurance

Mrs. Dr. h.c. Birgit Breuel
Commissioner of the World Exhibition EXPO 2000

Additional Board Seats:
Gruner+Jahr AG, Novartis AG, J.P. Morgan GmbH

Mr. Jean-Marie Messier
Director of Compagnie Generale des Eaux

Additional Board Seats:
Compagnie de Saint-Gobain, LVMH, Strafor Facom, Havas, Canal+, UGC

Mr. E. John P. Browne
Group CEO of British Petroleum Company plc. (BP)

Additional Board Seats:
SmithKline Beecham, Intel Corporation (both non-executive)

Dr. Manfred Schneider
Chairman of the Management Board of Bayer AG

Additional Board Seats:
Metro AG, RWE AG

Dr. Michael Endres
Member of the Management Board of Deutsche Bank AG

Additional Board Seats:
Deutz AG (Chairman), Heidelberger Printing, Mannesmann Arcor

Mr. Bernhard Walter
Chairman of the Management Board of Dresdner Bank AG

Additional Board Seats:
Degussa AG, Fresenius Medical Care AG, Metallgesellschaft AG, Rheinmetall AG, Rütgers AG, Thyssen AG

Mr. Ulrich Hartmann
Chairman of the Management Board of VEBA AG

Additional Board Seats:
Degussa AG (Chairman), Munich RE Insurance (Chairman), RAG AG (Chairman), Hochtief AG, IKB Deutsche Industriebank AG, Henkel KgaA

Dr. Mark Wössner
Chairman of the Management Board of Bertelsmann AG

Additional Board Seats:
Gruner+Jahr AG

Figure 6. Board Members of Daimler-Benz AG – Capital Side (1998)

EMPLOYEE REPRESENTATION

Mr. Karl Feuerstein
Chairman of the European Daimler-Benz Works Council

Mr. Helmut Lense
Chairman of the Works Council at the Untertürkheim passenger car plant

Mr. Willi Böhm
Member of the Works Council at the truck plant in Wörth

Mr. Walter Riester
Vice President of IG Metall Union

Mr. Manfred Göbels
Head of Truck Sales, White Collar Representative

Mr. Herbert Schiller
Chairman of Works Council at Debis AG

Mr. Erich Klemm
Chairman of the Works Council at the Sindelfingen plant

Mr. Peter Schönfelder
Member of the Works Council at Daimler-Benz Aerospace

Mr. Rudolf Kuda
Member of the IG Metall Union

Mr. Bernhard Wurl
Member of IG Metall Union

Figure 6 (continued). Board Members of Daimler-Benz AG – Employee Representation (1998)
Source: Daimler-Benz Annual Report 1997

DCX: role model for convergence

The extraordinary shareholder meetings of Daimler-Benz AG and Chrysler Corporation on the merger decision took place on the same date: September 18, 1998. Both shareholder groups agreed to the merger in an overwhelming fashion: 99.89% of the Daimler-Benz stock owners, and 97.5% of the Chrysler share holders approved of it. This gave the deal the official imprimatur.

The modalities of the deal

Here are some of the key modalities of the deal:

- DaimlerChrysler AG is incorporated in Germany. Tax reasons (mainly the loss-carry forward of Daimler-Benz AG) spoke compellingly for this solution.
- In a complex, multi-step deal, each share of Daimler-Benz AG was de facto exchanged for one share of DaimlerChrysler AG.
- In a similar procedure, each share of Chrysler Corporation was exchanged at a rate of 1 to 0.62 for each new share of DaimlerChrysler AG. This exchange ratio was equivalent to a premium of 28% over Chrysler's share price on the day the exchange ratio was fixed (April 16).
- The composition of the shareholder body of DaimlerChrysler at ''Day One – November 18'' was split equally between American and European shareholders. Both groups held 44% each of the outstanding shares. Chrysler only had 6% foreign shareholders, while the former Daimler-Benz AG had 25% of its shares in non-European hands (the State of Kuwait was the biggest shareholder with a total of 13%).
- The supervisory board of DaimlerChrysler is composed in the following fashion (*refer to Figure 7*). A particularly sensitive point in this context was the representation of the US employees on the DaimlerChrysler board. Stephen R. Yokich, president of the American United Auto Workers Union (UAW), initially demanded four seats for representatives from the American and Canadian factories of Chrysler. According to German law, the union can only claim 3 out of the 10 seats for the employees. As the supervisory board could not be enlarged, Yokich realized that his demand for four seats was unrealistic. To solve the problem at least partially, the German metal workers union, IG Metall, gave up one of its seats to allow Yokich to move in. He now represents Chrysler's 74,000 members of the UAW. Yokich stated in public his desire to bring some of the German co-determination practices to America. In addition, his announced goals included unionizing DaimlerChrysler's plant in Tuscaloosa (production site for the Mercedes M-Class) and improving the contracts at Freightliner Trucks, a subsidiary of DaimlerChrysler.
- The board of management of Daimler-Benz AG and the top management of Chrysler have been combined to form the Management Board of DaimlerChrysler (18 members, although one seat was vacant).
- Schrempp and Eaton serve as co-chairmen of the management board; it was also agreed that Eaton would stay up to three years. At the latest by 2001, Schrempp will be the only chairman.
- The post-merger integration will be handled by an organization shown in *Figure 8*. The structure consists of the Chairmen's Integration Council (CIC) with a total of 8 members and the board of management (10 members). The integration council oversees the post-merger integration phase. It has been left small in order to keep track of progress. However, all 17 management board members are involved in the integration. Each member of the management board (except for the chairmen) is responsible for at least one issue resolution team (IRT). These teams are used to identify and realize the synergies between both companies. Each team is jointly run by a management board member from Chrysler and one from Daimler, and they report directly to the CIC. Due to the heavy workload of the board members, each team also has two coordinators who are in close contact with their counterparts from other issue resolution teams. The coordinators form the so-called ''post-merger integration team'' and exchange their experiences in the integration process.
- Payment of Dividends: The parent companies had different approaches to paying out their dividends. In accordance with their national habits, Chrysler paid a quarterly dividend, while Daimler-Benz paid out their dividend only once a year. After the appropriate decision was made at the annual shareholders' meeting, DaimlerChrysler will pay an annual dividend.
- Compensation: The differences in absolute amounts and in the structure of the compensation at different levels of the two firms varied markedly. There is a major integration task awaiting DaimlerChrysler in this area. This vast problem can

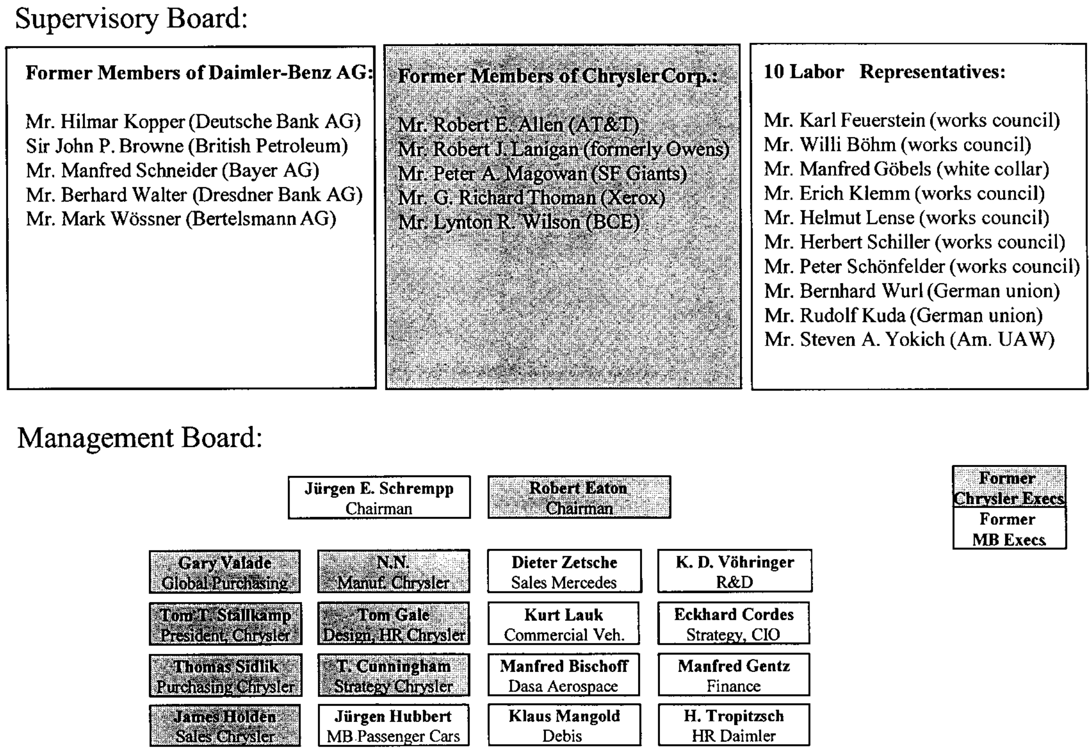

Figure 7. Management Board and Supervisory Board of DaimlerChrysler AG
Sources: DaimlerChrysler AG, various newspaper articles

