

# HARLEY-DAVIDSON, INC.

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*In 1903, two young childhood friends from Wisconsin developed their first prototype of a motor-powered bicycle. It was capable of speeds of almost 25 miles per hour. Today, Harley-Davidson (HD) is the only major American manufacturing concern that continues to produce American-made motorcycles.*

*Harley-Davidson has had a long and proud tradition. However, it has also faced many problems. While producing a poor product and encountering significant competition from Japanese companies, Harley-Davidson came close to bankruptcy. The company's turnaround was spectacular.*

*During its history, Harley-Davidson has had five distinct management tenures or waves, each of which had a significant impact on its operations. The story of Harley-Davidson shows the impact that management can have on a company, both for bad and for good. Much can be learned from one of the greatest comebacks in the history of American business.*

## INTRODUCTION

The story of Harley-Davidson Motor Company (HD) is one of the most remarkable in the history of American enterprise. From its humble beginnings in 1903 in a backyard shed, the company grew steadily even through the travails of the Depression and two World Wars. However, the growth stalled and severe problems became evident in the late 1960's. The excellent reputation that Harley-Davidson had developed was on a downward spiral as the products they produced were of poor quality and dated design and technology. Their market share was minuscule. To make matters worse, during the 1960's and 1970's, Japanese companies significantly increased exports of motorcycles to the United States and, in the process, were accused of dumping. During the first part of the 1980's, the company was on the edge of disaster, close to bankruptcy. However, through its leadership, Harley-Davidson began a dramatic comeback from the throes of death. Under new administration, Harley-Davidson embarked on a major strategic and internal management systems change and has thereafter enjoyed extraordinary success. As of 2008 it was the domestic market share leader, surpassing Honda. International markets were also being more aggressively pursued and were growing. Much can be learned from the comeback of the Harley-Davidson Motor Company.

## BEGINNINGS

Bicycles were, of course, the immediate predecessor of the motorcycle. By the close of the 19th century, bicycle racing had become a celebrated sport, and the first experimental "motor

bicycles” had appeared in Europe. Although the early models usually used steam power, there had been some tinkering with the idea of a power-driven, two-wheeled vehicle in America prior to the turn of the century. However the first commercially produced motorcycle in the United States did not appear until 1901.

It was not long after this that two young childhood friends and bicycle enthusiasts from Milwaukee, Wisconsin, William Harley and Arthur Davidson, turned their inquisitive minds to the development of a motor-powered bicycle of their own. By the spring of 1903, the first prototype model was completed. It was capable of speeds of almost 25 miles per hour. Realizing the limits of simply attaching a small motor to a bicycle frame, the two original entrepreneurs designed a whole new bicycle from the ground up, with a frame made of heavy-gauge tubing, a lengthened wheel base, and a single cylinder gasoline engine. This became the first commercial Harley-Davidson motorcycle.

William and Arthur were now joined by the remaining Davidson brothers, William and Walter. Erecting a 10 x 15-foot wooden shed in the back yard of the family home and painting “Harley-Davidson Motor Co.” on the door, these four young men quietly heralded a new chapter in American transportation history.

Enlisting the aid of an uncle, James McLay, who possessed the necessary capital, the four young visionaries built the first major production facility at the corner of 27th and Chestnut streets in the industrial sector of Milwaukee. By 1906, production was approaching 50 machines a year, all quickly snapped up by Milwaukee residents. As the first mass-produced inexpensive automobile was not yet available, motorcycles were an attractive substitute. On September 22, 1907, the Harley-Davidson Motor Company of Milwaukee was legally incorporated and entered the growing field of American motorcycle producers.

By spring 1908, factory floor space had increased to 5000 square feet and production had reached 456 machines a year, produced by 36 employees. Early on, retailing was established through bicycle dealerships which by then were selling Harley-Davidsons all through the eastern United States. Though the industry was somewhat crowded, with about 33 different manufacturers, only several were considered of high enough quality to compete with Harley-Davidson. Among these the most notable were Indian, Excelsior, Pope, Iver Johnson, Merkel, Reading Standard, and Wagner. A major marketing achievement occurred in 1909 when Arthur Davidson demonstrated his machine to a convention of rural delivery mail carriers, who promptly switched in large numbers from their Wagners to Harley-Davidsons. By the mid-teens there were many American companies manufacturing motorcycles, but the “Big Three” were Indian, Excelsior, and, in third place, Harley-Davidson.

Motorcycle racing had become a serious sport before the end of the first decade of the 20th century, and Walter Davidson immediately realized the advertising potential of this activity. Entering himself in the 1908 endurance run, sponsored by the infant Federation of American Motorcyclists, and against 84 other riders, he finished the grueling 24-hour course with a perfect score of 1000.

By 1914 Europe was already in the throes of World War I, and almost all motorcycle production there had been diverted to military use. While it was not immediately apparent, a subtle difference in motorcycle design had been taking place between the European and American machines. Because the United States was still a growing, developing country (when Harley-Davidson was founded there were only 45 states), the American-made motorcycle required greater durability and more power than was necessary for European machines. American roads, where they existed, were mostly unpaved and distances were farther than in European countries. Frequently riders resorted to using railroad tracks, bumping along on the ties, in preference to the morass of muddy roads. As a result, the motorcycle that evolved was better suited to wartime duties than the usually small, lighter, and more fragile European machine.

America entered World War I in April of 1917, and the U.S. motorcycle industry immediately began military production. The war provided a huge market for motorcycles equipped with sidecars for use by the allied forces. Motorcycles already had seen some military duty on the Mexican border when Pancho Villa attempted a token invasion of New Mexico, which had recently become a state. Impressed with the performance of motorcycles at that time--often cycles could "get through" when larger, four-wheeled vehicles could not--the government placed large orders with the Milwaukee-based Harley-Davidson. By 1917-1918, half of Harley-Davidson's production went into government service. The "Big Three" motorcycle producers supplied to the war effort 41,000 Indians, 15,000 Harley-Davidsons, and 2,600 Excelsiors.

At the close of World War I, Harley-Davidson and Indian were each producing 35,000 motorcycles a year; Excelsior followed with 25,000. With a greatly enlarged factory on Juneau Avenue, Harley-Davidson was rapidly gaining on the long-standing first-ranked producer, Indian.

The 1920s saw a decline in popularity of the motorcycle, as affordable automobiles had at last become a reality. While domestic demand declined, overseas interest picked up and, by 1927, 50 percent of all motorcycles manufactured in the U.S. made their way to Europe. By this time, Harley-Davidson's top of the line product was the 74 Cruising J-model, and constituted the backbone of Harley-Davidson's production as the industry leader.

With the arrival of the Great Depression, Excelsior folded and a vicious competitive battle developed between Harley-Davidson and Indian, which had been saved from financial ruin when it was acquired by E. Paul du Pont. Following the Depression the American law enforcement community became an important market for Harley-Davidson, procuring a little over 10,000 units a year.

The close of the depression was marked by two difficult events: unionization of Harley-Davidson's workers and the death of William Davidson. While Harley-Davidson had never employed "sweat shop" labor, pro-union sentiment was strong. In 1936, the employees joined the United Auto Workers Union. Shortly thereafter, Harley-Davidson suffered a second blow in the death of William Davidson. Nevertheless, year-end production for 1937 reached 11,676 units, an increase over 1936 of nearly 3,000 machines. Over 50 percent of this output was sold overseas.

The 1930s saw the concentration of Harley-Davidson production in two main motorcycle types which would be the mainstay of the line for the next three decades. The 61E “Big Twin” was perfected despite initial faults. Utility vehicles were also produced: one was a motorcycle fitted with a sidecar, and one was a three-wheeled motorcycle or “trike.” Trikes were produced until 1969. The Harley-Davidson Big Twin had reached a level of reliability equal to current automobiles and capable of carrying an extra passenger on a buddy seat; it was a machine in which a rider could plan with certainty to travel across the United States with only minor maintenance.

By 1940, because of World War II production for the government, the main Juneau Avenue production facility was expanded and put into round-the-clock production. Shortly afterward, the company lost another original founder, President Walter Davidson. He was succeeded in the leadership of Harley-Davidson by his son, William Davidson. A third founder, William Harley, died in 1943.

Harley-Davidson’s cumulative war production had been stupendous, rolling out 88,000 machines before the cancellation of the government contracts. A side effect of the war effort was increased awareness of the Harley-Davidson motorcycle by thousands of GIs who learned to ride on Army motorcycles. This eventually translated into more sales in the domestic market after the war.

### **The Postwar Era**

Although the war had increased awareness of motorcycling, the early postwar period saw the beginning of serious inroads by imported motorcycles into the American market. Most of these early imports were British and, by the end of 1946, over 10,000 had been sold. The foreign middle-weight models had no counterpart coming from the American motorcycle industry. In 1948, Harley-Davidson introduced the 125, a smaller machine designed to compete against the imports, and sold 10,000 in its first year of production. Although an import tariff of eight percent was levied in the United States, exported Harley-Davidsons felt the weight of a 33 percent to 50 percent tariff on exports.

