

## **1.0 Introduction:**

Warren Buffet was once asked what is the most important thing he looks for when evaluating a company to invest in. Without hesitation, he replied, "Sustainable competitive advantage." Sustainable Competitive Advantage (SCA) is gained by effectively exploiting the distinctive capabilities and characteristics of a company that cannot be easily replicated by its competitors.

This paper will examine the (SCA) that Harley-Davidson (H-D) is seeking to maintain or to gain in certain target markets - specifically in the United States and China, respectively - for motorcycles. Included will be a value chain analysis of two generic forms of competitive advantage – low cost and differentiation - that contribute to H-D's quest for dominance in those markets.

**2.0 Situation Summary:** Although motorcycles are sold internationally, 3 main geographic markets comprise the bulk of motorcycle sales: North America, Asia, and Europe.

### **2.1 North America:**

The largest market for motorcycles is North America (USA and Canada), accounting for about 60% of worldwide motorcycle sales. According to the company's Web site (2008), H-D leads the industry in domestic (United States) unit sales of heavyweight motorcycles. Japanese producers - Honda, Yamaha, Kawasaki, and Suzuki - are producing a full line of motorcycles ranging from scooters to heavyweights. Japanese companies' success began with copying other products, but evolved to depend on innovative designs and technology. Harley Davidson is producing heavyweight motorcycles

emphasizing good quality product and after sales service, thereby building up brand loyalty. Honda is the largest company in terms of size, financial backing, and reputation. It is offering the widest selection of styles, classes and sizes within the heavyweight category. Kawasaki's products include a full line of motorcycles, all terrain vehicles, jet skis and other. It is the leader in super bikes manufacturing but US legislation is limiting the number of sports bikes to be imported because of safety reasons. Yamaha produces Harley clones but lacks Harley's image.

## **2.2 The Global Market:**

With the baby-boom generation in North America aging, one of H-D's major market segments is on the verge of declining, so the company has sought opportunities to penetration new markets, especially in Asia and Europe. Major Asian target areas include China, Korea, Taiwan and Vietnam, along with India in Eastern Asia. The European Market is another area with great potential since Europeans have high levels of disposable income. To succeed in these markets, H-D has needed to offer products to meet local needs, meet government standards, change their marketing approach, provide after sales service, expand distribution networks, and create strong customer loyalty.

## **3.0 Key Problems - H-D faces 3 key problems:**

**3.1** Maintaining its unique place in the North American market for heavy cruising motorcycles

**3.2** Enhancing its position in European markets.

**3.3** Penetrating Asian markets. H-D is known for large-bore engines, heavy chassis and high prices. Younger riders prefer sleeker, more agile, less expensive bikes. The Asian market is vast, but government regulations and trade policies make it difficult for foreign manufacturers to enter.

#### **4.0 Hypothesized Causes**

**4.1** The baby-boom generation in North America that has traditionally favored the iconic large-bore, heavy cruisers is aging. Younger riders in the U.S., along with their European and Japan counterparts, prefer sleeker, more agile bikes.

**4.2** In both the European and Asian markets, the main barriers the company has faced are competition from indigenous competitors who have catered to the demands of local customers, high customs duties and quotas, and cheaper competing products.

**4.3** In the China market, there exist riding bans in big cities and motorways, high customs duties, poor insurance coverage and stiff competition from illegally imported motorcycles. In December 2007, Reuters News (Palmer, 2007) report that four U.S. senators were urging the Bush administration to raise pressure on China to open its market to U.S. motorcycle maker Harley-Davidson Inc. "The Chinese market should be a hog heaven for U.S. motorcycle companies, but China's unfair trade practices are slamming the brakes on Harley sales," said Sen. Charles Schumer. "Fair trade must be a two-way street," said Sen. Robert Casey, a Pennsylvania Democrat. "China's roadblock to Harley-Davidson is unacceptable. There will always be a

demand for a classic like Harley-Davidson motorcycles, but artificial barriers are threatening U.S. jobs." Alan Tonelson, a research fellow at the U.S. Business and Industry Council, said all U.S. manufacturers face a "very formidable array" of barriers to gaining access to the Chinese market. "U.S. government attempts to reduce, much less eliminate, these trade barriers, has been woefully ineffective," he said (Nakashima, 2006.)