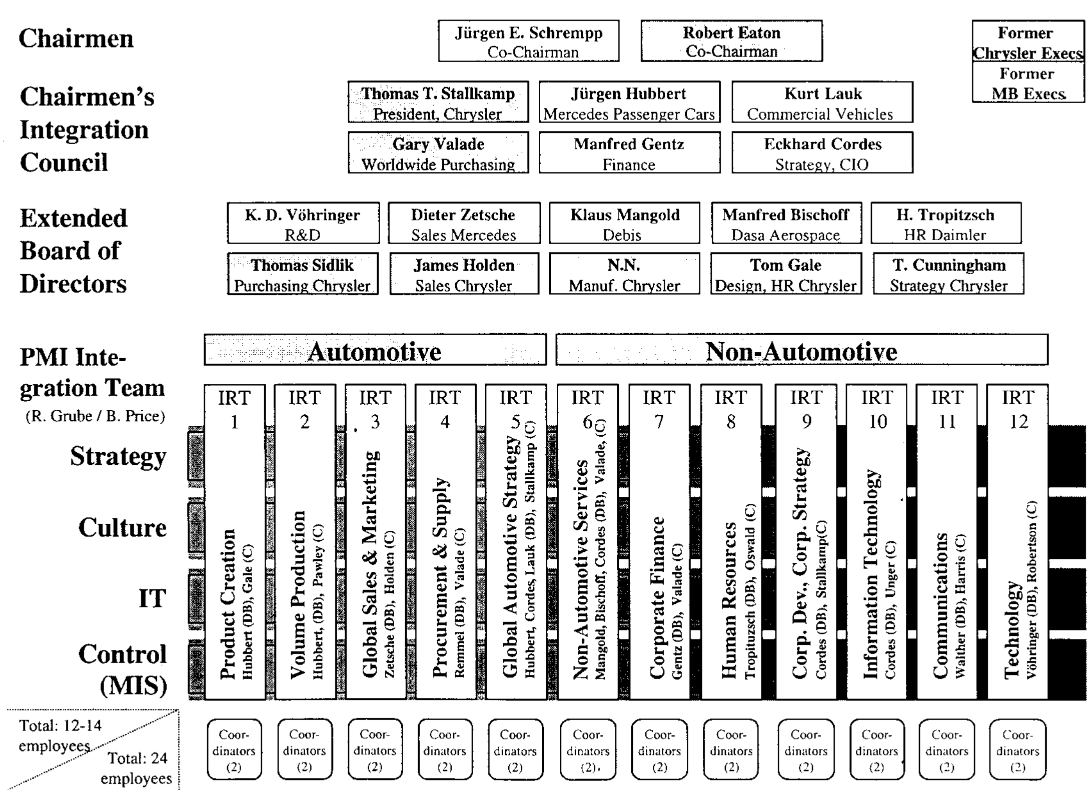

Figure 8. Post-Merger Integration Structure of DaimlerChrysler AG
Source: DaimlerChrysler AG

Policy Statement on the Subject of Remuneration for the Members of the Board of Management

(Presented by Mr. Hilmar Kopper, chairman of the Supervisory Board, Shareholders Meeting 1999)

The new method of remuneration is identical for all members of the Board of Management – irrespective of nationality and location. (...) Total remuneration for the Board of Management is made up of four different components. These are: a basic salary, an annual bonus, the three-year performance plan as a medium-term incentive and stock options or stock appreciation rights as a long-term incentive. The latter three components are the variable elements.

The fundamental component of total remuneration is the basic salary, as all the other elements are related to it. Basic salary was arrived at by comparing with the relevant data of around 15 selected international corporations and also by means of a process of analytical job evaluation. This resulted in differing basic salaries for the individual Board of Management members. In this way the system reflects the differing levels of strategic and operative responsibility of the individual members. In order to ensure that these basic salaries remain competitive, they will be examined every year in the context of the relevant figures for the group of international companies.