The postwar era also saw the rise of the now notorious “outlaw” motorcycle riders and gangs. While these so-called outlaw motorcyclists became the focus of national attention, they did not represent a significant percentage of American motorcycling enthusiasts, and Harley-Davidson dealerships refused to deal with them in the servicing of their machines.

Arthur Davidson, the last of the founders, died in December of 1950. The 1950s also ushered in the first significant threat to the company from imports. But despite the imports, Harley-Davidson managed to continue to sell all it produced. However, as an ominous note of things to come, a November 1959 issue of *Cycle Magazine* featured an advertisement introducing the Honda; a small machine, 50 cc, which featured electric starting. The first advertising line read “You meet the nicest people on a Honda.”

The mid-1960s brought Harley-Davidson to a precarious position - it claimed only six percent of the market, although sales were at a record high of \$31 million. The rest of the market was being

held primarily by European and Japanese manufacturers. At this time, it was decided to offer stock to the public, a first time ever infusion of outside capital. Control of the corporation remained in the hands of the surviving members of the Harley and Davidson families, who held a majority of the tendered stock.

Despite the injection of capital, Harley-Davidson continued on shaky financial ground through the mid-1960s, and in 1967, it was decided to put the company up for sale to a conglomerate, although the Harley-Davidson top management called it a “merger.” American Machine and Foundry (AMF) acquired Harley-Davidson for an exchange of AMF stock valued at \$210 million. Harley-Davidson management and most of its staff were retained.

The acquisition of Harley-Davidson by AMF brought about a harsh reappraisal of Harley-Davidson’s problems. While the four founders had run the company well in the early years and managed to survive the Great Depression, their deaths and replacement by their descendants was not best for the company. Control was spread out among too many Harleys and Davidsons, some of whom lacked the ability to be in upper-level management. Harley-Davidson’s production facilities were incredibly outdated and badly in need of modernization and retooling. The problem of Harley-Davidson’s management was not addressed during this period, but some renovation and retooling of the production facilities was accomplished. The product line was also expanded somewhat with the introduction in 1970 of the “Super Glide.”

A new approach to marketing was also developed in 1970. The once shunned custom motorcycle enthusiasts were now being sought. At this time AMF opened another production facility in York, Pennsylvania. In addition, a new logo was also introduced: a broad-ribbed number “1,” carrying a symbol of the American flag together with the slogan “The All American Freedom Machine.”

With an expanded product line beyond heavyweight motorcycles to include smaller bikes and even scooters, and new facilities, 1973 was a record year for the industry and for Harley-Davidson. It was generally believed that the greatly increased demand was primarily due to baby boomers, who were maturing into driving and motorcycling age.

The increased output and transition from more traditional, craftsman-like production to modern assembly-line techniques brought on a sharp rise in quality control problems. Riders began to discern a distinct difference between Milwaukee and York machines, mainly because about half the York-made machines were defective in some respect. They leaked oil, vibrated, and could not match the performance of the smooth Japanese-made bikes. The problem was further complicated by AMF’s policy of reimbursing dealers for shop time necessary to bring defective machines up to running standards only if they could prove the defect had occurred in the factory. These various problems, coupled with AMF’s huge capital infusion into Harley-Davidson that had yet to show a substantial return, caused AMF’s management to consider getting rid of Harley-Davidson. In the meantime, the Japanese continued to improve their motorcycles’ performance. Also, their manufacturing techniques yielded operating costs that were much lower than Harley-Davidson’s.

## **The Early 1980s**

Signaling the end of an era, in 1981, Harley-Davidson's top management, led by Vaughn Beals, took the company private again by separating it from the AMF conglomerate in exchange for \$81.5 million. Immediately following this leveraged buyout, the company began an aggressive advertising campaign which included such slogans as ...“motorcycles by the people, for the people,” and stressed an almost patriotic theme to encourage the public to support this veteran American industry. They instantly began a new direction for the reorganized company through marketing and more dealer cooperation in updating present products and developing additional models.

A newly formulated mission statement described Harley-Davidson as a company that “designs, manufactures and sells heavyweight touring and custom motorcycles and a broad range of related products. The Company is the only American manufacturer of motorcycles. In addition, the Company manufactures other products for the defense industry including metal bomb casings and liquid fuel rocket engines.”

Following this return to private ownership the most pressing problem to be solved was quality control, which was hurting dealer-factory relationships. During the first months of 1982, the company began an aggressive legal campaign designed to do away with the large number of unfranchised garages and repair shops across the country for their unauthorized use of Harley-Davidson trademarks and logos. There were estimated to be approximately 3,000 of these types of operations. Also during 1982, the country was experiencing an economic recession and motorcycles were among the first to be affected. In Japan, however, production increased at a very rapid pace due to an industrial system which fostered good labor-management relations. In order to protect this relationship, Japanese management maintained high production and would take a reduction in profits in order to do so. This resulted in a surplus of goods now being “dumped” at very low prices in the world market. Motorcycles were among these goods, of which United States buyers purchased approximately 800,000 units during 1981.

The effect was drastic for the sales of domestic motorcycles. Many of these importers were ordered to clear their surplus stock by any means. Many dealers were already swamped with excess inventories and were selling the products at very low prices. Harley-Davidson, having never been very competitively priced, was hurt. Its share of the heavyweight motorcycle market fell from 75 percent in 1973 to less than 25 percent in the early 1980s.

With a month-long plant shutdown occurring in 1982 to reduce inventories, Harley-Davidson was now faced with a severe cash flow problem. Many dealers, who were loaded up with machines which were taking up floor space and eating up interest, were now offering models at prices near their own factory cost.

It was at this time that Vaughn Beals, president of Harley-Davidson, announced that the country's oldest motorcycle manufacturer faced bankruptcy. He began to cut company operations by eliminating nearly 200 clerical jobs, and in the spring of 1982, laid off 3,800 employees. Meanwhile, many dealers were complaining of quality control problems and were deluging the factory with warranty demands.

## **The 1983 Tariff**

Despite several drastic cost-saving efforts, the company was still teetering on the edge of disaster. In September 1982, Harley-Davidson took its complaints before the Federal Trade Commission (FTC), claiming the Japanese were dumping large motorcycles in the United States at very cheap prices and were threatening Harley-Davidson with bankruptcy.

In April 1983, President Ronald Reagan took the advice of the FTC and raised the tariffs and imposed quotas for five years on motorcycles over 700 cc in displacement. This was said to be the most aggressive trade restraint ever taken by the United States.

In some instances, the large motorcycle importers were not hurt a great deal. For example, Honda was currently shipping parts into the United States and was then assembling the machines here. This allowed them to get around the strict import tariffs. Another way the Japanese avoided the tariff was by replacing many of their 750 cc models with engines with 690 to 699 cc engines. In addition, the tariff contained a provision where during the five-year period, the rates would decline annually.

On July 8, 1986, Harley-Davidson took another step by going public again. It was on this date the company completed a public offering of two million shares of common stock and \$70 million of unsecured subordinated debentures. A portion of these funds was used to repay outstanding loan balances and to purchase warrants, which would allow the company to acquire its common stock that was held by its creditors. The remainder of the funds was used for capital expenditures and for additional working capital.

A significant move was made by Harley-Davidson in December 1986 when it acquired the Holiday Rambler Corporation which was a producer of motor homes and large travel trailers. As part of a new diversification strategy, Holiday Rambler was seen as an excellent opportunity because both companies were manufacturing-intensive and produced leading recreational vehicles. Both sold products to very committed groups of people whose lifestyles were heavily influenced by their recreational activities. One final reason for this acquisition was to diversify into an industry that was without Japanese competition.

## **MOTORCYCLES AND MOTORCYCLISTS**

Motorcycles were developed from bicycles as an inexpensive, practical, and reliable means of transportation. However, motorcycles were primarily recreational vehicles in the most developed countries of Europe and North America. In Africa, South America, and the developing countries of Asia, they were transportation for the masses while the wealthy used motorcycles for recreation. In these countries one moved from a motorcycle as transportation to an automobile as one moved up economically. In the U.S. an automobile was the first choice for transportation, and a motorcycle was used primarily for recreation.

Two wheeled motorized vehicles were categorized as scooters, mopeds, and motorcycles. Scooters had small wheels, small engines, and one stepped through rather than straddled the

vehicle. Mopeds had small engines, large wheels, and were much like a bicycle but with a small motor. These two types of two-wheeled vehicles were mostly used as basic transportation and infrequently for recreation. Motorcycles were categorized by size such as heavyweight or lightweight, with heavyweight having an engine displacement of 651 cubic centimeters or more. Considerable variation in the size and use of motorcycles existed.<sup>1</sup>

The Harley-Davidson motorcycle, commonly referred to as a Harley, had unique characteristics which other manufacturers attempted to copy. Most important was the engine, a 45 degree air cooled V-twin which produced high torque at low engine speed. Japanese manufacturers have produced V-twin Harley clones which appeared to be similar but often lacked the performance characteristics. The one defining characteristic which motorcyclists readily recognized was the distinct Harley sound. To accentuate this sound some Harley owners modified the exhaust system to make the distinct sound louder. Knowing the importance of this attribute, Harley-Davidson unsuccessfully attempted to patent its sound. Harleys were also considered to be the best in the industry for the “fit and finish” of their motorcycles, which referred to the quality of the paint and chrome, and the precision with which parts were designed and assembled. The opportunity to personalize a Harley was significant with the many optional accessories. The annual accessory catalog was nearly 900 pages which offered owners a rich selection of the means to customize their ride. As a result it was rare to see two identical Harleys.

