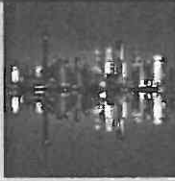


CHAPTER CASE



Harley-Davidson, Inc.: Troubled Times Increase H-D's Reliance on International Sales

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2009 Mission Statement, as stated on the company Web site: *We inspire and fulfill dreams around the world through Harley-Davidson motorcycling experiences.*

2007 Mission Statement: *We fulfill dreams through the experience of motorcycling, by providing to motorcyclists, and to the general public, an expanding line of motorcycles, branded products, and services in selected market segments.*

Harley-Davidson, the over-100-year-old manufacturer of motorcycles, turned a corner in 2008–2009, but it was largely the wrong corner. Total sales for 2008 were down 4 percent from the company's 2006 high. Sales in North America, the company's dominant market, were off 17 percent, and the company estimated its total sales would be down an additional 10–13 percent in 2009. Part of the problem could be attributed to selling a luxury good during a recession, but Harley-Davidson (H-D) had also made some notable tactical errors.

Harley-Davidson's Financial Services (HDFS) had financed the sale of motorcycles to buyers of questionable financial means. These motorcycle loans were resulting in a high default rate. H-D's questionable loans and high default rate closely paralleled the 2008–2009 bank crisis brought on by subprime mortgages. H-D wrote off \$80 million in loans in 2008, and 2009 is expected to be worse. Where H-D had been a Wall Street darling since the early 1990s, as of mid-2009 it is on many sell lists.

The most damaging aspect of loan default was not the loss on the loans, but the thousands of used H-D motorcycles that entered the marketplace at bargain

prices. Traditionally, used H-D motorcycles had retained their value, and value retention was a major selling point. However, the glut of used H-D motorcycles not only eroded the sales of new H-D motorcycles but significantly reduced the value of H-D owners' investments.

H-D had been touted as a model for favorable labor relations management for many years. This era may have come to an end in 2008 when H-D announced the layoff of up to 1,500 employees, or about 15 percent of the company's workforce. While the labor force was being reduced as the result of declining domestic sales and diminished profits, outgoing CEO James Ziemer's pay jumped from \$4,447,713 in 2007 to \$5,625,595 in 2008, a 26.5 percent increase.

The bright spot for H-D was international sales. Between 2006 and 2008 H-D's international revenue increased by 49 percent. During the same period the number of motorcycles sold in international markets grew 28 percent, while the domestic market decreased 25 percent.

H-D produces and sells only heavyweight motorcycles under the H-D brand. These motorcycles, showcasing chrome and flawless paint, are intended to make a statement for their owners. It can be an expensive statement; 2009 base prices ranged from \$6,999 for the smallest model, the venerable Sportster, to over \$29,999 for the massive Tri Glide Ultra Classic. Accessories, shipping, import tariffs, and other duties and licenses can more than double the factory price in off-shore markets. The company also manufactures about 13,000 motorcycles a year under the Buell brand.

The company has defined the heavyweight segment as motorcycles with engines displacing a minimum of 651 cc. Following a decade of short supply, the production of H-D heavyweight motorcycles rose markedly

in the first six years of the twenty-first century. A portion of the rise in production was attributable to a nontraditional design, the V-Rod or VRSC. Introduced for the 2002 model year, H-D's VRSC model merged engineering from German auto manufacturer Porsche with H-D's classic design. Increased production capacity and a slowing domestic market were driving H-D's increased focus on international markets.

International Market for Luxury Goods

Economists define luxury goods and services as goods for which demand increases more than proportionally as income rises. From a sociocultural perspective, a luxury good is seen as a product at the highest end of the market in terms of design, quality, durability, performance, and price. The definition of luxury is not solely objective; it is also subjective as a function of the buyers' personal circumstances and the status the good conveys. The concept of luxury evolves constantly with the ever shifting economic, demographic, sociocultural, and geopolitical climate. Classic luxury goods include haute couture items such as clothing, perfume, and luggage. Most products and services have a luxury segment, such as cars, hotels, and even chocolate. Bain and Company, consultants, put the value of the global market for luxury goods at \$201 billion. Estimates of this market can vary widely depending on the goods and services included and range up to \$1 trillion. What does not vary widely are estimates of the global decline in the luxury good market, about 10 percent for 2009. The decline will be even higher in the United States, where sales are expected to be off 15 percent. Not all markets for luxury goods are expected to contract; China should be up 7 percent. Whether sold in the domestic or international market, H-D motorcycles fall into the highest end of the market in terms of price, quality, and finish—the luxury segment of the motorcycle market.

North and South America The United States consumes roughly 25 percent of the world's luxury goods,

with the remainder of North and South America consuming an additional 8 percent. In the United States, four million households have an income of more than \$1 million. This population defines the luxury sector through its patronage. There are an additional 18 million households in the U.S. with incomes over \$100,000. Although the purchase of luxury goods is less frequent in these 18 million households, their collective purchase of luxury goods is a significant share of the market. The purchasers of luxury goods are not price resistant, but they do want to know what they get for their money. Thus, companies must demonstrate that not only are their products luxurious but that they will also add value to the consumer's lifestyle.