The second element of remuneration is the annual bonus. This is a variable cash payment, related to the basic salary and determined by the operating profit achieved by DaimlerChrysler AG. Depending on the particular situation of the company, additional possible goals can be shareholder return and growth in revenues. Furthermore, the Supervisory Board is free to consider other specific performance factors when determining the level of the annual bonus, factors which are not necessarily reflected in the performance of the Group as a whole. In general it is true that the target values for operating profit are determined annually in advance, based on the approved planning.

An element of remuneration that is new for our company is the so-called three-year performance plan or mid-term incentive. The main idea behind this component is that medium-term corporate developments should also be reflected in the level of remuneration. Consequently, the mid-term incentive is linked to the performance goals set by the operative planning for return on capital, return on sales and growth in revenues. Furthermore, the quality of our vehicles and customer satisfaction will also be considered.

The fourth element of remuneration is the stock option as a long-term incentive. Nowadays this is an essential element of any system of remuneration that is to be internationally competitive. We are compelled to design stock option plans according to our national legal system. The current legal situation in Germany since the share law amendment was passed has not quite put an end to the previous uncertainty. For this reason, we have decided at first to award stock appreciation rights for 1999, the design of which is independent of the new share laws. We will have to tackle the new legal situation during the course of this year so that we can present a stock option plan at the Annual General Meeting in the year 2000, a plan which on the one hand can be regarded as internationally competitive and practical, and which on the other hand also fulfills the requirements of German law.

Figure 9.
Source: DaimlerChrysler AG

be exemplified with the situation at the top management level.

In 1997, Robert Eaton as chairman of Chrysler, earned more than the whole management board of Daimler-Benz combined. Eaton's salary reached almost DM 20 million (DM 1 = $0.55), while Schrempp earned only DM 3.5 million (including DM 1 million from stock options). The business combination agreement states that employees would not be worse off, in financial terms, during a transition period of two years. How this aim and the goal to reward equal work with equal pay will be achieved simultaneously is not yet very transparent from the outside. The company has been rather reluctant to divulge many details (*refer to Figure 9*).

- Closeness to shareholders: In order to signal to the former shareholders of Chrysler (94% of whom were American before the merger) that the newly formed company would be as close to them as Chrysler had been, a shareholder committee was set up. Both chairmen are members of this committee in addition to the ten shareholder representatives from the supervisory board. This composition was chosen to give this new circle some weight in the eyes of the shareholders. The committee will meet every two months. One of its tasks will be to discuss the business strategy directly with the shareholders. (Access to this committee is, of course, open to all shareholders, not only the former Chrysler owners.) Overall, the company wanted to transfer some financial reporting tools from Chrysler. Kopper stated:

> The American reporting system is very concise. The management regularly updates the board on sales, profit levels, extraordinary items, tax and net income. Moreover, the audit committees in American companies are much more involved in internal audits than their German counterparts.

Condemned to succeed?

The key question at the point of this writing is, of course, what the chances are that the merger will succeed. Nobody will be able to answer this for some time to come. Most observers feel, however, that combing these two companies is a matter of such significance that a failure would have extremely far-reaching consequences.

Research Associate George Rädler developed this background note under the supervision of Professors Fred Neubauer and Ulrich Steger as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Notes

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3. Simonian, Haig and Richard Waters. ''Chrysler's Backseat Driver: The Battle Between Kirk Kerkorian and the Car Maker Over the Company's Cash is Coming to a Head.'' *Financial Times*, January 16, 1996.
4. Simonian, Haig and Richard Waters. ''Unlikely Fellow Travellers.'' *Financial Times*, May 9/10, 1998.
5. Weidenfeld, Ursula. ''Zum letzten Gefecht.'' *Wirtschaftswoche*, Nr. 19/ 1.5. 1997: 52.

''A merger with KLM will produce the biggest boardroom shake-up in the history of British Airways, with an influx of international business talent. The board, as it is, might be suitable for the Royal Cout Theatre but it is hardly appropriate for a global airline.''

An executive of British Airways, commenting on the effect of a merger between BA and KLM, proposed by the Chief Executive, Rod Eddington