**5.0 Analysis:** This segment will discuss H-D's ability to gain SCA, based on costs and differentiation

### 5.1 Cost Considerations

**5.1.1 Economies of Scale:** Also important in non-manufacturing operations, such as purchasing, research and development, distribution and advertising (Grant, 2008). Harley does not have an advantage over its competitors based on economies of scale due to the sheer size of its competitors and their abilities to bargain with suppliers. However, Harley is able to capitalize on the limits of Economies of scale, in particular product differentiation and flexibility. An example of how Harley is capitalizing on limits to economies of scale is described in the following statement:

“Reconciling product differentiation with scale economies was a continuing challenge for Harley. The solution was to offer a wide range of customization options while standardizing on key components. For example, among the 36 different Harley models there were three engine types (Evolution XL, Twin Cam 88, and

Revolution), Four basic frames, four styles of gas tanks etc.”  
(Grant, 2008).

- 5.1.2** Process Design: H-D has rebuilt its production methods to reduce costs by implementing JIT (MAN) inventories, Total Quality management, and CAD/CAM designs. The processes were designed to pull components and sub-assemblies in response to final demand instead of pushing them through production, which eliminated costly inventories.
- 5.1.3** Business Process Reengineering: Harley instituted a non-hierarchical, team-based management structure fostering motivation and accelerating innovation and learning. The bottom line was a flatter, team based organization, which reduced cost of upper level management. This management style also helped to eliminate wasted steps, pare costs, and enhance quality throughout.
- 5.1.4** Product Design:
- 5.1.4.1** Harley’s commitment to traditional design features has minimized complications of manufacturing. While Harley manufactures only three types of heavy bikes, they also design, manufacturer and sell custom and performance motorcycles. Currently the company has over 28 models of touring and custom Harley motorcycles. In order to satisfy the more "sedate"

European tastes, HD purchased Buell and manufactures a sleeker, more lightweight bike under that label.

**5.1.4.2** An important linkage for HD is its design engineering and marketing. HD is not a high performance bike. They are not comfortable to ride, but the people who buy them love the designs of the bike. Another important linkage is the ability to customize a stock bike. “Central to Harley’s product strategy was the idea that every Harley rider would own a unique, personalized motorcycle...with the potential for augmentation through a range of 7,000 accessories” (Grant, 2008, p. 153).

**5.1.5** Economies of Learning:

**5.1.5.1** Even though Harley has alliances with numerous car manufacturers to help with technological development it rarely implements significant changes to original designs. Because of Harley’s reluctance to change product designs, Harley’s technicians do not have to re-learn new procedures very often - this facilitates economies of learning. “Harley’s commitment to traditional design features may be seen as making a virtue out of necessity. Its smaller corporate size and inability to share research expenditure across cars and

bikes (unlike Honda and BMW) limited its ability to invest in technology and new products. As a result, Harley lagged far behind its competitors in the application of automotive technologies: its motorcycles not only looked old-style, much of the technology is old-style” (Grant, 2008).

**5.1.5.2** H-D has provided extensive, universal training for their dealers in efforts to improve the customer service aspect of the business. They also flattened the organization and started work teams that focus on process improvement throughout the organization.

**5.1.6** Input costs:

**5.1.6.1** Through H-D’s Supplier Advisory Council (SAC) the company has fostered close relations with its key suppliers and not only improved purchasing efficiency but also is able to share information, ideas and strategy with its suppliers. Over 80% of its suppliers are located within 160 miles of one of their manufacturing plants, which contributes both to minimal transportation costs, as well as to efficiencies in the just-in-time delivery system (Milligan and Carbone, 2000).

**5.1.6.2** Too, a product development center in Milwaukee was opened in 1996 to shorten the length of time it took

to get products from design stage to the markets. Some of the tangible results of its efforts have been a 50 percent inventory reduction, a 50 percent reduction in scrap and rework, a 32 percent productivity increase, an increase in inventory turns from 5 to 17, and a decrease in warranty claims despite a longer warranty period (Minahan, 1998).

**5.1.6.3** HD's gross margin was 37.9% in 2004, compared with Honda at 31.3%, Yamaha at 27.3%, and BMW at 23.2% - indicating that H-D has a competitive advantage on costs. As well, the company enjoyed a Return on Assets for 2006 of 28.9% and a Net Margin of 17% ,while their competitors, Net Margins were below 6%, which further indicates that H-D is a highly cost-efficient operation compared with their competition (Grant, 2008).

**5.1.7** Capacity Utilization: H-D is working at maximum capacity, yet is unable to meet demand for its production bikes. Customized products can take up to a year to ship.

**5.1.8** Residual Efficiency: Additional affects of the Business Process Reengineering have been Residual Efficiencies. According to the company's 10K filings, a ratio between SG&A and sales before 2001 was around 18%. After 2001 the ratio has a steady decline to



about 14% in 2005. This alludes to the fact that Harley has been able to root out institutionalized inefficiencies in general administrative costs. H-D's customer loyalty and repeat business - with 45% of purchases being made by existing customers - greatly reduce the costs of advertising, marketing and sales. The fact that Harley Davidson motorcycles are slightly unique allows its customers to feel as though they have a custom bike that has led to acceptance of higher prices. Due to high demand for the HD motorcycles, resale prices are higher than those of its competitors. Owners feel as though their Harley is an investment, thereby helping them rationalize paying the higher price.