Europe The estimates for the size of the European luxury good market is currently 38 percent of the global market. Europe is the spiritual home of luxury goods and the originator of many traditional brands, such as Chanel, Louis Vuitton, and Ferrari. European demographics bear many similarities to those in the United States. However, in Europe income growth has been more evenly distributed across the population. Europe also has doubled the population of seniors. Those seniors control more wealth and are more likely to spend that wealth on luxury goods.

Japan Japan is the home of the largest Louis Vuitton store, a fact that seems appropriate given that 94 percent of Tokyo women in their 20s own something from Louis Vuitton. Japanese luxury goods retailers account for 12 percent of the global market, and they often charge 40 percent more than in the European market. Prestige is valued in Japanese culture, and external signs of status are evident.

China China, together with India and Russia, is part of what is seen as the so-called golden triangle of the newly wealthy who are thirsty for luxury goods. These growth markets are attractive to Western luxury goods businesses, whose sales efforts have traditionally been concentrated on the United States, Europe, and Japan. China currently accounts for 3 percent of the global market for luxury goods. China is expected to pass Japan to become the world's second-largest

Harley-Davidson: Motorcycle Sales in Units: Domestic and International Markets

H-D Units Sold	2008	Percentage Change (%)	2007	Percentage Change (%)	2006	Percentage Change (%)	2005	Percentage Change (%)	2004
Domestic	206,309	-15	241,539	-12	273,312	3	266,507	2	260,607
International	97,170	9	89,080	17	75,984	22	62,510	10	56,682
Total	303,479	-8	330,619	5	349,196	6	329,017	4	317,289

purchaser of luxury goods by 2015. Consumers are status conscious, increasingly wealthy, hungry for brand image, and fanatical about shopping. A recent survey of young urbanites on the Chinese mainland found that over 60 percent of them are prone to buying high-end consumer goods. On the average, luxury goods consumption accounts for 4 percent of consumer spending, but in China the proportion is estimated to be as high as 40 percent.

India Of all Indian households, 1.6 million spend an average of \$9,000 a year on luxury items. India has the highest wage growth in Asia. Multi-income families and increasing international exposure are driving a sociocultural transition from saving to spending. Sales of luxury products have risen by 20 percent per year, and consumers want the latest models and exclusive editions. India's luxury car market has tripled in the past five years despite import duties of about 100 percent.

Russia Russia accounts for 5 percent of the global luxury goods market. The country is producing today's most determinedly conspicuous consumers and may rival China as the fastest growing market for luxury goods. A lot of this spending is abroad, as more than 23 million Russians travel outside the country each year. While the luxury market continues to develop in Russia, it is not yet saturated and the demand for exclusive and prestigious brands continues.

Consumption of luxury goods reflects a movement to a single luxury esthetic that incorporates influences from every corner of the globe. This means that a brand's ethnicity is no longer an indicator of where its owners are from, where the goods are produced, or who buys them, but rather a matter of buyer preference—for anyone who can pay the price.

The International Heavyweight Motorcycle Market

In the United States, H-D clearly trades on its image and nostalgia to sell its traditional bikes. While Harley's quality and engineering are excellent, the technology of the company's traditional bikes lags behind that of competitors. The technology gap is largely intentional; customers are paying for an American icon. H-D relies on something other than nostalgia for an American icon to sell motorcycles in the international market, however. That something consists of the image and status conveyed by a luxury good. Like the traditional styling and dated mechanical movement of a Rolex watch, the value of an H-D motorcycle is in its status and image and not in its technology.

Heavyweight bikes constituted 55 percent of the U.S. motorcycle market in 2008. H-D has led the motorcycle industry in domestic unit sales of heavyweight bikes for 20 straight years. In 2008 H-D manufactured 46 percent of the heavyweight motorcycles sold in the United States. In the face of recession, the company's domestic unit sales decreased 10 percent from 2004 to 2008. The company faces a challenge in balancing motorcycle availability to ensure high mark-ups for itself and its dealers, while maintaining market share in the face of stiff competition.

Traditionally, a maximum of 20 percent of the production of H-D's traditional motorcycles has been shipped offshore. This policy ensured that the supply of new motorcycles favored domestic dealers. The company broke this unwritten policy in 2006 when it exported 22 percent of production, and by 2008 the export percentage had reached 32 percent. In 2008 the company's combined market share in the heavyweight motorcycle segment for the United States and Europe was 31 percent.

The European market is a particularly difficult one for H-D, and the company's market share hovers around 10 percent. The market is an attractive one, however, because European heavyweight motorcycle sales are 83 percent of those in the U.S. market. Unlike the U.S. market, in Europe the H-D image and nostalgia don't sell many bikes. Seventy percent of the European market is comprised of performance bikes, a market segment in which the traditional H-D offerings are not competitive. Harley-Davidson's newest design, the V-Rod or VRSC, with its Porsche-designed engine, competes in this market segment. Europeans differ in their tastes on a regional and national basis. Those that favor Italian flair have the option of the racy Ducati and similar bikes, while those who like Teutonic thoroughness can opt for the highly refined BMW. H-D would like to double its European market share over the next few years. In 2008, H-D acquired an Italian manufacturer of motorcycles, MV Agusta. The MV Agusta acquisition appears to have been made to advance H-D's pursuit of the European market.