### **ASSUMING A COMPETITIVE POSTURE**

To successfully compete with imported motorcycles, the company undertook significant engineering programs that made dramatic improvements in its V-twin engine designs and, at the same time, resulted in markedly lowered production costs. In addition, the company substantially broadened its product line, offering 16 heavyweight models by 1988 as compared with only three models in 1976. One of those most responsible for the company’s transformation was Thomas Gelb, senior vice-president of operations. His style was to “get a team together to define a problem, set up milestones and work out a solution.” That first improvement team set the tone for the whole recovery. This approach, begun in 1987, was also in line with the views of the Chief Financial Officer, Richard Teerlink, who believed that management, more than materials, machines or labor, was the company’s biggest problem.

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<sup>1</sup>Motorcycles can be considered by use as: on-road or *street bikes* which are legal for highway use, off-road or *dirt bikes* which are for dirt racing and trail riding, and *dual-purpose* which are both street legal and off-road capable. Another classification schema involves standard, performance, custom, cruiser, and touring motorcycles. Standards are smaller, lightweight, inexpensive, and often are purchased for basic or supplemental transportation. Performance models have fast acceleration, high maximum speed, and nimble handling. Often they are also referred to as Sport Bikes or “Crotch Rockets.” Customs originated in the U.S. and resemble the type exemplified by those in the movie *Easy Rider* and can be called “Choppers.” These are often quite individualized with numerous cosmetic accessories and/or functional modifications. Touring motorcycles are large, heavy, and expensive and designed for longer trips and comfort for two persons. Frequently they are outfitted with a radio, cruise control, windshield, GPS, two-way radio, and significant luggage capacity. They are termed “Baggers.” Cruisers are similar in size to touring but less equipped for longer road trips. Motorcycles made in Europe or Japan are called “Metric Bikes,” and those from Japan as “Rice Burners.”



Beginning in the mid-1980s, Harley-Davidson was among the first American firms to initiate the use of various quality-enhancing manufacturing techniques that borrowed heavily from the Japanese style of management. It stressed employee involvement in the manufacturing process. Employees were taught to recognize and eliminate waste and to provide critical input into the way motorcycles were produced. According to Anthony Dadante, director of organization development and training, "We have a simple philosophy: Business is people ... We want to get employees to own the corporate vision - they are involved in writing it - but we also want them to have an individual mission."

Harley-Davidson also introduced a just-in-time inventory control process called 'materials as needed' (MAN), which required that only enough parts to satisfy one day's production be manufactured and shipped to the job site. This eliminated the need for large stockpiles of inventory, thus greatly reducing capital requirements for warehousing surplus parts, and permitted much better quality control. Furthermore, excess inventory was subject to damage and obsolescence. The parts had to be perfect; no tolerance for error was permitted. Harley hired Tom Schwarz to merge the company's inbound materials and outbound finished goods transportation. In this regard, one of his department's first contributions to the MAN program was coordinating motorcycle deliveries to dealerships with pickups from parts suppliers. In less than one year, this system saved Harley-Davidson more than \$22 million by reducing the in-process inventory.

The third technique utilized to counter foreign competition was statistical control of operations. It involved the use of statistical charts by employees to monitor the quality of each motorcycle, one piece at a time. It gave them a tool to monitor trends in their machining process and reduced the possibility of an imperfect part being produced and installed on a motorcycle. Not only did the company teach its workers these tools, it had to train skeptical plant managers to become team leaders instead of supervisors, and help suppliers to adopt similar methods. These changes were accompanied by a major restructuring effort that drastically reduced the number of managers and line employees.

These techniques were applied first in the Milwaukee engine plant. When that plant proved successful, Harley transformed all of its old-line factories into state-of-the-art facilities. Gelb championed these innovations, building grass-roots support as he went. He told employees, "We have to play the game the way the Japanese play it or we're dead."

Coupled with production changes, a new marketing program targeting more up-scale consumers was initiated. Special events, such as "HOG rallies" (for Harley Owners Group), were staged throughout the country. The company also began a program to assist dealers in remodeling their dealerships. Each new store was designed for improved traffic flow as well as for increased appeal to a much larger number of people. In addition, Harley-Davidson abandoned the policy of competing broadly against foreign manufacturers. Instead, it decided to develop a niche in the big-bike category.

As a result of these changes, the company raised the percentage of motorcycles leaving its production lines without defects from about 50 percent to more than 98 percent, and there was a sharp drop in the number of warranty claims and consumer complaints. In one year, the

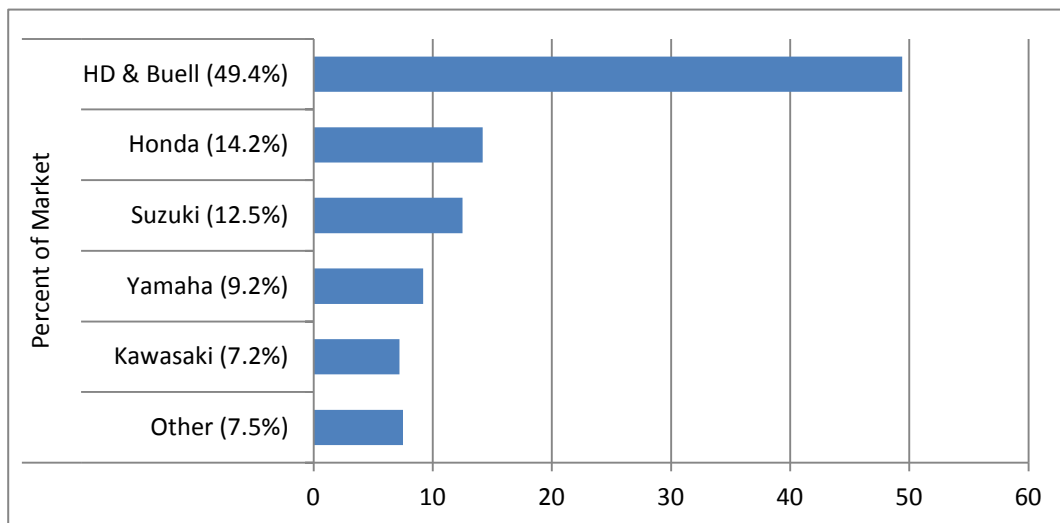
company was able to lower its break-even point by one third, from 53,000 to 35,000 units annually. Production time for a motorcycle frame was reduced from 30 days to three days. By 1986, Harley-Davidson's share of the U.S. market for heavyweight motorcycles moved up to 33 percent; it had dipped from 42 percent in 1976 to 23 percent in 1983. For all types of motorcycles, the company's share increased from 12.5 percent in 1983 to 19.4 percent in 1986.

In March 1987, the company concluded that its competitive position had improved so much that it asked President Reagan to end its tariff protection a year ahead of schedule. Reagan then visited the York plant to celebrate the company's turnaround and spotlight it as an example of a "rustbelt" manufacturing company that transformed itself into an American success story. In 1986, Harley-Davidson's motorcycle business was profitable for the first time since the company's managers bought it from AMF in 1981. Beals was quoted saying: "We're profitable again. We're capitalized. We're diversified. We don't need any more help."

### SUPPLY, DEMAND, AND SALES

Immediately after the announcement of the first profit in five years, the company reported that, for the first quarter in 1987, it had sales of \$162 million and a net income of \$5.2 million. These compared with \$70 million in sales for the first quarter in 1986 and a net loss of \$0.16 million. By 2008, Harley-Davidson's share of the heavyweight market was nearly 50 percent. Buell Motorcycle, a subsidiary of Harley-Davidson, Inc., acquired in 1993 to produce sportbikes, accounted for about .2 percent of the motorcycle share. Figure 1 shows the market share by company.

Figure 1. U.S. Heavyweight (651+cc) Motorcycle Market Share



Source: Harley-Davidson, Inc., Form 10-K (2007 Annual Report), filed February 22, 2008.