## **5.2 Sources of Differentiation- Based Advantage**

### **5.2.1 The Demand Side**

**5.2.1.1 Product Attributes and Positioning:** The characteristics by which H-D's products are identified and differentiated are comprised of quality and reliability; styling ("throwback" traditional design); customization;

### **5.2.1.2 Social and Psychological Factors:**

**5.2.1.2.1** Grant (2008) contends that "HD is in the business of selling lifestyle, not transportation." The factors of H-D's products that satisfy a range of customer needs include image (esteem, status symbol, a way of life, individuality,

freedom, adventure, an American tradition); reputation (one of the world's oldest motorcycle companies); sense of community; financing and other complementary products.

**5.2.1.2.2** Harley Davidson in previous years included the mystique of the rugged individualist, and the company recognized that a large segment of bike riders placed great value on that perception. As H-D's customer base has aged, however, its U.S. market segment has placed ever-more value on such intangibles as credibility, trust, safety, and the tangibles of quality of product, financing and service.

**5.2.1.2.3** HD centralized its marketing on these topics, for example creating a Harley Owners' Group who rallies more than 900,000 members worldwide, including many of HD's executives and managers. This strategy ensures the HD maintains a strong relationship with its customers, according to whom, HD understands them and their needs, and also that the company is responsive if a problem arises with either the product or the company's services.

**5.2.1.2.4** A key attribute may be the reputation of the organization. The customer may be motivated by the image that H-D represents, choosing a Harley over another brand due to the reputation for a lifestyle along with gaining a customized bike that is unique and reflects their personality.

## **5.2.2** The Supply Side

### **5.2.2.1** Drivers of Uniqueness

**5.2.2.1.1** Product features and performance: H-D's iconic product is the big-bore, heavy cruiser, and Harley remains the predominant brand worldwide for that segment of the market.

**5.2.2.1.2** Complementary products and services: Complementary products really sell Harleys. The ability to customize a bike is a major attractant toward buying a Harley. At rally events, bike modifications are one of the main topics of discussion.

**5.2.2.1.3** Intensity of marketing activities: The demographics are older, well-off men (and some women - women account for 10% of retail sales). HD understands what their North

American customers want and they play to that desire.

**5.2.2.1.4** Technology embodied in design and manufacture: There is a traditional design style to many of H-D's models. Where HD has innovated, however, is in the customized accessories and after-market add-ons. The ability for a customer to "personalize" one's bike is a key element in HD's marketing strategy. Technology, while somewhat invisible to the end design, is actually embedded in every aspect of HD's operations, helping them to become cost-efficient, if not cost-competitive.

**5.2.2.1.5** Quality of purchased inputs: H-D focused on gaining a greater market share by achieving higher product quality than rivals, maintaining a stronger reputation and a better branding strategy than its competitors, increasing levels of customer satisfaction and finally attaining stronger customer loyalty.

**5.2.2.2** Location: HD has not only expanded their retail outlets, but has made vast improvements in the appearance and level of service offered by those stores.

A look at the company's Supplier Direct Manual (<http://www.h-dsn.com/genbus/business.jsp>) gives one a good insight as to the level of competency the company expects of both its suppliers and dealers.

**5.2.2.3** Signaling, Reputation and Branding: H-D has had a long standing tradition of nurturing relationships with customers – of connecting with them on a personal level. This has led customers to view H-D not only as a company, but also as a family to whom they are very loyal. The fact that many Harley-Davidson garments are worn on biking excursions further increase brand equity and loyalty. This loyalty is exhibited through its various groups and organizations such as the Harley Owners Group (H.O.G), which was established in 1983 in response to a growing desire by Harley riders for an organized way to share their passion and show their pride. By the late-1990's, worldwide membership numbered over 650,000, and the number of local chapters totaled 1,157, the largest factory-sponsored motorcycle organization in the world, and it shows absolutely no signs of slowing down (Shiflett, 1999).

## **6.0 Recommended Solutions and Action Plans:**

**6.1** Capitalizing on both its cost-efficiencies and its product differentiators, H-D's efforts at securing a sustainable competitive advantage during the first half of the Twenty-First Century will hinge on its ability to maintain its position in the North American market and to penetrate and capture the Asian market.

The major factors that will influence that ability will be:

**6.1.1** Opening manufacturing and sales operations in China - employing Chinese materials and subcontracting labor to neighboring countries, such as Viet Nam. Unlike in the U.S., China has no health care costs, and pensions for its workers are minimal. Viet Nam's labor costs are significantly lower than even those in China. Parts and materials are also less expensive in China, and transportation/distribution costs to the Asian markets are significantly less when shipped locally than from North America.

