

CASE 7

Harley-Davidson, Inc., May 2015

TEACHING NOTE

■ SYNOPSIS ■

Since its rebirth as an independent company in 1981, Harley-Davidson has experienced a remarkable renaissance, taking market share from the once-dominant Japanese motorcycle companies to become the global market leader in heavyweight motorcycles and generating the highest rate of profit in the industry.

The Harley-Davidson story is one of a clearly-focused, tightly-integrated strategy where Harley carefully exploited its brand strength and reputation while building its capabilities in design, manufacture, marketing, and distribution. Harley's success has been built upon a differentiation strategy that focuses upon delivering a unique customer experience. This positioning has sheltered Harley from direct competition with bigger, technologically superior rivals such as Honda, Yamaha, and BMW.

By early 2015, Harley bounced back from the downturn that accompanied the financial crisis of 2008-9. However, unit sales are still well below their pre-crisis levels and Harley's faces the challenge of rekindling growth. The central problem is that the US baby-boom generation that has formed Harley's core customer group is now beginning to forsake motorcycling in favor of more leisurely activities. Harley's recent strategy has been to broaden its customer appeal to embrace younger generations, minorities, females and, most of all, overseas buyers. But will Harley's carefully-honed resources and capabilities give it the same potential for competitive advantage as in its core market segment?

The case calls for a careful identification of Harley's competitive strategy, identification of the resources and capabilities upon which its competitive advantage has been based, and a consideration of whether and how Harley's strategy needs to be adapted to meet current challenges.

■ TEACHING OBJECTIVES ■

I use Harley-Davidson as a case study in the analysis of resources and capabilities. Despite its small size, and weaknesses in cost efficiency and technology relative to its competitors, Harley has one key strength: its unique image and heritage. The key lesson from Harley is that by focusing strategy around this key strength, Harley has been able to build a position of unassailable differentiation advantage. Hence, Harley offers a straightforward and illuminating application of the approach to resource/capability analysis outlined in Chapter 5 of *Contemporary Strategy Analysis*—especially the sections on “Identifying Resources and Capabilities,” “Appraising Resources and Capabilities,” and “Developing Strategy Implications.”

The case also offers an insightful application of the analysis of differentiation advantage outlined in Chapter 7 of *Contemporary Strategy Analysis* (9th edn.). Harley is an exemplar of a company that has built

a focused, integrated, and brilliantly executed strategy that provides its customers with a unique experience. In analyzing Harley's differentiation strategy and identifying opportunities to extend it, the case is an excellent vehicle for utilizing the differentiation advantage framework outlined in the section "Differentiation Analysis" in Chapter 7, especially the value chain analysis of supplier-customer linkages.

However, the strategic issues that the case raises and the learning potential for students go beyond the application of specific tools for analyzing resources and capabilities and differentiation advantage. Key learning objectives for the Harley case include:

- How a company can establish competitive advantage against bigger, better-resourced rivals through a strategy that exploits a few critical resource strengths (namely, the Harley image and reputation) while protecting against resource weaknesses (small scale, lack of technology, lack of global distribution).
- The importance of an integrated strategy. A key feature of Harley's strategy has been the integrated nature of its strategy – its product design, manufacturing, marketing, distribution, and customer support policies have all been built around the need to exploit and project the unique Harley image.

■ POSITION IN THE COURSE ■

I teach this case in the section of the course that deals with the analysis of resources and capabilities and the nature of competitive advantage (Chapters 5 and 7 of *Contemporary Strategy Analysis*).

■ ASSIGNMENT QUESTIONS ■

1. What is Harley-Davidson's strategy? How successful has this strategy been?
2. What resources and capabilities are needed to compete within the motorcycle industry? In relation to these resources and capabilities, how does Harley-Davidson compare with other leading motorcycle companies?
3. How effectively does Harley's strategy exploit its key strengths while protecting itself from its key weaknesses?
4. What threats to continuing success does Harley-Davidson face? How is Harley responding to these threats and what more can it do?