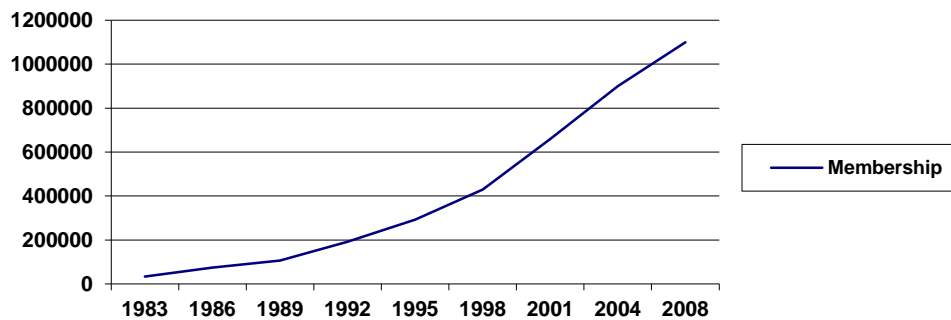
The Motorcycle Division's 2008 net sales totaled \$5.6 billion, compared to less than \$.3 billion

in 1986. This represented an increase in sales of nearly 1900 percent. Financial data for the last five years are shown in Tables 2 and 3 at the end of this case.

The biggest impediments to motorcycle sales had been their danger and image. Rather than seeing them as an economical mode of transportation or recreation, many people had associated motorcycles with gangs and “bad elements.” Thus, while the name Harley-Davidson evoked nostalgic images of a company and a machine with a certain mystique, the thought of a Harley-Davidson rider was not nearly so pleasant. The company and industry, however, estimated that “outlaws” represent far less than one percent of all motorcycle riders (a.k.a., the “one-percenters”).

However, by 1990 it appeared that there was a “new” Harley-Davidson rider that had evolved with the “new” Harley-Davidson. The Harley rider was generally more educated, had a higher income, and was more likely to be a professional or a manager than the owners of Japanese motorcycles. In addition, by 2007 the owners’ club, the Harley Owners Group (HOG), had grown to more than one million members and was the world’s largest motorcycle club or organization. Figure 2 illustrates this dramatic growth in membership.

Figure 2. Harley Owners Group® (HOG) Worldwide Membership



Source: Harley-Davidson, Inc., Unaudited Historical Data: As of Q2 2009, October 30, 2009.

## OTHER BUSINESS SEGMENTS

Holiday Rambler had been a financial drain on Harley-Davidson since it was acquired in 1986. During those years of ownership the recreational vehicle industry had been in a prolonged slump, and new models and aggressive marketing did not improve Holiday Rambler’s profitability. Although it accounted for about 25 percent of Harley-Davidson’s sales, in 1992 only two percent of the profits were attributable to Holiday Rambler. That year the president and CEO were replaced. The financial results generated by Holiday Rambler in 1993 were still very disappointing. In 1994, there was a replacement of key executives in marketing, sales, and engineering. With no improvement in sight, Holiday Rambler was sold to Monaco Coach Corporation.

In 1993, the company acquired a 49 percent interest in Buell Motorcycle Company. Erik Buell,

a former Harley-Davidson engineer, formed the company to manufacture American sport performance motorcycles to compete with those Japanese products. The Buells were made using the smallest of the Harley engines which were also used in the Harley-Davidson Sportster models. Harley-Davidson hoped this acquisition would enable it to gain entry into select niches within the performance motorcycle market. In 1998, Harley-Davidson bought the remaining interest in Buell, and Erik Buell was named as Chairman of Buell Operations. Harley-Davidson also owns Harley-Davidson Financial Services, which in turn had several subsidiaries, including Eaglemark Savings Bank, Harley-Davidson Leasing, and Harley-Davidson Insurance Services. These segments provided financing for retail purchases of Harleys and motorcycle insurance for Harley owners. Also financing was provided to dealers for their wholesale purchases of vehicle inventory. The Harley-Davidson Visa credit card earned points which could be redeemed for motorcycle accessories, parts, supplies, and for Harley branded apparel and other merchandise in dealerships. Except for 2009, this venture had been profitable. In 2010, the income before taxes from this segment was \$181.8 million. From 2004 through 2007, Harley-Davidson Financial Services averaged over \$200 million of income before taxes, which amounted to 13.5 percent of the company's pretax income over this four-year period.

In addition to motorcycles, significant dealership showroom floor space was allocated to Harley branded men's and women's apparel; riding gear such as helmets, boots, and protective riding jackets and pants; and a variety of other branded merchandise. Dealerships have had significant service facilities and well stocked parts departments for the do-it-yourself owner.

Harley-Davidson motorcycles offered the greatest variety and opportunity for customization of any other brand. Essentially all Harley owners customized their motorcycle to one degree or another beyond those choices which were present when it was manufactured, such that it was quite rare to see two which were the same. Each year, Harley-Davidson issued a parts and accessory catalog, which showed essentially all accessories, numbering nearly 900 pages and listed almost 6000 items. A sizeable portion of each dealership space and inventory was dedicated to the accessory segment of the business.

Harley-Davidson was the only remaining U. S. manufacturer of motorcycles of any significance. Clearly, dramatic quality improvements, cost reductions, and astute marketing had been the foundation of the company. The next largest U.S. motorcycle manufacturer was Victory, part of the Polaris Company. Polaris also made snowmobiles and all-terrain vehicles and had produced Victory motorcycles since 1998. Their sales accounted for slightly more than one percent of the U. S. motorcycle market.

## **THE IMAGE OF A MOTORCYCLIST**

By 1913, the Ford Model T had become quite successful, selling for less than \$500, while motorcycles were about \$250. This price difference, successful marketing, and immediate public acceptance of the automobile being for the common man, relegated the motorcycle in the U.S. to forever being used for recreation and utilitarian purposes, such as police use, rather than for everyday transportation. By the end of World War II, motorcyclists were viewed and marketed as being typical harmless recreation seekers, not much different from camping or fishing. This image began to change July 4<sup>th</sup> weekend in 1947 in Hollister, California, when 400 members of a

motorcycle club came for a three day rally. Motorcycle clubs had been in existence since the 1920's and were mostly benign groups involved in touring, track racing, or hill climbing. This group was no different, but as can happen, a few got intoxicated and rowdy, which resulted in 49 arrests. What actually occurred was not much worse than spring break for college students at the beach. However, a photograph was taken of what appeared to be a drunken disheveled biker sitting on a motorcycle with dozens of beer bottles scattered around. The photograph was published by *Life* magazine, the most respected weekly of the time, and the accompanying report said there were riots and the town was terrorized. It was later determined that the scene was staged by the photographer and that several photographs were taken until just the right arrangement of beer bottles and expression was had. The fact that the photograph was staged and the reporting exaggerated (e.g., 1,400 attendees became 4,000) was of no consequence because the image of the outlaw biker was now solidified with the public. In the following years, the theme of menacing motorcyclists was advanced by dozens of movies such as The Wild One in 1954 with Marlon Brando and Easy Rider with Peter Fonda in 1969. Since Harley-Davidson was the dominate motorcycle of the time, there was also some connection made to that brand and the image of being bad. At that same time, almost all motorcycle police rode Harleys, which was a counter balancing image. To be sure, there were truly unsavory persons, such as the Hell's Angels, which the public rightfully viewed with suspicion.

While at the time Harley-Davidson did try to put aside the less pleasing aspects of this image, in the long run it had strangely evolved to be its salvation and niche in the motorcycle market. Since then, the outlaw image has softened and transformed into images of freedom and independence, spiced with just a dash of attitude and patriotism. The Harley brand and mystique, in particular, was inextricably tied to these values and those who wished to make a statement to that effect. In many ways this explained the brand identity and solid customer identification and loyalty. However, the image had also been an impediment to acceptance and hence to sales on the part of some.

### **THE HARLEY CUSTOMER**

The typical purchasers of Harleys and the other brands of heavyweight motorcycles were clearly neither the motorcycle bums depicted in the movies nor the blue collar customers who were common immediately after World War II. Rather they were the antithesis of rebellion and anti-establishment; given that they were most likely educated male professionals whose average income was nearly \$87,000 and age was 48. The demographic profile of Harley-Davidson's customers is shown in Table 1. In 2009, a Harley was priced 30 to 40 percent higher than the Japanese clone heavyweight and was considered the prestige upscale motorcycle. As a result, the consumer profile in 2009 was that of a baby boomer who now had higher disposable income and the desire to recapture the attitudes of youth and temporarily shrug off the strictures of the conforming traditional life. The few remaining old style blue collar Harley traditionalists derisively referred to these Harley converts as RUBs or Rubies, which meant "Rich Urban Bikers" or the "Rolex Brigade." Jay Leno and the late Malcolm Forbes were notable celebrity examples.

Table 1. Demographic Profile of Purchasers in the United States

	1987	1990	1993	1996	1999	2002	2005	2008
Gender								
Male	98%	96%	93%	91%	91%	90%	88%	89%
Female	2%	4%	7%	9%	9%	10%	12%	11%
Median Age								
Years	34.7	36.7	41.6	42.5	43.4	44.8	46.5	48.0
Median Income (\$000's)								
Household	38.4	47.3	61.9	68.5	72.8	81.2	81.6	86.9

Source: Harley-Davidson, Inc., Unaudited Historical Data: As of Q2 2009, October 30, 2009.