In 2008 H-D sold over 14,600 motorcycles in Japan through a network of 81 dealers. The VRSC model is popular with Japan's 20-something thrill junkies. Overall motorcycle ownership in Japan peaked in the mid-1980s and has been in a slow decline since then. However, the decline in ownership has been largely limited to motorcycles less than 250 cc. Japanese law currently does not allow a motorcycle driver to carry a passenger.

China and India offer large and fast growing motorcycle markets. In both countries motorcycles meet the

H-D: Motorcycle Retail Unit Sales by International Market (1,000 motorcycles)

	2008	Percentage Change (%)	2007	Percentage Change (%)	2006	Percentage Change (%)	2005	Percentage Change (%)	2004
United States	218.9	-13.0	251.8	-6.2	268.4	5.9	253.4	4.2	243.2
Canada	16.5	11.7	14.8	9.4	13.5	15.9	11.7	4.1	11.2
Europe	40.7	4.8	38.9	15.0	33.8	14.6	29.5	19.9	24.6
Japan	14.6	6.5	13.8	3.6	13.3	16.3	11.4	11.1	10.3
Other markets	23.1	25.0	18.5	23.7	15.0	34.3	11.2	19.4	9.3
Total	313.8	-7.1	337.8	-1.8	344.0	8.5	317.2	6.2	298.6

basic transportation needs of millions of families and businesses. Each country currently consumes about six million new motorcycles each year with almost all bikes displacing 250 cc or less. Price is the competitive issue, and joint ventures between domestic companies and international motorcycle manufacturers like Honda and Kawasaki produce affordable motorcycles of good quality. H-D has an agreement with China's Zhongshen Motorcycle Group to develop the Chinese market, and a H-D dealership was opened on the outskirts of Beijing in 2006. Trade barriers at all levels remain a problem in the Chinese market, and motorcycles are banned from a large portion of Beijing. Import tariffs are also onerous in India, running over 90 percent for a heavyweight motorcycle. India's emission standards for bikes over 500 cc are exceedingly rigorous and exclude H-D's current products. H-D has engaged in talks with the government of India, but there is little reason to think India will change its regulations to permit the import of H-D motorcycles. Despite the vagaries of Indian regulations, Suzuki and Kawasaki have enjoyed modest success selling performance motorcycles in India.

Australia and New Zealand continue to be strong markets for H-D motorcycles. Australia in particular has roads and landscapes similar to those found in United States. H-D is seen as a symbol of the freedom of the open road and has a loyal and passionate following. The growth segment in the Australian motorcycle market is off-road or dirt bikes with 40 percent of the market. H-D operates a wheel manufacturing plant in Adelaide, Australia. Other significant markets for H-D include Canada, Brazil, and Mexico. H-D opened its first dealership in Moscow, Russia, in 2005.

Competitors

According to H-D:

Competition in the heavyweight motorcycle market is based upon a number of factors, including price,

quality, reliability, styling, product features, customer preference, and warranties ... The Company emphasizes quality, reliability and styling in its products and offers a two-year warranty... (2008 Form 10-K).

All of H-D's major competitors have their headquarters outside the United States. Most of the major competitors are operating units of large diversified companies like Honda, Yamaha, Kawasaki, Suzuki, and BMW. At least one of H-D's major competitors, Honda, manufactures its largest motorcycles in the United States. A major exception to the large diversified company rule is Ducati, an Italian company that is a leader in the European performance market. In addition to offshore competition, H-D faces domestic competitors. These companies include relatively new brands like Big Dog and Polaris, and a number of small custom shops that cater to the ultrahigh-end motorcycle market.

Ducati Motor Holdings Ducati is representative of H-D's European competition and is listed on both the Milan and New York stock exchanges. Ducati has adopted a cyberspace model selling motorcycles, accessories, and clothing online. The company promotes its cyberspace model through participation in motorcycle racing where Ducati has dominated the world Superbike Championships for over ten years. Unlike H-D, Ducati does not build bikes on the basis of nostalgia and comfort; rather Ducati sells style and performance based on technologically advanced designs. Ducatis are race-proven bikes, sold for use on the street—the ultimate café racer. Like H-D, Ducati employs a premium pricing strategy, even though its customers tend to be younger and somewhat less affluent. Unlike most of its competitors, Ducati's sales were up 22 percent in 2008. H-D's V-Rod appears to be aimed squarely at the high end of Ducati's customer base.