■ READING ■

R. M. Grant, *Contemporary Strategy Analysis* (9th edn.), Wiley, 2016, Chapter 5: "The Analysis of Resources and Capabilities; also Chapter 7, especially the section on "Differentiation Analysis" (pages 186-197).

■ CASE DISCUSSION AND ANALYSIS ■

Identifying Harley-Davidson's Strategy

There are two reasons why I ask students to describe Harley-Davidson's strategy. First, to gain practice in how to identify and describe a company's strategy. Second, to provide a foundation for the analysis of Harley's resources and capabilities, its competitive advantage, and its options for the future.

Using the approach outlined in "Describing a Firm's Strategy" (Chapter 1 of *Contemporary Strategy Analysis*), Harley's strategy can be described in terms of *where* it is competing (the industry in which it competes, the market segments it serves, the geographical scope of its markets, etc.) and *how* it is competing (the basis on which it seeks to establish competitive advantage):

- *Where?* Harley's strategy is distinguished by its *focus* – it concentrates on a narrow segment of the motorcycle market: super-heavyweight cruiser and touring bikes. However, while the bikes form Harley's core offering, Harley also offers a range of other products and services. Through its dealer network Harley offers spares, repairs and maintenance and, most importantly, financial services—primarily consumer credit and also insurance. In addition, Harley has a trademark licensing business extending the Harley-Davidson brand to a wide range of products including clothing, Ford trucks, and cafes.
- *How?* Harley's competitive strategy is distinguished by an unremitting quest for differentiation advantage. This strategy is implemented by a full range of functional strategies – from design through to customer support (e.g. the Harley Owners Group (HOG) activities). This analysis can lead to a discussion of the nature of the Harley appeal: terms such as "individualism," "freedom," "macho," and "rebel" tend to be mentioned. Clearly there is something about the Harley image that appeals strongly to the American male psyche and links today's urban professional with the lonesome cowboy of the Wild West.

Perceptive students will observe that these two dimensions of Harley's strategy are inextricably linked: how Harley competes also defines where it competes. This unity is expressed in the company's explicit statement that what it is supplying is not motorcycles, but *an experience*. Hence, we need to look beyond the product and recognize that Harley's business is really about selling a lifestyle. While the bike is central to this lifestyle, it also comprises the supply of various other accessories and services that Harley offers—including the community activities (owners' meetings, rides, charity activities) offered through the Harley Owners Group.

Harley-Davidson's Performance

How well is the strategy working? This question should elicit the following information:

- HD has displayed remarkable long-term growth. From 1983 to 2014, output grew from 30,000 to 271,000 bikes—the only dip occurred in 2008-9.
- In terms of profitability, HD is outstanding. Even with the poor performance in 2009 and 2010, ROE averaged 26% during 2003-14.

Harley's Resources and Capabilities

To understand why Harley's strategy has led to outstanding performance, we need to see its linkage to the firm's underlying resources and capabilities.

I begin this exploration by asking: "What resources and capabilities are needed to be a successful supplier of motorcycles?" I begin by focusing upon motorcycle production generally to appreciate that Harley-Davidson is the way it is because of the strategic decisions it has made to position itself in a particular way.

This typically elicits lists such as:

RESOURCES

Plant(s)
Skilled employees
Brand
Customer loyalty
Dealership network
Financial resources

CAPABILITIES

Purchasing/supply chain management capability
R&D/technological capability
Engineering capability
Manufacturing capability
Design capability
Marketing capability
Customer service capability.