While such an affluent customer profile might be welcomed by any business, it was a primary concern to the Harley-Davidson Motor Company. Harley-Davidson understood that the current customer base was firm, but it would dwindle in time. As result, it embarked on a number of strategies to broaden the customer base beyond the affluent baby boomer. One was to reach ahead a generation and interest those in their late 20s and 30s in the Harley-Davidson images of independence, freedom, and the non-traditional attitude that their older predecessors grew up with in the 1960s. The maintenance of this key element of brand identity and customer loyalty was being pursued by softening the bad-guy image just a bit and making biking more mainstream. For example, the Harley-Davidson dealerships made a concerted effort to encourage and support their local chapters of the largest motorcycle club in existence -- the Harley Owners Group (HOG) -- to support local charities, public service activities, and family oriented motorcycle activities. HOG celebrated its 25<sup>th</sup> anniversary in the summer of 2008. In 2009, there were over 1,091,000 members in 1,458 chapters world-wide. Another effort which was aimed primarily at women, who may be intimidated by motorcycles, and at attracting the young was the Riders Edge program. It was a 25-hour course which was half classroom instruction and half riding which stressed safety and confidence building. It was quite successful in that about one-third of the participants were under 33, almost half were women, and 30 percent of the graduates bought a Harley. In some states, passing this course substituted for the riding test required to get a motorcycle license. Harley-Davidson was the first among the few manufacturers to have a test-ride program, just as automobile manufacturers had long done. Coincident with Harley-Davidson's 105<sup>th</sup> year and the 25<sup>th</sup> anniversary of HOG, the 130,000 square foot Harley-Davidson Museum was opened on a 20 acre site in July 2008.

The goal of attracting younger riders had focused Harley-Davidson more on new product offerings rather than appealing to the traditional image associated with the heavyweight motorcycle. As shown in Table 1 above, the median age of Harley-Davidson's customers was increasing. The younger riders had been attracted to the sportbike and performance motorcycles, which was different from the typical Harley heavyweight. The Japanese manufacturers had produced a wide variety of these performance products and had been the major players in that segment. Only since 1995 had the four Japanese motorcycle producers made heavyweight

cruiser Harley clones. The 1992 purchase of a minority interest in the Buell Motorcycle Company enabled Harley-Davidson to successfully market to younger riders who otherwise would have purchased a Japanese sportbike. By 2008, most Harley dealers carried the Buell line.

The missing element to the Harley-Davidson line was a product attractive to the age group between 20-something and the baby boomer. The Japanese V-twin heavyweight clones filled that niche somewhat since they were more technically advanced, had better performance, and yet still looked and sounded similar to a Harley. To plug this product line hole, Harley-Davidson embarked upon the formidable task of creating a heavyweight, technically advanced modern performance motorcycle which maintained the Harley image and yet was radically new. In 2001, the V-Rod was introduced to fulfill this need. It was an immediate success in the industry, winning many awards, and was enthusiastically received by targeted consumers. It was hoped that this platform would be competition for the Japanese and European performance motorcycles.

The worrying problem of the early 2000s was keeping the aging baby boomer on a Harley. The result was a renewed interest in three-wheeled motorcycles or trikes. Harley-Davidson believed trikes would appeal to mature motorcyclists whose strength, reflexes, and stamina may have diminished. Three wheels were easier to ride than two. Harley-Davidson produced trikes from 1932-1969, but they were used during that time as delivery and service vehicles. Harley-Davidson partnered with Lehman Trikes to produce the Tri Glide beginning in the 2009 model year. The production of trikes was brought in-house to the York, Pennsylvania facility starting with the 2011 model year. The company applied for a patent for a trike with its two wheels in the front which had the capability to lean as does a two wheeled motorcycle. Trikes also appealed to some women who were discouraged by the weight and strength issues of riding two wheeled heavyweights. Sales of new Harleys to women were four percent in 1990 and 11 percent in 2008. Another effort to attract women riders, and smaller statured men, was to redesign the entry level Sportster by lowering the seat height and the center of gravity, both of which added to the ease of handling.

In August of 2008, Harley-Davidson acquired all of Italian motorcycle manufacturer MV Agusta Group (MVAG) for \$109 million. This acquisition enabled Harley-Davidson to have the cachet of the European sports motorcycles in its lineup and added greater global penetration through MV Agusta's existing dealership network. The organization was founded in 1945 by Count Vincenzo Agusta out of an aviation company and had two lines of sport motorcycles. One was the premium high performance MV Agusta brand which had the F4-R model that was rated at an extraordinary 190 horsepower. MV Agusta had been well known in motorcycle racing for many years. These more costly bikes competed with Ducati, another Italian motorcycle, rather than the less expensive Japanese performance motorcycles. It had been the philosophy for the MV Agusta brand to produce an elite machine of limited production quantity as does Ferrari in performance automobiles. The Cagiva line was a smaller displacement, lighter weight, less expensive motorcycle. In 2007, both lines shipped a total of only 5,819 motorcycles to its 500 dealers worldwide, most of which are in Europe. MVGA continued to be operated from the Varese, Italy headquarters. The president, Claudio Costiglioni, remained in a leadership capacity as Chairman, and the chief designer, Massimo Tamburini, continued in that role. A fifteen year

veteran and Vice President of Harley-Davidson was appointed Managing Director of MV Agusta Group for Harley-Davidson.

The acquisition was reversed following the appointment of a new Harley-Davidson President and CEO effective May 2009. In the October 2009 third quarter results announcement it was revealed that Harley-Davidson would divest its MV Agusta unit and seek a buyer. The sale of Agusta back to its original Italian owner, Claudio Castiglioni, took place in August 2010, for the token sum of three euros. Harley-Davidson paid Castiglioni 20 million euros or about \$26 million to take back Agusta and also forgave the 103.7 million euro loan made to the Agusta unit at the time of the 2008 original purchase. In this announcement an even greater surprise to the motorcycle industry was the Harley-Davidson decision to discontinue the Buell product line. Production ceased in December 2009 and resulted in a \$125 million one-time cost.

These two actions ended the efforts begun in 1992 with the acquisition of Buell to have products under the Harley-Davidson umbrella which were meaningfully different in type from the traditional Harley. Harley-Davidson had come full circle and had returned to a single brand strategy and narrowed identity as solely a heavyweight custom, touring, and cruising motorcycle company.

By 2008, as the domestic market matured Harley-Davidson looked to emerging economies where the numbers of the upper middle class and the affluent were growing rapidly. This was most pronounced in China, India, and Brazil where Harley-Davidson dealerships had been increasing. Harley-Davidson sought to add 100-150 new dealerships to the international market by 2014.

## **FIVE WAVES OF LEADERSHIP**

Harley-Davidson has had five distinct management tenures or waves, each of which had a significant impact on its operations. Each had their own style of management. One nearly destroyed the company, but another set it on the road to become one of the great comeback stories in American enterprise.

### **Wave One**

The Harley-Davidson Motor Company was founded by four tinkers who today would be called shade tree mechanics. When the company was incorporated in 1907, Walter Davidson (the machinist) was president, William S. Harley (the draftsman) was chief engineer, Arthur Davidson (the pattern maker) was sales manager, and William A. Davidson (the tool maker and foreman) was the works or production manager.

The four founders were all exceptional visionaries in their own functional areas of administration, engineering design, marketing, and production. Each of them were avid motorcyclists who knew their product first hand and knew personally what a customer would value. Also, each had an abiding passion to assure that Harley-Davidsons were the dominate motorcycle, and to that end, each was active in the company until their deaths.



## **Wave Two**

The four founders were active in the business until the last one died in an automobile accident in 1950. By that time, the management and ownership had passed to the second generation of Harleys and Davidsons who also were avid motorcyclists, shared the founders' passion, and were not just producers and sellers of a successful product. Hindsight suggests, however, that this second wave of family management may not have been as able or committed as their parents. These family members were responsible for allowing Harley-Davidson to be acquired by American Machine and Foundry (AMF) in 1969.

## **Wave Three**

Many of the Harley and Davidson' relatives sold their stock, and hence, their influence was gone as well. Soon to go also were the relatives active in the management. No longer were those making the decisions managers who also rode the motorcycles they produced, rather the AMF leaders were professional managers who were only making motorcycles as a part of their diversification and growth strategy.

As the third wave of Harley-Davidson leadership, AMF was essentially a stodgy industrial products and equipment manufacturer which had recently begun to diversify into leisure products such as bowling equipment, golf clubs, and yachts. From the beginning for Harley-Davidson, this business combination was an uncomfortable mismatch of individual personalities and corporate cultures. AMF was not attuned to nuances of the motorcycle market in general and the Harley mystique in particular. In time, AMF became discouraged with the difficulty of managing the different Harley culture and the disappointing financial performance. As a result, AMF decided it wanted out of this bad marriage and cut its losses. In 1980, AMF quietly let it be known that Harley-Davidson was for sale, but there was no interest.