BMW BMW's focus is on putting their best efforts into a small range of products, a policy that makes

their products unique in quality, style, and performance. Their motorcycle production concentrates on three different series, each stressing superior quality. BMW's strategy is based on premium pricing and building the best motorcycle that money can buy by setting the standard in technology, environment, and safety in all of their product offerings. Each of their motorcycles portrays the traditional motorcycle image; however, BMW also includes elements of sophistication and class in their products. All of BMW's motorcycles have high resale values; however, their high purchase price limits their market share.

Honda Honda is the world leader in motorcycle manufacturing with 17 percent of the North American market, 22 percent of the European market, and 23 percent of the Asian-Pacific market. In 2008, Honda and its affiliated companies sold over four million motorcycles in India alone. Honda combines excellent engineering and quality with highly automated manufacturing to achieve significant economies of scale. Honda has been able to leverage its low-cost advantage into global leadership.

Honda is a diversified company that at one time surpassed Toyota in sales to become the third-largest automobile company in the United States. In addition to motorcycles and automobiles, Honda manufactures all-terrain vehicles (ATVs), outboard motors, generators, lawn care equipment, and other power products. Honda has a presence in the financial services industry, providing financing options for motorcycle and automobile dealers and consumers. Honda's niche in the U.S. motorcycle market is touring bikes. With up to 1,500 cc water-cooled engines, Honda's touring bikes are high quality, refined, comfortable, and fuel efficient. Honda encourages creativity and is widely regarded as being the global leader in four-cycle gasoline engine technology.

Kawasaki Kawasaki is a world leader in the transportation equipment and industrial goods industries with diverse product lines in each category. Kawasaki motors is focused on motorcycles, ATVs, jet ski watercraft, utility vehicles, rail cars, wheels, robots, and engines for consumer products such as lawnmowers. Kawasaki is well-known for providing a wide range of products that offer high-performance and low-maintenance attributes. Kawasaki offers multiple models of motorcycles, making them competitive in many different facets of the industry, including touring bikes, sport bikes, off-road bikes, dual-purpose bikes, street bikes, and police bikes.

Kawasaki has a large international presence with production facilities in Southeast Asia, China, Europe,

and the United States. They hold the third-largest motorcycle market share in North America at 10 percent, the fourth-largest share in the Asian-Pacific market at 19 percent, and the fifth largest share in European markets at 12 percent.

Suzuki Suzuki manufactures automobiles, commercial vehicles, outboard motors, and ATVs. Suzuki is the third largest manufacturer of motorcycles, lagging behind only Honda and Yamaha. Motorcycles comprise 19 percent of the company's total sales. Suzuki motorcycles have a significant international presence with sales in over 190 countries. Eighty percent of Suzuki's total motorcycle sales are in offshore markets. Suzuki began using joint manufacturing efforts in foreign countries in 1993 and uses direct sales subsidiaries to reach customers. The joint manufacturing efforts require constant and dynamic technical cooperation between groups using cost-reduction activities to achieve their ongoing goal of providing a low-cost product. Efficiency is the backbone of Suzuki's low-cost position in the industry.

Yamaha Yamaha has manufacturing facilities, distribution, and R&D operations in many international markets. Yamaha focuses on tailoring its products to local market conditions. Yamaha Motor Company has a diverse product line including outboard motors, boats, personal watercraft, generators, golf carts, ATVs, snowmobiles, outdoor power equipment, race kart engines, accessories, apparel, and motorcycles. Yamaha produces a full line of motorcycles, ranging from scooters to heavyweights; however, their competitive advantage focuses on speedy and high-performance racing bikes. Yamaha's motorcycle sales are strong globally; they currently hold the fifth largest market share in North America, the third largest in Asia-Pacific, and the second largest in Europe. Their target market throughout the world is the young and thrill-seeking consumer who sees riding as a sport.

The H-D Company in 2008

H-D is an American icon with a loyal customer following that has been described as cult-like. The company has to be careful not to offend its traditional customers by going too far, too fast. With one notable exception, H-D's line of motorcycles are engineered and designed to evoke an earlier age. Although the company has continuously been in business since 1903, today's company is the result of a leveraged buyout in 1981. The 1980s proved to be a difficult time, and the company was often on the brink of failure. The 1990s brought a complete reversal in H-D's fortunes with the

demand for the company's motorcycles far outstripping supply. During this period it was not unusual for a buyer to have to wait as long as two years to take delivery on the company's most popular models. Profits soared and H-D became the darling of Wall Street. By 2005 management had narrowed the gap between demand and supply. By carefully managing growth, the company ensures that its bikes are not too easy to come by. Starting in 2007, the company was forced to cut back on manufacturing to avoid oversupplying the market. Managing the supply of H-D motorcycles maintains high prices and permits H-D to avoid having to offer promotions and discounts to sell its product. Promotions and discounts are practices that are inconsistent with a luxury good.

H-D's premium pricing limits the number of young buyers. Two-thirds of its customers are between the ages of 35 and 54 years. H-D has redesigned some of its bikes to better accommodate female riders. The percentage of female buyers has reached 12 percent and continues to move slowly upward. H-D also offers motorcycle driver education courses, where 40 percent of the participants are women.