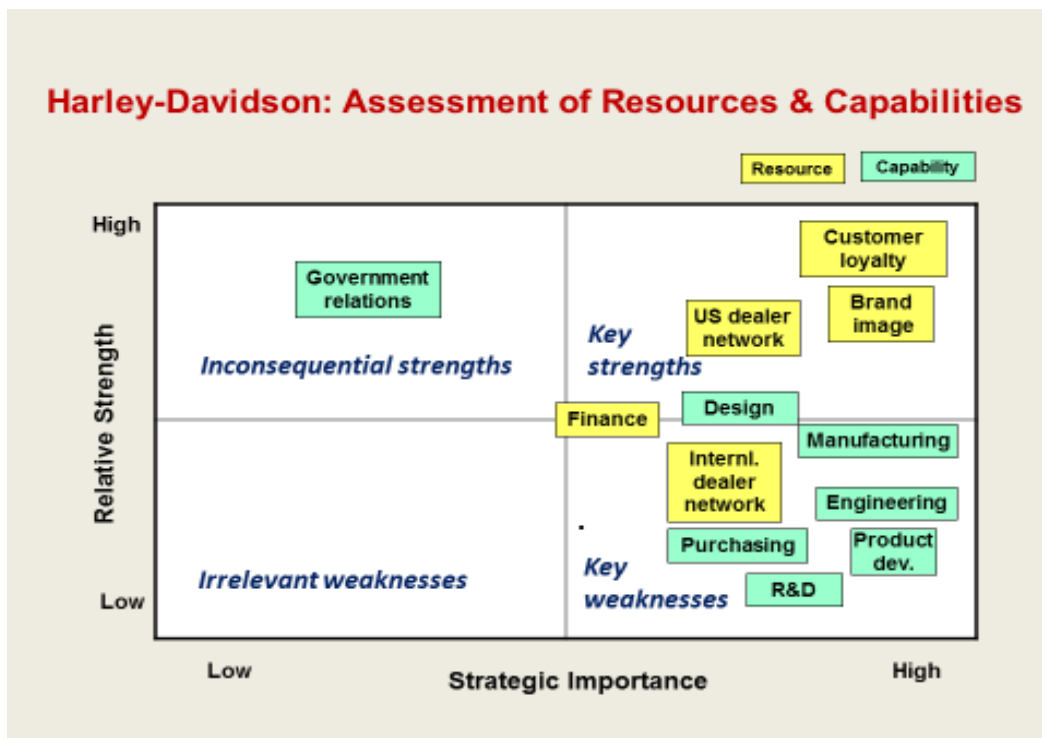
I then go a step further by asking the class to quantify the strategic importance of these resources and capabilities. How do we do this? First, by (subjectively) assessing the extent to which a resource or capability can establish a competitive advantage (e.g. by linking with a customer's choice criteria); second, how far that resource or capability can sustain a competitive advantage (i.e. how difficult is it for a competitor to acquire or replicate it).

I next ask the class to compare the strength of Harley's resources and capabilities relative to other leading motorcycle companies (Honda, Yamaha, Suzuki, Kawasaki, and BMW would be a reasonable comparison). This comparison is inevitably perceptual and impressionistic, however, these judgments can be backed by hard facts. For example, the case allows Harley to be compared to Honda (see slide below).

Harley-Davidson and Honda: Resources & Capabilities

Resource/Capability	Harley	Honda
Technology	R&D budget <\$0.2 bn.	R&D budget \$6.5 bn.
Design	Traditional design concepts. Strong in customization.	History of innovative design. Specialist design studios in several countries.
Purchasing	270,000 units annually limits leverage with suppliers	11m. motorcycles (+ 3.6m. cars)
Manufacture	Access to scale economies limited by <270,000 annual output.	A world leader in high volume vehicle production. Capacity of most assembly plants >1 m. units. Advanced automation.
Distribution	Very strong dealer network in US. Few in many other markets	Worldwide dealer network
Brand	Unrivalled image in heavyweight bikes. Advertising budget \$0.1 bn.	Reputation for quality, performance, reliability, and value-for-money. Advertising budget \$2.8 bn.
Customer loyalty	Extremely high	Based on product attributes
Financial resources	Debt/Equity 1.29; net profit \$0.7bn; credit rating A-	Debt/Equity 0.53; net profit \$5.1bn; credit rating A+

Putting together these two assessments: strategic importance and relative strengths allows us to display Harley's resources and capabilities using the framework shown in figure 5.8 of Chapter 5 (page 131). The resulting display should resemble the slide below:



The Match between Harley's Strategy and its Resources and Capabilities

We can then see how Harley's strategy fits with the strengths and weaknesses of its resource and capability base:

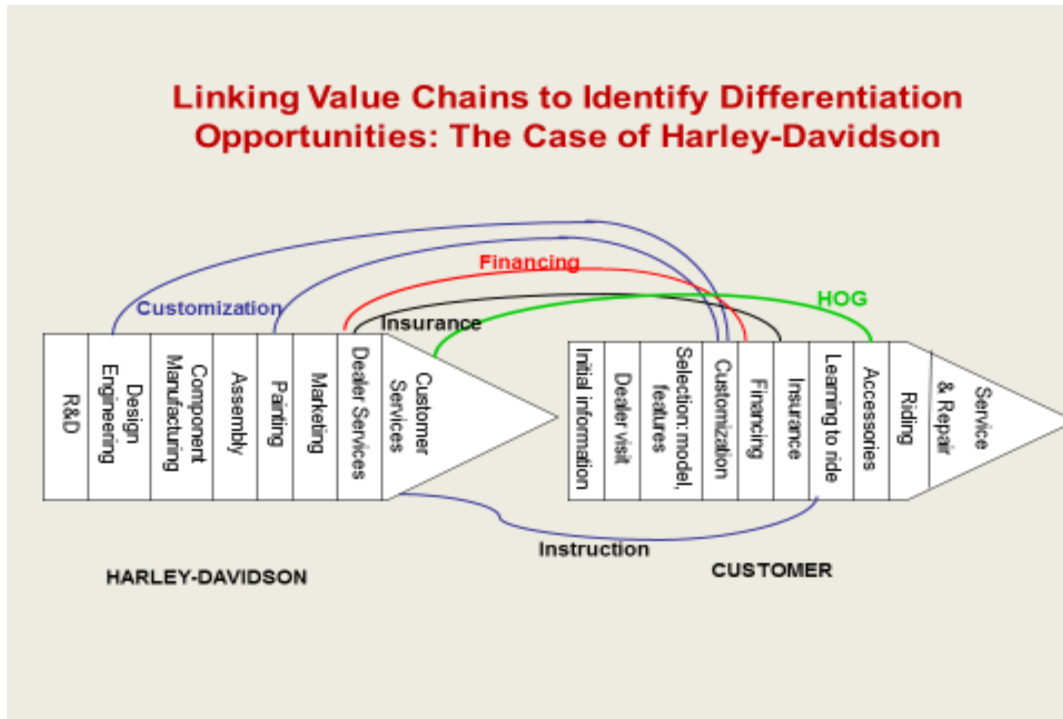
- Segment focus: Harley produces almost exclusively heavyweight bikes. It is this segment where differentiation advantage is most important and cost advantage least important.
- Types of motorcycle: within the heavyweight segment, Harley avoids performance bikes (where technology is key), and produces mainly cruisers and touring bikes. In cruisers especially, style and image are key, technology and engineering less so. By emphasizing its "retro look", Harley has turned its lack of technology into a virtue!
- Differentiation: by focusing on the "Harley experience" HD emphasizes a uniqueness that is distinct from the product. Competitors can make Harley lookalikes, but "the experience" requires authenticity. Harley's dealerships and customer relations (especially HOG) reinforce the Harley experience.
- Marketing has focused on upper-income baby boomers—this group has the disposable income to afford \$15,000 to \$35,000 for a lifestyle leisure product.

Delivering the Harley experience has required an upgrading of resources and capabilities. Key features of HD's strategy from 1981 to 2015 have been: improving product quality, upgrading dealerships, developing customization (including a state-of-the-art paint shop), and incremental technical and design improvements aimed at increasing the accessibility and usability of Harley bikes: electric starters, radios, heaters, improved transmission, reduced vibration etc..

