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Volkswagen's Big Bet on Tennessee

Despite the industry's travails, the German automaker expects to boost U.S. sales with its \$1 billion investment in a Chattanooga factory set to make midsize cars

By [Jack Ewing](#)

Detroit carmakers may be fighting for survival, but further south in Chattanooga, the auto industry is still making at least two guys happy. They would be Ron Littlefield, mayor of the Tennessee city, and Claude Ramsey, mayor of the surrounding county. In July, they learned that German carmaker Volkswagen ([VOWG.DE](#)) had chosen Chattanooga as the site for a new U.S. factory that will produce a new midsize VW by 2011. As Littlefield said during a recent stopover in Frankfurt, "An auto plant is the holy grail of economic development."

Certainly that has been true in the past. Auto plants are prized not only for the jobs they create directly, but also because they attract suppliers who create more jobs and generate sales for restaurants, builders, and other local businesses. Volkswagen has vowed to hire 2,000 people in Chattanooga and invest \$1 billion. All told the VW plant will create 11,500 jobs, including the VW employees, and boost personal income in the region by more than \$500 million a year, according to an August study by the Center for Business Research at the University of Tennessee.

But is a VW plant still so desirable when the global auto industry is going through one of its worst downturns ever? Quite possibly, yes. Although Ford ([F](#)), General Motors ([GM](#)), and [Chrysler](#) are in such dire shape that they had to beg Congress for a bailout, Volkswagen remains relatively healthy thanks to its [strong presence in developing markets](#) such as China, Russia, and Latin America. To be sure, VW also is feeling pain these days—sales worldwide fell 5.1% in October vs. a year earlier, to just over 500,000 vehicles. But that compares with a 16% plunge for the industry as a whole. VW's premium Audi unit even reported a slight uptick in sales in November. (VW hasn't yet reported November sales for the whole group.)

Intense Local Lobbying

Despite the global downturn, VW's reasons for building a U.S. factory may be more compelling than ever. While U.S. automakers must retool massively away from gas guzzlers, Volkswagen already has generations of experience building midpriced, fuel-efficient cars for the European market, where gasoline is at least twice as expensive as in the U.S. If Volkswagen can deploy

that compact-car expertise in America, it could be in a position to profit when the economy recovers. "For them this situation holds a lot of opportunity," says Christoph Stürmer, analyst at market watcher Global Insight ([IHS](#)) in Frankfurt.

Chattanooga's civic boosters certainly wouldn't disagree. They began competing for the VW plant late in 2007, shortly after losing a bid to attract a new Toyota ([TM](#)) plant which the Japanese carmaker instead decided to build in Blue Springs, Miss. The city's first personal contact with Volkswagen came in January 2008, when Trevor Hamilton, vice-president of economic development for the Chattanooga Area Chamber of Commerce met with [Stefan Jacoby](#), president of Volkswagen Group of America, at the North American International Auto Show in Detroit. The brief meeting gave Hamilton a chance to emphasize Chattanooga's virtues, such as good highway connections and 1,350 acres of vacant land located just 12 miles from downtown.

But VW was also looking at sites in Michigan and in Alabama, where German carmaker Daimler ([DAI](#)) already produces Mercedes SUVs and station wagons. As the mayors remember it, a critical point came in May, when Chattanooga hosted VW executives for a presentation at a local hotel. Actually, what the city representatives heard was not encouraging. Volkswagen execs were concerned about the condition of the proposed factory site, which had been abandoned for many years and was overgrown with forest and shrubs. As Ramsey, the county mayor, remembers it, VW execs said, "We like your city, but your site is in third place. We can't see it, we can't get a feel for it."

Crash Site-Clearing

That very afternoon, Ramsey says, local officials began dispatching equipment to the site, which was once home to a dynamite factory. Within three weeks, after an all-out effort involving some 200 earth movers, wood chippers, and other heavy machinery, the Chattanoogaans had cleaned up the land. "I think Volkswagen saw that our community wanted this plant and was committed to making things happen," Ramsey says. (Chattanooga's crash brush-clearing effort indeed made a big impression on VW execs, a company spokesman confirms.)

Of course, money also played a role in winning the hearts of VW execs, who [announced their choice of Chattanooga last July](#). Local and state governments committed \$577 million in incentives to win the VW plant, including tax breaks, road construction, and training of local workers.

Volkswagen representatives say the global downturn hasn't dampened their ambitions for Chattanooga. VW, which currently has only 2% of the U.S. market, [plans to triple sales there](#) to 800,000 vehicles by 2018. To do that, VW needs local manufacturing to protect against currency fluctuations. All of the German carmakers have suffered in recent years from the strength of the euro vs. the dollar, which makes their European-built products more expensive in dollar terms.

More important, having a strong base in the U.S. may help VW better understand American drivers. Volkswagen has lagged in the U.S. in part because products such as the \$16,000 Rabbit (sold as the Golf in Europe) don't correspond to U.S. tastes, says analyst Stürmer. The

suspension in VWs tends to be stiff for American tastes, and the cars lack popular details such as cup holders for supersize beverages. "They don't have a product portfolio the average American would buy because it's just too European," Stürmer says.

For Volkswagen to get the maximum payoff from Chattanooga, Stürmer says, the company should use it as more than just a production site. "If the location is not just a dumb factory, but more a transplant organization, there is a chance they will be able to develop a staff that has the authority to produce and translate the VW core values into American products fit for the American user," he says.

Leveraging Diesel

VW designers based in Wolfsburg, Germany, and Los Angeles are currently at work on a new model that will be built in Chattanooga and aimed at U.S. drivers. The new car will be slightly larger than VW's \$28,000 Passat and begin rolling off the Chattanooga assembly line in early 2011. VW plans to build 150,000 a year, of which 30% will be diesel-powered. VW hopes to leverage its expertise in fuel-efficient diesel engines, which are popular in Europe but have yet to catch on in the U.S.

The Chattanooga mayors allow that they're concerned about the state of the economy, but are confident things will be better by the time VW starts producing cars in their city. "The important thing is for the economy to be in substantial recovery two years from now," Mayor Littlefield says.

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