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PAGE ONE**ACCELERATING GROWTH**
**In China, Chery Automobile
 Drives an Industry Shift**

**Low Costs, High Output
 Attract Global Partners;
 Chrysler's Leap of Faith**

By GORDON FAIRCLOUGH
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WUHU, China -- In this city on the Yangtze River, more than 25,000 blue-uniformed workers are busy churning out cars for Chery Automobile Co. As they motor through double shifts using the latest imported technology, they're also helping to change the dynamics of the global auto industry.

Barely a decade after it was founded, state-owned Chery has emerged as China's largest independent vehicle maker -- and one that is determined to compete against the world's automobile giants.

"In the beginning, no one had confidence in us," says Yin Tongyao, Chery's chairman and general manager, in a rare interview. Now, he says, "we are looking globally for markets."

The tale of Chery's improbable rise is in large part the story of China's ballooning domestic car market, which has roughly doubled in size since 2004. Its products -- mostly inexpensive cars and SUVs -- are also gaining a following in developing countries hungry for low-cost vehicles.

But rapid growth is already taking its toll, as executives strain to manage the company's expansion amid a shortage of experienced workers. "We are still fighting for our survival," says Mr. Yin. "We didn't get to

Get a rare glimpse of China's largest car maker, Chery Automobile Company located in the Yangtze River city of Wuhu.

learn from books. We have to learn everything by doing it."

In July, the company signed a landmark deal with Chrysler LLC to sell a series of small cars made by Chery under the American auto maker's Dodge brand. Chrysler has said it plans to start selling the cars in Latin America and other developing markets next year and aims to have

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- **Photos:** Building an Auto Maker³

them on the market in the U.S. and Western Europe by 2009.

The pact marks the first time that one of Detroit's Big Three has outsourced the production of entire vehicles to a Chinese company. The deal also sends a warning to high-cost workers in the U.S. and Europe that even more of their jobs could be at risk.

Chery's arrangement with Chrysler follows years of breakneck expansion. Sales of Chery cars have increased more than tenfold since 2001. This year, Chery expects to sell more than 400,000 compacts, sedans and sport utility vehicles. By 2010, the company says it will be turning out a million vehicles annually, for markets both at home and abroad.

Holding the reins of this galloping enterprise are Mr. Yin and a handful of other men who've been with the company since it started as the brainchild of local Communist Party officials in the poor eastern province of Anhui. The founding group is known in China as the "Eight Guardians" -- a reference to eight defenders of the faith in Buddhist legend.

The corporate culture they spawned is an odd hybrid of Communist state enterprise and entrepreneurial start-up. Party propaganda posters hang on factory walls. "Know plain living and hard struggle," one poster exhorts workers, "do not wallow in luxuries and pleasures." In another part of the plant, bulletin boards display quality-survey data from J.D. Power & Associates comparing Chery's cars with those of its rivals.



Inside the gates of Chery's sprawling production complex, where few foreign reporters have been allowed before, assembly lines run 16 hours a day. Much of the equipment is state-of-the-art, imported from Europe. The engine plant has German precision-milling machines and Italian robots. The paint shop is from Germany.

Chery this year expects to export more than 110,000 cars, up from about 50,000 in 2006, mainly to emerging markets such as Russia, the Middle East and Latin America, where its low prices are helping to win it business. The company is building a car-shipping port on the Yangtze near its plant to send vehicles to China's coast and overseas.

Still, Chery remains far smaller than the world's big auto makers. **Volkswagen AG**, **General Motors Corp.**, **Toyota Motor Corp.** and **Honda Motor Co.** have each outsold Chery in the China market so far this year. World-wide, GM and Toyota both sell nearly nine million vehicles a year.

At Chery's research and development center, engineers say they are now at work developing 40 to 50 new car models, at least 10 of which could be ready for production as soon as next year. The company is building new assembly lines that next year will boost its capacity to about 700,000.

Mr. Yin sets an urgent tone both inside and outside the company. Parts suppliers say they are frequently called to meetings at Chery headquarters late in the evenings and on weekends, as Chery engineers and executives try to push projects forward in a hurry.

Chery says it expects to benefit from Chrysler's technical expertise and established sales and service networks. Even though their cars will be sold under the Dodge brand, they expect consumers will know they are made in China by Chery.

"People look down on our products. There are many doubts about our safety and quality," says Mr. Yin. Selling under the Dodge name initially will boost buyers' confidence, he says. "If we work together with Chrysler, we can go global faster."

Chery has combined low wages with massive capital investment and other government backing. This recipe is powering the latest phase of China's industrial revolution, helping firms in industries from cars to consumer electronics become significant global players.

Junior engineers at Chery earn about \$6,000 a year, and many sleep in bunk beds four to a room in company dormitories. Some don't have driver's licenses and, like most Chinese people, didn't grow up riding around in a family car. Few workers can afford to buy the automobiles they make.

Assembly-line workers earn an average of slightly more than \$1 an hour -- far less than their counterparts in Europe or North America but, in Anhui, a sought-after wage.

Chery can "offer low-cost platforms with speed," says Tom LaSorda, president and vice chairman of Chrysler, which has said it will eliminate 25,000 jobs in North America. Visiting Chery's plants in 2006, he says, he found that "everything was very familiar," with production processes and equipment very similar to those in top Western factories.

Chery's conception dates to the mid-1990s, when a handful of officials in Anhui decided to place a bet on cars. Developing a local auto industry, they figured, would boost incomes and growth in a province where the average annual income of people in rural areas is less than \$400.