Differentiation Advantage

The Harley case offers powerful illumination of a number of the concepts in differentiation advantage (see Chapter 7 of *Contemporary Strategy Analysis*, particularly pp.186-197 of the 9th edition). These include:

- The role of social and psychological factors in intangible differentiation
- The concept of product integrity—in integrating different aspects of differentiation into a lifestyle product distinguished by the overall user experience, Harley has built differentiation not just into its products but also into the company as a whole and all its relationships with its customers. Consider how employees and managers identify with Harley owners and the common values that link the company and its customers.
- The application of the value chain in linking the supply of differentiation with the demand for differentiation (see pp. 196-198, especially Strategy Capsule 7.8). This involves establishing a value chain for both Harley-Davidson and the motorcycle customer, showing how Harley has adapted each of its activities to make the activities of the customer easier, or more satisfying. The chart below shows a simplified representation.



Threats to Harley's Future Success

For all Harley's success in recovering from the financial crisis of 2007-8, the case points to a number of clouds on Harley's horizon. I ask my students: "What do you see as the major threats to Harley's future prosperity?"

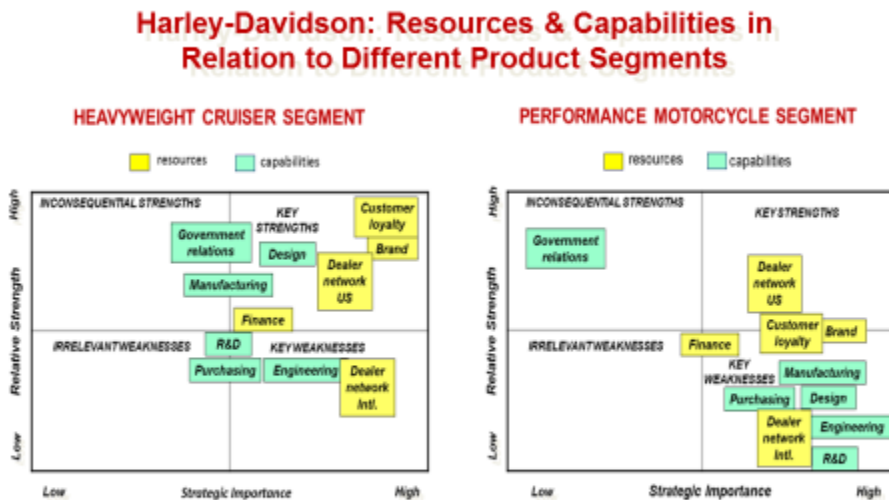
Problems include the following:

- The motorcycle market. In all of Harley's major markets—the US, Canada, Europe, and Japan—consumer discretionary expenditure shows slow growth—a key constraint for leisure items costing in excess of \$10,000. Moreover, Table 1 shows declining sales of heavyweight motorcycles in both North America and Europe—is motorcycling a declining leisure activity?
- Demography. Harley's core customer group is white, US males in their 40s and 50s. But the baby boomers are aging. Will Harley's bikes have the same attraction to generations X and Y?
- The appeal of the Harley image. All lifestyle products run the risk that lifestyle changes will unseat their appeal. Will the macho, individualistic, leather-clad biker image be as popular in during the next 10 years as in the last 10? Even if heavyweight motorcycles retain their appeal, will preferences shift from heavy, noisy cruisers to the stylish, high-performance sports bikes produced by Ducati, Triumph, Yamaha and Kawasaki or the smooth-riding, highly engineered touring bikes sold by Honda and BMW?
- Excess capacity. Harley increased its capacity over the past two decades from 50,000 to 400,000 bikes a year in response to growing demand. All that changed in 2008. Harley has had to cut production and lay off workers. Harley's introduction of "surge production" implicitly recognizes that it had underused capacity during certain periods of the year. The fact that there is no longer a waiting list for new Harleys may result in lower second hand prices for Harley bikes.