For the most part, the company has failed in its attempts to diversify into related industries. The economic downturn of 2007–2008 negatively impacted Harley-Davidson Financial Services (HDFS). HDFS's primary business is to provide financing and insurance to H-D dealers and buyers. In 1998 H-D moved to expand its presence within the motorcycle industry when it acquired the outstanding shares of the Buell Motorcycle Company. While sharing components and technology with H-D, the performance-oriented Buell is intended to attract younger and nontraditional riders to the H-D family. In 2008 H-D acquired the European motorcycle manufacturer, MV Agusta, which includes the MV Agusta and Cagiva brand names. MV Agusta products emphasize design and performance and feature a liquid-cooled, four-cylinder engine design. Cagiva products are lightweight sport bikes featuring 125-cc air-cooled engines.

H-D Strategy In 2008 H-D's strategy incorporated three objectives, at least two of which are a direct result of the economy: (1) investing in the H-D brand, (2) restructuring operations and reducing the cost structure, and (3) obtaining funding for HDFS.

The first objective, investing in the brand, is to be achieved through a two-pronged approach. First, the company intends to increase its market base by reaching out to nontraditional rider groups, including women and minorities. The second prong is directed at its traditional rider group, and product innovation is the vehicle of choice for reaching this group.

The second objective, restructuring operations, is to be accomplished by plant closing and outsourcing. The company will close two engine and transmission plants in Milwaukee and move their operations to a third plant in Menomonee Falls, Wisconsin. Paint and frame operations in York, Pennsylvania, will be combined with other operations at that site. A distribution facility in Franklin, Wisconsin, that handles parts and accessories will be closed and its operations outsourced. Finally, the company's trucking operation will be terminated and its activities outsourced. It is expected that restructuring and reduced product demand will result in the loss of 1,500 hourly and salaried positions.

The third objective, obtaining funding for HDFS will be the most problematic and includes:

- Accessing the unsecured debt capital markets.
- Increasing asset-backed credit.
- Renewing existing lines of credit.
- Accessing the asset-backed securitization market through the U.S. Federal Reserve programs.

H-D has found it difficult to sell motorcycles without providing a source for financing. Consequently, the company's well-being hinges on the liquidity of HDFS.

H-D Human Resources Management H-D prides itself on open communication with its union and non-union employees and on its team-based culture. Employees are involved in goal setting, and this practice facilitates a shared vision of the company's direction. Self-directed work groups are the norm. Departmental differences are minimized through a focus on cross-functional communications. These types of personnel practices are known as partnering at H-D; partnering results include increased employee motivation and a reduced need for supervision.

The company developed its Performance Effectiveness Process to foster both employee performance and career development. Employees are rated on a form that includes over 90 descriptors, which include: (1) values diversity in the workforce, (2) does what he/she says he/she will do, and (3) responds in a positive manner to criticism. The performance evaluation was tested and refined on managers before it was used on the workforce. H-D takes career development seriously and has formalized all the company's learning, training, and development initiatives under its Leadership Institute. Each year over a third of the company's employees attend the institute's courses. Management believes these courses improve the company's

competitiveness, while giving employees the knowledge and skills needed for advancement and personal growth. H-D prefers to promote from within the company to give employees opportunities for advancement and to demonstrate the company's commitment to retaining talent. This is why they also have an extensive tuition reimbursement program, including undergraduate and graduate programs offered through Marquette University and Milwaukee Area Technical College. H-D even developed a program to assist its distributors. Classes offered at H-D University (HDU) help distributors improve customer satisfaction, store layout, and merchandising.

An emphasis for HDU is teaching dealers how to market and sell motorcycles. Until 2005–2006, the H-D's dealers functioned as order takers. Demand for H-D motorcycles exceeded manufacturing capacity, and most buyers had to wait a few months before receiving their bikes. During the transition from the 2005 to the 2006 model years, supply briefly exceeded demand. For the first time in the memory of most dealers, unsold motorcycles were sitting on the showroom floor. The fact that dealers simply didn't know how to handle this situation became painfully evident when sales trended downward in 2007. HDU stepped in to help H-D dealers learn what every successful car dealership already knows: how to sell your product.

In 2008 the company employed approximately 9,000 employees in the manufacture of motorcycles. As a function of their geographical location, unionized employees are represented by one of two unions. H-D had incurred only one previous strike since the AMF buyout in 1981 when in 2007 the employees at the York, Pennsylvania, plant went on strike for three weeks. The bones of contention were pay, a tiered wage system, and copay for medical benefits. In the end workers received a 12 percent wage increase

over three years, and the company received a lower starting wage for new employees. The tiered wage system flew in the face of Harley's compensation structure, which had traditionally been driven by two guidelines: (1) make a larger portion of the employee's pay at risk or variable and (2) compensate all employees in the same manner. An example of a bonus compensation system used for employees is giving equal percentage bonuses, based on 15 percent of sales. It is believed that this practice minimizes differences in employee pay and promotes teamwork and lessens jealousy among employees. H-D generally evokes a deep commitment from employees. Building consensus with union employees is H-D's standard practice. Resolving the occasional union grievance is left to the employee's filing the grievance, the union steward, the work group, and the work group's advisor (manager). The grievance resolution is considered binding by the union and the company.