## **Wave Four**

Early in 1981, thirteen Harley-Davidson executives with a combination of their personal assets and, in some cases life savings, and heavy debt proposed a buyout to AMF. Among those were Vaughn Beals, Harley group executive under AMF; Richard Teerlink, later to also be CEO; and Willie G. Davidson, a great grandson of one of the founders. Since AMF had no interested buyers, they had no choice but to negotiate with the group of thirteen about their unconventional and unusual offer. Since both AMF and the Harley leadership and employees wanted to split, an agreement was made for \$80 million. The transaction was a leveraged buyout (LBO), and Harley-Davidson became a private and independent company once again. This group of thirteen now constituted the fourth wave of Harley-Davidson leadership. It was an unlikely mélange of mostly long-term Harley insiders, a few former AMF executives who were transferred in but who subsequently got converted to the Harley mystique, and notably, Willie G. Davidson, who served as Vice President of Styling.

This fourth wave faced a daunting task with enormous odds against them. There were no interested buyers for Harley-Davidson and hence little faith by outsiders and insiders that Harley could be saved. The Harley products were of mediocre quality and dated design and hence by

mid-1981 had 6000 motorcycles in unsold inventory. Honda and Yamaha were in a war for domination of the world motorcycle market and each was introducing new models and cutting prices and dumping on the U.S. market. In late 1984, the main creditor, Citicorp, made it clear that they would no longer grant additional loans to the company. Without this financing, Harley-Davidson was near bankruptcy.

Vaughn Beals and the management team went to work on all fronts simultaneously. They made their case to the employees that extraordinary sacrifice and hard work was needed from all. The credibility of this group was high with their employees since the leadership had their personal assets at stake. Work rules and other union fostered restrictions would have to change including manufacturing costs, productivity, and product quality. The employees and their union responded such that assembly time for a motorcycle was reduced by one-third. Quality was improved resulting in fewer defects and rework, meaning that fewer repairs were needed by the dealership. This quality improvement, along with other initiatives, helped improve relationships with dealers. Leaks and breakdowns, which were the brunt of industry and customer jokes, diminished. Following a thorough study of the Japanese motorcycle industry marketing and manufacturing practices, Harley-Davidson executives filed an unfair competition complaint with the U.S. government. The charges were that the Japanese were dumping excess inventory of heavyweight motorcycles at below cost in the U.S. market and that they were copying Harley designs. In 1983, the Federal Trade Commission acted on the complaint by placing a 45 percent tariff on imported Japanese motorcycles over 700 cc for five years.

Harley-Davidson also reached out to current owners of their motorcycles in unprecedented ways. One was the creation by the marketing director of the Harley Owners Group, or HOG, which was company owned and operated. New customers were automatically members for a year. The company sponsored and promoted picnics, pleasure and charity rides, bike shows and rallies, races, safety programs, and more. "HOG" was trademarked and a now quarterly publication, *HOG Magazine*, was published for the membership. Dealerships were encouraged, some say required, to sponsor local chapters and programs. Dealerships were upgraded, modernized, and a cleaner, more wholesome image was fostered. Executives regularly began to attend HOG rallies and mingle with their customers at the major annual bike events in Sturgis, Laconia, and Daytona Beach.

In an LBO, a company is straddled with a significant increase in debt. As a result, many companies who go through an LBO have significant cash flow problems. Fortunately, Citibank agreed to restructure Harley-Davidson's loan and wrote off \$10 million of a loan that Harley-Davidson had with the bank. The debt problem and the associated threat of bankruptcy were greatly diminished with a 1986 public stock offering. With the debt restructured and market share and sales increasing, Harley-Davidson became profitable. The changes in employee relations, manufacturing efficiency and effectiveness, customer relations, marketing, sales, and product offerings, continued to dramatically and quickly improve the prospects of Harley-Davidson. The position had improved so much that in 1987 management asked the government to terminate the five year tariff one year early.

Vaughn Beals and the other top managers had the support and cooperation of employees and other stakeholders during this time of difficulty to make quick major changes. While Beals

sought and was open to input from all, he believed that the managerial group possessed the technical and managerial acumen to see the problems, craft solutions and impose those solutions. Of necessity there was cooperation for survival, but the management was by inclination commanded and controlled from the top down. This authoritarian approach was part of the corporate culture in varying degrees extending back to the later generations of the founding families' involvement. One executive observed that "the company culture keyed around a very, very powerful president or CEO - from the Davidson generations right down through Vaughn Beals. You'd wait to be told what to do, and you'd do it. If you did it right, you'd get promoted." Beals also had the charisma and interpersonal skills to additionally leverage the crisis situation by coalescing the employees and their union, dealers and government around the common goal of saving the company. Also Beals made a personal connection to customers more effectively and dramatically than his predecessors.

### **Wave Five**

Harley-Davidson and its fourth wave of leadership had demonstrated its ability to respond to a real crisis. With stability and good prospects the fifth wave of leadership began in 1988 with Richard F. Teerlink, CEO and President. Teerlink realized that the management approaches and processes which brought Harley-Davidson back from near extinction could not be the same as those which would ensure continued and great success moving forward. Teerlink hired Lee Ozley, who was an organizational consultant and theorist who specialized in designing comprehensive integrated change processes for manufacturing firms. Ozley was a colleague of Edward Lawler and a former student of Abraham Maslow, both well-regarded management academics. His task was to serve as a catalyst for change and assist Teerlink in the process. Teerlink began with several ideas of his own. One was that the top down command and control approach, which saved Harley-Davidson, could not sustain it for long. Another was that the only sustainable competitive advantage Harley had was its people; that is, the wisdom and experience of the employees of the Harley family. Also, he believed that leaders had to stop taking answers to their people and instead take questions to their people.

Teerlink and Ozley began in 1987 what was later called the Joint Vision Process (JVP) which had as a purpose to decide what the desired future for Harley-Davidson was to be. Including all union and management leadership, each level of each unit of all Harley-Davidson sites met among themselves. After two years, the result of the JVP was consensus on: financial performance; quality; product; customer satisfaction; management effectiveness; union effectiveness; relationships; compensation and benefits; safety, health, and housekeeping; work environment; and communication.

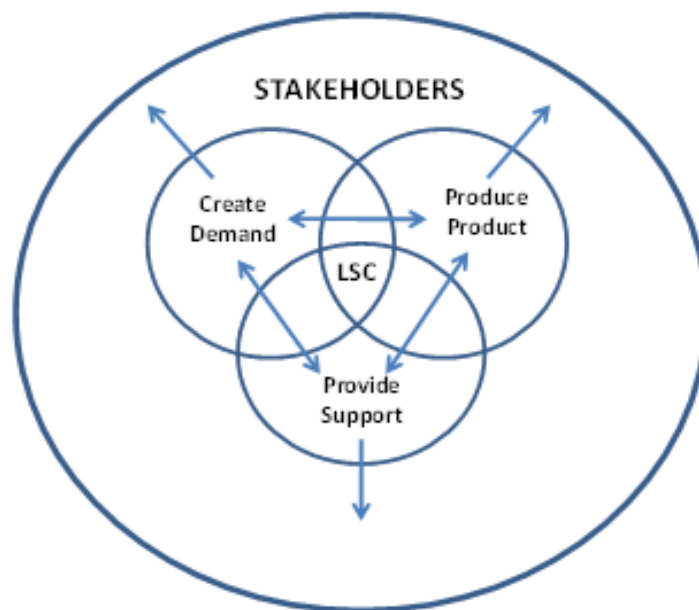
Teerlink realized that the JVP had created energy and fostered introspection within Harley-Davidson and that a different structure or mechanism to channel this in a productive direction was needed. What was developed by 1989 was called the Business Process and in many respects was how Harley did business and managed in 2008. According to Teerlink, the value was that it provided an understandable framework for dialogue within and provided each person the appropriate amount of information, as defined by them, to allow them to do their job in service to Harley-Davidson. The Performance Effectiveness Process (PEP) was similar in concept to a traditional Management by Objectives performance system. However, it operated in a non-

traditional context in that an employee had the opportunity and responsibility to influence what happened at Harley-Davidson but that influence had to be earned. It was earned by being informed about how information flowed in Harley-Davidson, being active in the development of one's work unit plans, and helping to define individual performance - of one's self and others in the unit. Therefore, if one did not know what was going on, or did not meaningfully participate, or one was not involved in determining their own and others performance, they had not earned the right and standing to have influence. The PEP was a major cultural change from a top down approach to one in which each employee had to take personal responsibility and responsibility even beyond themselves. A changed culture needed a different organizational structure, so thought Teerlink.

## Structure

What was needed was something other than the traditional structure where an idea or information originates at one point, flows up the organization, crosses to another functional area and flows down again to where it was needed. The parameters of a new structure included the development of "natural" work groups, not just functional territories. Also, organizational boundaries should be permeable such that information should flow constantly in all directions to where it would be helpful. Leadership would be more dispersed and responsibility shared. What emerged was called the Circle Organization and was made up of what was considered to be the natural work of the organization: Create Demand, Produce Product, and Provide Support (see Figure 3). The elements of the natural work overlapped and information flowed in all directions. The work was surrounded by the stakeholders and at the center were the Leadership and Strategy employees to take on a new challenge and gain experience in other areas. As an adjunct to compensation, the recognition programs were reviewed.