- Competition. Competition is intensifying on two fronts. On one side, there are the Japanese manufacturers all of which produce Harley-style V-twin cruisers but typically with more advanced technologies and lower prices. On the other is a set of small producers (Excelsior, Polaris, Enfield, and Indian) that have imitated Harley by producing retro bikes.
- The international market. Does the Harley image travel? It is difficult to judge the international appeal of Harley. In a few countries—Australia, Japan, and several Western European countries there is significant demand for Harleys. Harley is also making major efforts to expand into emerging markets—notably Brazil, India, and China. How far should Harley adapt its products, image, and dealership strategies to different national markets? Does Harley really understand its overseas markets? Will these countries yield the kinds of margins Harley earns in North America?

How is Harley-Davidson Responding to These Threats and What More Can It Do?

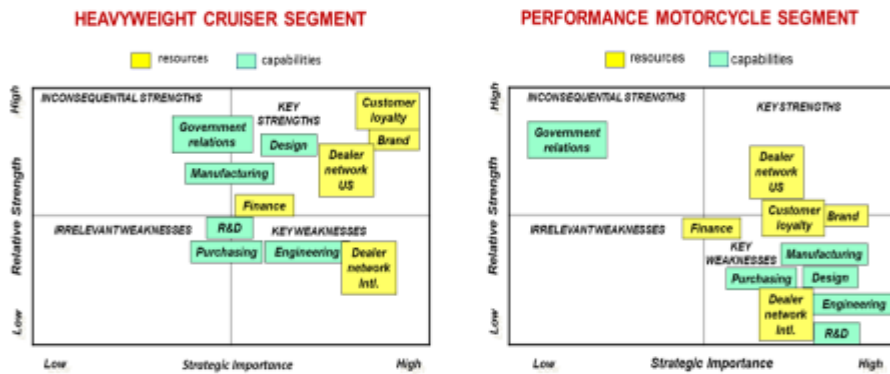
Harley’s previous CEO, Keith Wandell embarked upon three main initiatives:



nger riders with lighter

ilar, it gives greater and its market both ld like to restore sales is not nearly so close a kets. We can see this by :ifics of individual nger resource and ey weaknesses such as : Harley faces a different

Harley-Davidson: Resources & Capabilities in Relation to Different Product Segments



Doubts concerning the Harley's potential for success in smaller bikes are reinforced by the failure of Harley's subsidiary Buell Motorcycles that was closed in 2009, and the limited success of Harley's V-rod model which embodied new technologies (such as a liquid-cooled engine).

In terms of international expansion, the key questions are:

- To what degree the strength of Harley-Davidson's brand appeal can be carried over
- How far Harley will be able to replicate its customer experience—including dealer services, sponsored rides, etc.

There may also be the potential for Harley to extend and reinforce its existing differentiation advantages. By revisiting the value chain framework, it may be possible to identify further linkages between Harley's value chain and that of owners. Harley has recently begun offering vacation services: vacation packages that include the rental of a Harley in a different location.

Finally, if Harley is effectively locked within its existing market and there are limited growth prospects, what about opportunities for acquisitions and/or diversification? The remarkable job Harley has done at developing the business and implementing a comprehensive differentiation strategy suggests outstanding management capabilities that might be applied using a similar strategy in another business. The acquisition of MV Agusta was an interesting move: although subsequently divested, it raises the possibility that Harley might use its expertise in differentiation and delivery of a unique customer experience to another motorcycle company—or even another leisure products company. Although the case does not mention the fact that, during the 1980s, Harley owned recreational vehicle manufacturer, Holiday Rambler.

■ **KEY TAKE-AWAYS FROM THE CASE DISCUSSION** ■

Key Take-Aways from the Harley-Davidson Case

- Even with a firm with few resource and capability strengths, astute strategic positioning can generate superior performance
- To exploit to key strengths while minimizing vulnerability to key weaknesses, requires a strategy that carefully selects
 - (a) market segments and target customer groups
 - (b) dimensions of differentiation
- Effective differentiation requires a systematic, comprehensive approach to creating value for customers—analyzing value chain linkages can be a useful guide
- Outstanding success in positioning for the present makes it difficult to adapt to the needs of the future – “organizational ambidexterity” is a difficult challenge!