Harley has a time-tested device for keeping up with customer demands and ensuring product quality. Half of the company's 9,000 employees ride a H-D, yet every employee, including the CEO, must go through a dealer to get a bike. This is just a testament to H-D being a company driven by the human resources function. Fairness and equality are driving this company into the future with a workforce that believes they are part of something special.

H-D Operations H-D has an ongoing production strategy of increasing the supply of its motorcycles, but at a rate less than that demanded by the market. To this end, the company expanded its manufacturing capacity through 2006. The company tries to position its product development staff in proximity to its manufacturing operations in order to ensure that new product and model changes are coordinated prior to and during ramp-up.

Harley-Davidson Manufacturing Facilities

Facility	Size (sq. ft.)	Part(s) Supplied
Wauwatosa, Wisconsin	430,000	Powertrain
Menomonee Falls, Wisconsin	881,000	Powertrain
Tomahawk, Wisconsin	211,000	Fiberglass parts and painting
York, Pennsylvania	1,331,000	Parts fabrication, painting, and assembly
Kansas City, Missouri	450,000	Sportster assembly, V-Rod powertrain
East Troy, Wisconsin (Buell)	40,000	Buell assembly
Manaus, Brazil	82,000	Office and subassembly for local markets
Varese, Italy	1,378,000	MV Augusta facilities
Adelaide, Australia	485,000	Motorcycle wheels

A company operation in South America imports parts and subassemblies from the United States for final assembly in Brazil. Assembling the bikes in Brazil reduces duties and taxes, thus reducing the selling price and increasing the company's market. However, the volume of this facility remains under 1,000 units per year. Bikes for all other international markets are exported from the United States.

H-D actively practices lean manufacturing and quality management. The company continuously strives to improve the quality of its operations while controlling costs. Quality management practices include statistical process control, employee involvement in operations-related decisions, supplier participation, just-in-time inventory control, and partnerships with the company's unions. H-D trains its employees in the use of statistical methods and problem solving through its Leadership Institute courses. The company is proud of its relationship with employees and encourages employee involvement, emphasizing a highly flexible and participative workforce. The company employs this flexibility in cross-functional teams that review every aspect of the production process.

H-D strives to establish long-term mutually beneficial relationships with its suppliers. The company involves suppliers in the design and manufacturing of its products and quality improvement programs. Harley requires that its suppliers be committed to annual cost reductions even when labor and material costs are rising. The company believes that vendor involvement results in improved products, the adoption of new technologies, and the smoother introduction of new products and product changes. Supplier involvement is not without its costs and has led to an increase in the number of purchasing engineers from 4 to 30 in the 1990s. The involvement of suppliers has resulted in improvements in productivity and product quality, and a four- to five-day component inventory, all of which translates into an estimated savings of over \$10 million per year.

In conjunction with its just-in-time inventory and assembly controls, H-D has introduced an automated electrified monorail (AEM) system in its two Wisconsin engine assembly plants. The AEM systems have increased productivity, improved ergonomics and increased the speed of changeover between different assemblies, while freeing up space on the factory floor. Similarly, the company's parts and accessories distribution centers have been highly automated leading to increased speed of delivery and a 99.7 percent level of accuracy.

H-D Marketing August 2003 saw the culmination of H-D's hundredth anniversary celebration when an

estimated 200,000 people participated in events in and around Harley's hometown of Milwaukee, Wisconsin. Riders came from every state and from every inhabited continent. H-D's anniversary was one of the biggest—some said the biggest—events in Milwaukee's history. H-D's public exposure from the carefully orchestrated event was beyond price, but events and promotions are the norm for H-D. Countless features in the media focus on the company, its bikes, and the image of Harley riders. The company has a long history of successful promotion, and its bikes have costarred in numerous major film productions.

The 130,000-square-foot H-D Museum opened in Milwaukee in 2008. The museum, showcasing both historic and current motorcycles, is intended to strengthen the company's bonds with riders and the general public. The museum includes a restaurant, café, retail, and meeting spaces. The company will use the space to host special events for the Harley Owners Group (HOG®).

The company's traditional advertising and promotional venues include dealer promotions and cooperative programs, magazine and direct mail advertising, and its famous HOG customer events. The annual gathering in Sturgis, South Dakota, has been the subject of public television documentaries. H-D's Web site offers an interactive and exhaustive online catalog. Customers can order accessories and customize bikes with hundreds of options. It wasn't until 2002 that Harley-Davidson felt the need to advertise its products on television. The result of the company's marketing actions is that Harley-Davidson ranks near the top among iconic brands, along with Disney and Apple Computer.