Figure 3. Circle Organization



The Leadership and Strategy Council (LSC) was made up of six members nominated from the three circles, and the president. This organizational concept was shaped beginning in 1991 and was completed at the end of 1992. Jeff Bleustein was approved to be the president with the understanding that Harley-Davidson would not fall back into the traditional command and control posture of the past. He agreed and became president and CEO on January 1, 1993. His first act was to appoint a group which would translate the Circle Organization concept into a workable plan for organizing and running Harley-Davidson, which was implemented in July 1993.

## **Compensation**

Another major change which took place was with the compensation system. The guiding principle for the overhaul of the compensation system was that all employees were to be paid more or less the same way. Both executives and hourly employees were to have some compensation at risk and based on performance. Also, compensation and rewards were to focus on behaviors, not other issues such as attitude. In addition the system sought to enable employees to change jobs or even work circles for the purpose of career development and learning, without the risk of a reduction in pay grade. The result was that seventeen pay grades for salaried employees were reduced to six Career Bands. The effect was to encourage programs for determining and expressing appreciation for exceptional performance, achievements, and employee milestones which had become unappreciated. Changing the former ineffective compensation system began with a thorough and comprehensive survey of all employees asking what behaviors and outcomes should be recognized and what form should the recognition be in each situation. The resulting new system was that what was recognized was better understood and the associated form of recognition was more appreciated.

## **Training and Development**

Training and development programs across Harley-Davidson were fragmented, decentralized, often ad hoc, and available only to those in their functional area on a job-related, need-to-know basis. In 1991, the Harley-Davidson Leadership Institute was created which centralized all learning, training and development programs. A 140-page Training and Development Catalog was produced covering every such effort or event in Harley-Davidson. Now all employees knew what courses and programs were available and could take anything, even if not at all related to their job. An assembly worker could take marketing research and an accountant could learn about heat treating metal.

## **Communications**

For the Circle Organization to properly function, information had to flow freely and it had to be what one needed. After two comprehensive communication audits, the analyses showed in 1993 that much information was incomplete, unneeded, unwanted, poorly timed, too complex, and too formal. To address these problems, a formal communication department was created in 1996 that subsequently created a multimedia information dissemination approach which included a company magazine written in a light style, intranets, and electronic bulletin boards. The purpose was to have at least one medium which would appeal to each employee. The electronic bulletin

boards, for example, were in all lunchrooms and break rooms throughout Harley-Davidson at all locations. There was a constant video feed which included both company-wide information of all types and information specific to that location. Since it was video only and no audio, one could watch or ignore it as one saw fit without the potential annoyance of unwanted audio while on break. After the new communication system was implemented, in 1997 a Fortune magazine survey of the 100 best companies found that 72 percent of those employees said they were well informed by their management, while 84 percent of Harley-Davidson employees felt this way.

All of Harley's manufacturing facilities had been unionized for many decades. That relationship had been up and down as such relationships often were, but most labor relations analysts concluded it had been good overall. During the pivotal days of the crisis, the unions understood that their cooperation was essential for the survival of Harley-Davidson, and they responded appropriately. The reasons for these fairly good relations were several, including the family-like attitude toward employees taken early on by the first and second wave of Harley-Davidson leaders. Also, many employees owned and rode Harleys and had a particular affinity for the products they made, so to many employees their association with Harley was more than just a job. The Harley-Davidson facilities were all located in areas where unions were a matter of fact part of manufacturing. By 1996, with continued increasing demand, Harley-Davidson announced that new additional production capacity was needed. Many in management and on the board of directors believed this was an excellent opportunity to build the new facility away from existing unionized plants and operate there union free. With increasing frequency beginning in the 1980's, manufacturing facilities in the Northeast and Midwest would relocate old or establish new facilities in non-union areas. Teerlink and Bleustein gave the "clean break" supporters a complete and fair hearing on the union free location idea. After a careful consideration of history, and current and future relationships, these two fifth-wave leaders decided against disrupting their long-standing union relationship and instead adhered to the old saying "to dance with the one that brought you." These two called a meeting in December of 1994 with the leaders of their unions and proposed to them an establishment of a true new partnership of management and union. The union surprised everyone and agreed with the Harley-Davidson leadership that this would be best for all. More specifically, they agreed on three issues: (1) that there would be continued production improvement at existing facilities; (2) there would be dramatic improvement at the new facility; and (3) that there would not be the same union contract at the new facility, but something quite different. They put together a Joint Partnership Implementation Committee in January 1995, consisting of four Harley-Davidson union leaders, one AFL-CIO representative, one Harley-Davidson manufacturing executive, and one Harley-Davidson human resource executive. This group started the process of implementing the three agreed-upon items and began a search for a site for the new facility. A site was selected in Kansas City, Missouri, and ground was broken in August, 1996. With unprecedented speed, the facility was built in two years. Innovative equipment and systems were installed, and the first products were made. Also by this time, the other agreements of this new management-union partnership were accomplished.

The first members of the fifth wave of leadership, Rich Teerlink and Lee Ozley, have reflected upon their journey in their book, *More Than a Motorcycle: The Leadership Journey at Harley-Davidson*. First they spoke of the values of the leadership. "The best starting point is recognizing that *values count*. Here, we're talking about the personal values of people in

leadership positions. Leaders have to live the right message, day in and day out.” Next, they mused that “on average, organizations die sooner than people. Fifty years is an unusually long life span for a company.” Therefore, “we believe that organizations should bet on the values, judgment, and skills of people.” After the crisis they felt it was necessary to leave the command and control structure because it did not allow the needed flexibility and creativity to move Harley-Davidson to the next level. Regarding organizational change efforts they stated: “The leadership challenge does not take rocket science, just a little common sense.” Finally, they made one summary remark, “This stuff works.”

Subsequent members of the fifth wave of Harley-Davidson leadership included James L. Ziemer who served the company in various capacities for 40 years, including VP and Chief Financial Officer, Board Member, and Harley-Davidson Foundation member. As President and CEO from 2005 to 2009, he undertook several initiatives to broaden Harley products to appeal to a wider range of customers. Those efforts included: ergonomic changes to the entry level Sportster to appeal to women; reintroduction of trikes to keep the aging males riding; more models of the Buell sportbike for younger riders; continual introduction of new models of the more technologically advanced V-Rod; and most dramatically, the purchase of Agusta, the premium Italian high performance sports motorcycle manufacturer.

The next President and CEO was Keith E. Wandell who previously was President and CEO of Johnson Controls, a Fortune 100 diversified, multi-industrial company. His twenty-one years of broad experience with Johnson Controls included international, operations, and particularly manufacturing. Since AMF in 1969, Wandell was the first to lead who was an outsider with no connection to Harley-Davidson and who was not personally a motorcyclist.

Wandell’s appointment was effective in May 2009, and he announced in October that the Buell product line would be discontinued and the MV Agusta unit would be sold. The Harley-Davidson press release stated in part that these decisions were “major elements of its go-forward business strategy to drive growth through a single-minded focus of efforts and resources on the unique strengths of the Harley-Davidson brand, and to enhance productivity and profitability through continuous improvement.” Therein also were references to global expansion, demographic outreach, and commitment to core customers. Wandell added, “as the announcement regarding Buell and MV Agusta indicates, we are moving with the speed and decisiveness required to bring our business strategy to life. The fact is we must focus both our effort and our investment on the Harley-Davidson brand, as we believe this provides an optimal path to sustained, meaningful, long-term growth.”

This announcement ended the seventeen year Harley-Davidson effort to offer Buell, the only American-made sportbike. The approach to attract young riders to this hybridized Harley product and perhaps to trade up to a traditional heavyweight later was at an end. Likewise, the 2010 sale of Agusta ended efforts to connect with the European style sportbike Grand Prix racing enthusiasts.

Given that the Buell line, even with modest sales, was an established brand with a committed following due in part to its unique technical innovations, industry analysts questioned the decision to discontinue rather than sell the division. Others suggested that Harley-Davidson

might want to use some of those technical innovations in the traditional Harley line and would be limited in doing so if they sold the Buell line with its associated patents.

The October announcement was also an indicator of changes in labor relations, as can be seen in the aforementioned press announcement reference to enhancing productivity, and to “successfully achieve with our labor union partners flexible and cost-effective agreements to accomplish restructuring goals and long-term competitiveness.” It was also stated therein that “the Company could experience delays or disruptions in its operations as a result of work stoppages, strikes...”

Wandell expressed the view that the York, Pennsylvania, manufacturing facility was not competitive and that it would be moved elsewhere if changes could not be made to union job classification rules and complicated overtime rules both of which reduced flexibility of labor and increased costs. As a result, subsequent negotiations for a new seven-year labor agreement resulted in sufficient changes such that Harley-Davidson announced in December 2009 that the York facility would not be relocated.