**6.1.2** Successfully selling its products to the Asian and sub-Asian markets.

**6.1.2.1** The company's managing director for China, Dave Foley, contends that, "Motorcycle riding fans are eager to get top machines like Harley-Davidsons." Despite its high costs, Foley maintains that owning a Harley is a status symbol in China, just as it is in the U.S. He cites the fact that the GM brand is No. 1 car seller in China, thanks to smart marketing, and contends that H-D can

emulate the GM success. GM went right to the top in targeting the consumer it wanted to reach: the rich. Its goal was to establish Buick as the dream car for every Chinese driver. Take the Buick minivan. It was designed for suburban moms in the United States, but in China, it is a status symbol (Alexander, 2007).

Another opportunity that H-D should explore is expanding its Buell line of products into Asia, as those bikes offer the sleeker, lighter frames favored by the Asian customer.

**6.1.2.2** Although there exist numerous trade barriers and local ordinances in China, which limit H-D's current ability to fully penetrate the market, the company has opened a dealership in the Beijing area, which has the highest concentration of riders of imported heavyweight motorcycles in the country. Harley has signed a memorandum of understanding with Zongshen, which is one of the largest, if not the largest, of China's hundreds of motorcycle manufacturers. According to Forbes (2007), Zongshen is a major player in the transportation-oriented Chinese motorcycle market. It makes a million 50cc to 250cc motorcycles a year and twice that many motorcycle engines. It is reportedly

working on a 1000cc four, and has been sponsoring entries (on Hondas and Suzukis) in world endurance and superbike racing for publicity and research. It employs about 20,000 people, has over 50 subsidiaries, and distributes its products throughout Asia as well as to Europe and the U.S. It recently spent \$30 million on an engineering center and has a 300-person R&D facility as well.

**6.1.2.3** "The potential is enormous but it's up to us to really develop that leisure-oriented market," Foley said. The company said it was too early to forecast sales, but estimated there were more than 1,000 heavyweight motorcycle riders in China, most of whom acquired their bikes through unofficial channels. Analyst Timothy Conder of A.G. Edwards & Sons, Inc. said it may be slow-going but Harley-Davidson should eventually win out. "What they're selling is Americana. I think they should do well," he said.

**6.1.2.4** Further bolstering H-D's optimism, Sens. Herb Kohl of Wisconsin and Claire McCaskill of Missouri joined Schumer and Casey in urging U.S. Trade Representative Susan Schwab and Commerce Secretary Carlos Gutierrez to press China on municipal



regulations that limit or even ban heavy-duty motorcycle use in urban areas. Opening the Chinese market to Harley-Davidson motorcycles "would create growth opportunities and help secure American jobs," the senators said (Nakashima, 2006.)

- 6.1.3** Providing superior customization opportunities for both its North American and European customer base by expanding its Buell line to accommodate enhanced options and to better compete with both top-end competitors such as BMW, as well as with the sleeker, faster Asian designs

## **7.0 Business Impact:**

- 7.1** Instituting the 3 key recommendations proposed in this paper (e.g., establishing operations in China; penetrating the Asian and sub-Asian markets; and providing superior customization opportunities for both its North American and European customer base) will profoundly impact H-D's sustainable competitive advantage. Already, its inroads in Europe and Asia are resulting in significant revenues for the company, as evidenced by the fact that Q4 2007 international sales for were up 17%. The near-term outlook is highly favorable in light of the dollar's recent decline against foreign currencies, which has made the products more affordable for a larger number of customers.
- 7.2** Both China and India's commerce ministry have tentatively agreed to recognize European engine emission standards for motorcycle engines

exceeding 800 cubic centimeters, a standard Harley's bikes already comply with. The door is now open to sell their bikes in one of the world's most populous regions.

**7.3** Harley is seeking a reduction in the Chinese import tariff to 10%, a level comparable to other imported items in the country. They report having "regular contact" with government regulators on the subject. Harley spokesperson Bob Klein said "this is step one". Already entering the Chinese market and with sales in Latin America and Europe very strong, HOG has proven its brand will sell very well outside the US.

**7.4** European sales may also be favorably impacted, as the Buell line can take advantage of the cost saving that will likely accrue from the company's importation of parts from China and other Southeast Asian countries.

**7.5** While it is likely that neither the China nor India ventures will contribute meaningfully in the near term, the groundwork is being set for explosive results down the road, which should continue to be strong for decades given the populations of both countries, and given both the potential cost and product differentiators the company enjoys, as cited in this paper.

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