The company's first chairman, Zhan Xialai, at the time an assistant to the mayor of Wuhu, recruited Zhou Biren, then a manager at a city-owned building-supply company. The two men faced significant opposition from bureaucrats who doubted local families would ever earn enough to buy a car.



Workers on the Chery assembly line in Wuhu, China.

"People thought we were crazy," says Mr. Zhou, now a Chery vice president and one of the Eight Guardians. "In those days, people weren't rich yet," says Mr. Zhou. They "thought it would be a waste of state funds."

But Messrs. Zhan and Zhou persevered. They cobbled together a team with connections to Anhui, including Mr. Yin, an Anhui native who was lured away from a Volkswagen joint venture. (Mr. Zhan later became the Communist Party's top official in Wuhu and stepped down from his post at Chery.)

For the first two years, Mr. Yin, Mr. Zhou and the other members of the Eight Guardians

worked from a crumbling building in an empty field. There was no heating or air conditioning. It took a computer crash, during a heat wave, to prompt the purchase of one cooling unit.

Initially, the founders sought to lure a foreign auto maker into a joint venture. Mr. Zhou and his colleagues talked to several multinational companies, he says. But none were willing to take a chance on such an inexperienced partner.

Flying solo, the first order of business was finding an engine to use in the company's still-theoretical first car. In 1996, Mr. Zhou flew to England to buy engine-assembly equipment that had been discarded by Ford Motor Co.'s plant there.

In March 1997, Chery started building its first factories. It hired a Taiwanese company to help it design its first model, a sedan known as the Fengyun, or Wind Cloud, which was cobbled together mostly using parts from components makers that supplied the China operations of VW and GM. The first cars rolled off the line in December 1999.

But Chery wasn't allowed to sell them, since it didn't have a government license to be in the auto business. The red tape was eventually untangled when Chery briefly became part of the much larger Shanghai Automotive Industry Corp., a large state-owned company that has partnerships with GM and Volkswagen. The Fengyun hit the market in 2001 and 28,000 were sold.

Chery also began work on a four-door hatchback minicar, which would lead to accusations that the young company was knocking off the designs of its competitors. The car, which went on sale in 2003 and is known as the QQ, is similar to a GM model known as the Chevrolet Spark.

GM sued Chery in Chinese court in 2004, alleging that the company had illegally copied its design for the Spark. The companies settled the lawsuit in 2005 without disclosing the terms of their agreement. Chery spokesman Jin Yibo says the deal with GM was "very friendly," and Chery has publicly denied that it did anything wrong.

Manufactured with local partners at a plant in southwestern China, the QQ remains the company's No. 1 model and far outsells the more expensive Chevy Spark in China. "We honor the intellectual-property rights of others," says Mr. Zhou.

Amid the controversy over the QQ, a fundamental shift was happening. In 2003, executives and government planners decided that Chery should go beyond recycling outdated technologies for the local market. They envisioned the company as an international player.

Encouraged by sales in Chery's first two years -- and by signs that China's auto market was revving up -- the company and its state owners decided to embark on a massive new investment program. Chery also stepped up its efforts to recruit Chinese nationals working for auto companies abroad, as well as to bring foreign expertise to Wuhu.

"There's no way you can move slowly and catch up," says Xu Min, a former Chery engineer who is now dean of Shanghai Jiao Tong University's Institute of Automotive Engineering. "It took the Japanese two or three decades. We didn't have that kind of time."

The central goal: to acquire and develop technology that would belong to Chery and help it compete even in the U.S. and Europe, with their daunting regulatory hurdles and high customer

expectations.

In 2003, Chery recruited Mr. Xu, the engineer who is now an academic. At the time a specialist on combustion and fuel injection at Delphi Corp. in the U.S., Mr. Xu says he got the hard sell from executives seeking to bring him back to Anhui, where he was born.

Mr. Xu says that a lot of his friends questioned his decision to abandon a secure job in Detroit for a post at a then-unknown Chinese company. But he says he felt like he was hitting a wall in the U.S. "In Detroit, you could spend years on something and never see it commercialized," he says. "The pace was so slow."

Chery, on the other hand, wanted Mr. Xu to oversee a project that would develop three new families of engines within just a few years.

In 2003, Mr. Xu and Chery turned to AVL List GmbH, an Austrian engineering consulting firm that specializes in internal-combustion engines, for help. AVL promised to train Chery engineers to design and build the sophisticated engines. Teams from the two companies worked side-by-side in Austria and in China. "They knew they had to exchange knowledge for money. That really speeds up your capacity building," says Mr. Xu.

The engines are good enough that Italian car maker **Fiat SpA** plans to use them in some of its cars as well, buying them directly from Chery. Fiat is to buy at least 100,000 1.6-liter and 1.8-liter engines a year for use overseas starting next year, according to Chery. In August, the two companies also signed a memorandum of understanding to form a joint venture that would produce Alfa Romeos and other cars.

Earlier this year, Chrysler executives visited Chery and could see the rapid progress that occurred over 18 months. "I would say the 'aha' moment for us would be when we subsequently visited Chery," in June, says Richard Chow-wah, a Chrysler senior vice president. The "ability to make decisions quickly without a lot of bureaucracy was what was most impressive."

--Ellen Zhu contributed to this article.

Write to Gordon Fairclough at gordon.fairclough@wsj.com²

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