Formed in 1983, the company-sponsored HOG had over 1.1 million members worldwide in 2008. The group sponsors events, including national rides and rallies, and the company sponsors racing activities. Harley's buyers are not locked into any social class. You are just as likely to find a CEO on a Harley as a worker off the assembly line. Harley owners are loyal, with 90 percent of buyers reporting the intention of purchasing another Harley bike. Clearly image sells to this demographic, Harley ranks near the 100th percentile on the Brand Asset Valuator scale for such qualities as authentic, rugged, daring, dynamic, distinctive, and high performance. As one Harley owner put it, "What Harley-Davidson appeals to me is that we all think we're cooler than we really are." (*Milwaukee Journal Sentinel*, August 24, 2003)

A creative tool in H-D's marketing program is its Authorized Rental and Tour program. Operated in the

United States and overseas, this program puts riders on factory-maintained Harleys for guided tours. Included in the tour are some meals, lodging, and a support vehicle to carry the heavy luggage and take care of any mechanical malfunctions. A lot of development ideas come from bike-riding employees and from employee attendance at the Harley rallies that are held around the country. Harley riders traditionally customize their bikes, and this practice led H-D to offer custom bikes in 1998. This ongoing product group allows buyers to alter their factory bikes with a wide range of accessories and paint. With an average of \$9,000 in extras, these bikes go for more than \$27,000 and carry a 40 percent profit margin. Delivery time for the factory-custom bikes can run up to a year. The company's marketing efforts were recognized when H-D was inducted into the 2001 Marketing Hall of Fame. Their selection was based on "an outstanding job of building and sustaining their brand through smart marketing" (<http://proquest.umi.com>). The honor recognized what Harley followers have known for years: Brand equity plus superior manufacturing has positioned H-D as the elite manufacturer in the North American motorcycle market.

H-D Distribution H-D products are sold through a network of 686 independently owned full-service dealerships in the United States. The company maintains a European headquarters in England. Dealerships can be found in 36 European, Middle Eastern, and African countries, in 8 Asian countries, and in 15 Latin America countries. Most dealerships sell only H-D and Buell products.

Uke's H-D/Buell dealership in Kenosha, Wisconsin, is fairly typical of Harley dealers. Uke's recently completed a new 54,000-square-foot facility alongside I-94. What may be unique to Uke's is a six-story glass tower that displays custom bikes like jewels in a showcase. The new building features a 15,000-square-foot showroom and a 10,000-square-foot service area. The basement is given over to the winter storage of customer's bikes, while the second-floor mezzanine houses a museum and art gallery. The architectural firm of Kubala Washatko of Cedarburg, Wisconsin, designed the new facility. Kubala Washatko has designed dozens of Harley dealerships around the United States.

H-D Research and Development H-D believes research and development is a key component of its ability to lead the touring bike market. The company maintains a 409,000-square-foot product development center and a separate 79,000-square-foot development center for the Buell product line. The product development centers are staffed with

Harley-Davidson Dealership Locations in 2007

Country/Region	H-D/Buell Dealerships
United States	684
Canada	74
Europe	370
All other	240
Total	1,368

employees from styling, purchasing, and manufacturing, as well as supplier representatives. The practice is consistent with H-D's commitment to quality management and results in seamless product development. Due to the increasing prevalence of environmental and safety regulations, the product development centers are staffed with professionals specializing in the regulatory process. The company has sought to be proactive in meeting environmental and safety regulations in both its products and facilities. The company spent \$163.5 million in 2008, \$185.5 million in 2007, and \$177.7 million in 2006 on product development.

The company's products are in compliance with all current federal and state emission and noise standards. H-D has made the investment necessary to comply with the Environmental Protection Agency's tailpipe emission standards that became effective in 2010. A more pressing problem for H-D may come from more stringent noise standards in the European Union and Japan. Such standards may interfere with one of Harley's most sacred traditions: the bike's distinctive, and loud, exhaust.

H-D Motorcycle Unit According to H-D:

The total on-highway motorcycle market, including the heavyweight portion of the market, is comprised of the following four segments:

- *standard (emphasizes simplicity and cost)*
- *performance (emphasizes handling and acceleration)*
- *custom (emphasizes styling and individual owner customization)*
- *touring (emphasizes comfort and amenities for long-distance travel) (2008 Form 10-K)*

The company currently addresses all categories with its offerings from the MV Augusta line in the performance segment, with the Buell lineup in the standard and performance segments, and with H-D offerings in the standard, performance, touring, and

custom segments. The larger displacement custom and touring models are the most profitable for the company.

The company's motorcycle unit consists of H-D Motor Company, the Buell Motorcycle Company, and MV Agusta. The motorcycle unit designs, manufactures, and markets primarily heavyweight bikes, as well as motorcycle parts, accessories, and merchandise. The company is the only major U.S. manufacturer of motorcycles and has led the heavyweight market since going public in 1986. The Motorcycle Industry Council figures give H-D a 45.5 percent share of the domestic heavyweight market for 2008. For some years the motorcycle unit generated about 80.0 percent of the total net sales of Harley-Davidson, Inc.

Harley's heavyweight bikes are, by the company's own definition, more than 650 cc of engine displacement. The company currently markets 33 models of performance, touring, and custom bikes with suggested retail prices up to \$29,999 for a limited-edition factory-customized model. These bikes are built on five basic chassis designs (Softail, Sportster, Dyna Glide, Touring, and the VRSC, or V-Rod) and are powered by one of four 45-degree V-twin air-cooled engines ranging from 883 cc to a huge 1803-cc brute (the V-Rod utilizes a liquid-cooled engine). The company pioneered the touring heavyweight motorcycle, and this segment includes well-equipped bikes with fairings, windshields, and luggage carriers. The custom segment includes the retro-look bikes that are typically highly customized through the use of chrome, paint, and accessories. These bikes sell for prices that are about 50 percent higher than competitors' comparable models.

The V-Rod or VRSC model is the first in a new series of bikes aimed at the performance café racer market. The VRSC shares nothing with existing bikes and is equipped with the Porsche-designed, liquid-cooled, 60-degree V-twin, 1130-cc, 110+hp, Revolution engine. It is the most expensive development project in the company's history, but H-D has not revealed the numbers. The VRSC model has met grudging acceptance at best with H-D's traditional buyers, but has done well with nontraditional buyers and the international market. Harley's previous foray into the performance segment with its Buell line of motorcycles has met with only limited success.

H-D manufactured and shipped 303,479 motorcycles in 2008 down from 330,619 in 2007. About half of all bikes on the road are Harley's big street cruisers, like the Softail, that sell for about \$18,000. Around 30 percent are the true heavyweight touring

machines; equipped with fiberglass saddlebags, CD players, radios, and cruise control, these bikes sell for \$20,000 or more. The remaining bikes are mostly the \$7,000-or-more Sportsters; with ongoing cosmetic upgrades, the Sportster remains Harley's oldest and most affordable model.

H-D Parts and Accessories Parts and accessories include genuine H-D replacement parts and cosmetic bike accessories. Parts and accessories comprised 15.4 percent of sales in the motorcycle segment in 2008. This segment includes general merchandise, an area encompassing such items as clothes and collectibles. Around the country are 80 dealerships with shops that feature H-D clothes and collectibles, as well as an additional 52 Harley stores in malls, airports, and vacation destinations and another 20 seasonal shops. General merchandise constitutes 5.6 percent of sales in the motorcycle segment. While general merchandise is a small entry on H-D's income statement, it is an important form of advertising and a major player in the company's quest to turn the brand into a lifestyle. H-D licenses its name and logo for such items as T-shirts, jewelry, and toys. The company believes that licensing is a useful tool for promotion and routinely polices the unauthorized use of its name and logo. Royalty revenues totaled \$45.4 million in 2008. While royalties are not great, the margins are high.

H-D Financial Services Unit The 700 employees of HDFS engage in the financing of dealer inventories and retail consumer installment sales contracts. The growth area in this market appears to be in the financing of new motorcycles. During 2008, 53.5 percent of all new H-D motorcycles retailed in the United States were financed by HDFS, up from 40 percent in 2004. H-D also reports that it provided financing to 95 percent of its dealers in 2008. Operating income from financial services was \$82,765,000 in 2008, down 61 percent from 2007. While most of its business is directed at H-D dealers and the dealer's customers, Financial Services also provides financing for noncommercial aircraft, as well as broker's insurance and service contracts for motorcycle owners.

H-D Financial Statements

In the face of the 2008–2009 recession, H-D's net profit remained strong but significantly off the 2006 high of \$1,043,153. Profits in 2008 were \$654,718, down 37 percent from 2006. The company has relatively little debt. Needless to say, H-D is no longer the darling of investors and the financial press. The board

of directors has authorized the company to repurchase shares of the company's common stock. Under these plans, large blocks of stock have been repurchased by the company in recent years and have helped to keep H-D's stock price up in an often down market. Nonetheless, the company's stock value has declined markedly. The high value in the first quarter of 2007 was \$74.03 per share, which may be contrasted against a low value of \$11.54 per share in the fourth quarter of 2008.

H-D has taken steps to reduce its exposure to fluctuations in the international financial markets. The company made \$95 million on foreign exchange adjustments in 2008, largely due to the decline in the dollar. The company expects to lose on foreign exchange adjustments in 2009. To reduce foreign exchange risks, the company selectively uses financial instruments. Forward foreign exchange contracts are used to hedge the effect of earnings fluctuation on the dollar. H-D is also exposed to loan defaults and interest rate fluctuations through its financial services division. To minimize its risk, HDFS packages and resells most of its loans. Harley's pension and SERPA benefit obligation has increased from \$963,824 in 2005 to \$1,178,283 in 2008. The postretirement health care liability went from \$298,340 to \$372,631 in 2005 and 2006, respectively. These liabilities will need to be closely monitored in the years to come.

CASE DISCUSSION QUESTIONS

1. Which of Porter's generic strategies is H-D using? Will this strategy work for all of the countries described in the case? Why or why not?
2. What does a Porter's five forces analysis reveal about the strategies H-D has employed in recent years?
3. How does H-D compare to its competitors?

CASE CREDIT

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