Later Wandell suggested that manufacturing facilities in the Milwaukee, Wisconsin, area would be moved if a suitable labor agreement could not be reached with those unions. Again, another new seven-year agreement with those three Wisconsin unions was ratified by union employees 55 to 45 percent in September 2010 and would take effect in April 2012. Afterwards it was announced that Wisconsin production operations were to remain in place. Union contract changes included a reduction in the regular workforce and adding a “casual” workforce component which would be made up of unionized employees who would work when required depending upon seasonal demands. This new contract resulted in a wage freeze and moved the hourly employees to the same health care plan as salaried employees. All restructuring changes, including product lines and labor agreements, were to be fully implemented in 2013, to result in annual operating savings of \$50 million that year, and \$290 to \$310 million each year thereafter.

This represented a major shift in strategy in union-management relationships from that of the Harley-Davidson leadership of Richard Teerlink’s more consultative role for the union. Wandell had told, rather than asked, unions that there would be more flexibility in labor deployment and there must be reductions in benefit cost and wage increases.

Wandell assessed Harley-Davidson’s situation quickly and made and implemented major strategic decisions rapidly. It would appear he did so in a commanding and controlled manner in the face of discontent with dropping the Buell and MV Agusta lines and with the firm positions he took with the employees and their union.

## **THREATS TO THE INDUSTRY**

Motorcycling was undergoing a resurgence in all segments of the industry up to 2006. However, there were important threats both domestic and international which impacted Harley-Davidson and other manufacturers. Sales growth was 6.8 percent from 1999-2004, but slowed thereafter. In fact, sales declined in 2007 and 2008. Some of the reasons pushing demand included increased traffic congestion and parking problems, fuel prices, and anti-car and truck legislation



in some parts of the developed world. The reasons retarding demand included an aging customer base in the U.S. and Western Europe. Some Asian countries including China placed restrictions on the use of motorcycles. While many more motorcycles were sold in Asia, they were mostly small inexpensive types used for transportation and not recreation.

### **Chinese Competition**

The U.S. market was the primary target for all manufacturers since most of the units sold were larger motorcycles which had the largest profit margin. All manufacturers worldwide were most concerned about Chinese competition. By 2008, China produced 50 percent of all motorcycles sold in the world. At that time there were 200 Chinese manufacturers; 70 percent of those had domestic investors. Competition among these had been fierce such that an expected shakeout would reduce that to five or six dominant producers, similar to the events in Japan in the 1950s and 1960s. While most of their production was the smaller motorcycles, the Chinese were also developing larger displacement 1000 cc four cylinder models and planned to market them in the U.S. By 2008, they had shown up at dealer shows around the world. While observers questioned the reliability, dealer networks, parts availability, and sophistication of the Chinese motorcycle, no one argued that their pricing was extraordinarily attractive to many buyers. To some it was likely the world motorcycle market would be flooded with inexpensive Chinese motorcycles as the Japanese did in the mid-1970s.

### **Safety**

Domestic problems for the U.S. industry included a growing perceived safety issue. Motorcycle fatalities dropped until 1997, but from 1997 to 2005 fatalities doubled. There were 5.8 million motorcycles registered in 2004 and 133.3 million passenger cars. That year there were 88,000 motorcycle crashes. Motorcyclists were 34 times more likely to die in a crash than in a passenger car. Obviously, motorcycling was inherently more dangerous than driving a car. Some suggested that there were simply more motorcycles and more traffic generally, and hence more accidents would be expected. In 2009, a long-term comprehensive study was commissioned by the Federal Highway Administration to study the causes. Some suggested that more helmet laws were needed, but this angered the motorcyclist rights groups. More rider safety training programs were being promoted and offered with much encouragement and support by all the major manufacturers. They realized that supporting safety and allaying the public apprehension was good for business. There also had even been the development of airbags for motorcycles. Some thought this was ridiculous and laughable given the reality and practicalities of motorcycle riding.

### **Noise**

Another problem which impacted the general public more was the noise of some motorcycles. When motorcycles were manufactured according to government noise standards and hence were legal to be sold and registered for street use, they were not annoyingly noisy. It was the modification subsequently done by the owner which produced a window rattling sound. The public reaction to this spawned legislation at the local level to enforce noise standards and limit where motorcycles could be ridden. This was an alarming development for the industry, and

steps were being taken to encourage motorcycle owners to quiet things down. Since the late 1990s, the Motorcycle Industry Council had been concerned that the Department of Transportation or the Environmental Protection Agency might take steps to restrict motorcycle design and sales of aftermarket accessories such as loud and environmentally non-compliant exhaust systems. While that did not occur, as a preemptive move Harley-Davidson announced in 2006 that it would no longer sell its Screaming Eagle “off road” louder exhaust systems, which were really bought and used on the road even though usually illegal. Harley-Davidson said this was in response to a 400 percent increase in the last 10 years of unfavorable news articles regarding loud motorcycles. Most modified noisy motorcycles were Harleys or Harley clones.

## **Declining Economy**

In 2007, industry unit sales dropped seven percent. Contributing factors included a slowing economy and a glut of used motorcycles on the market. As fuel prices increased some segments were experiencing greater interest in motorcycles and scooters for transportation rather than recreation due to their greater mileage. As a result, in 2008 scooter sales increased 48 percent while the motorcycle industry overall declined 5.59 percent. The only other growth area was the dual-sportbike segment which increased 24 percent. Harley-Davidson sales were down 16.63 percent in that year. Harley-Davidson retained its industry’s top spot at 27.15 percent of unit sales compared to Honda’s second position of 19.52 percent. The four major European manufacturers lost an average of 10.08 percent while the four major Japanese manufacturers lost an average of 4.92 percent of unit sales in 2008. Harley-Davidson continued to dominate the touring and cruiser markets (73 and 55 percent respectively), while the Japanese had 90 percent of the sportbike segment. In this segment Harley-Davidson offered the only American made sportbike, the Buell.

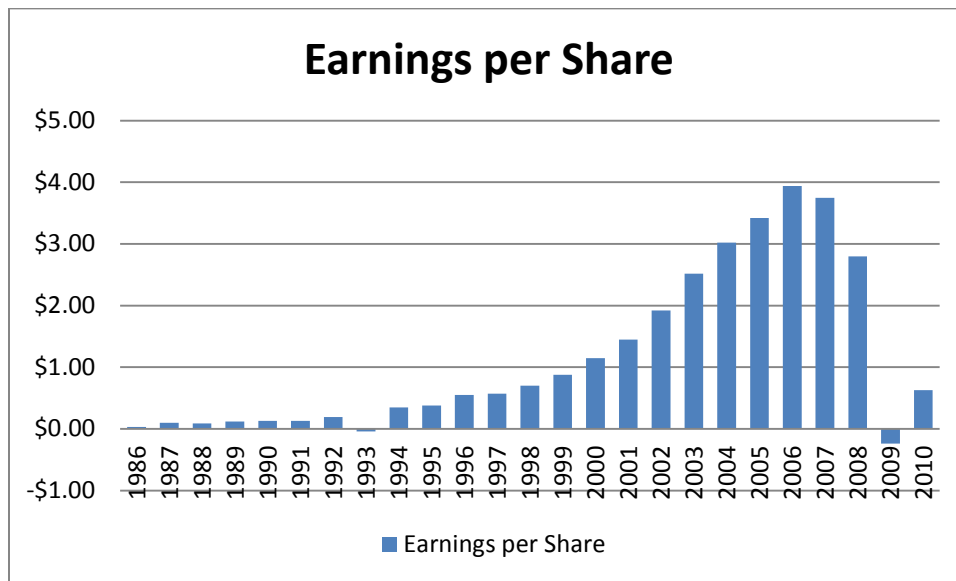
In a declining or uncertain economy, a recreational purchase of a motorcycle could be deferred or no longer considered. Also in such circumstances the industry could find consumers more price sensitive, putting downward pressure on more expensive models in a product line or on premium brands entirely. Likewise less expensive brands and less expensive models in premium brands could find favor with apprehensive or financially pressed consumers. That would present an opportunity to up-sell those riders in the brand when their financial situation improved at a later time.

For the motorcycle transportation buyer, an uncertain economy and energy prices would be the reasons for the purchase. This market segment would more likely tend to gravitate to the lower end of the product line and brands. The increase in new riders began with increased fuel prices and could increase more with economic decline or stagnation and credit restrictions. In the future many of this segment may move to used motorcycles of which there was a significant glut. This would hurt new unit sales until that oversupply worked its way through the market. Many transportation purchasers were new and sometimes unlikely riders, but who found the low purchase price (compared to an automobile), very low insurance cost, significant fuel economy, and ease of parking and urban travel quite compelling.

Coming back from the brink of ‘death’ in the 1980s, the growth of Harley-Davidson was phenomenal. Figure 4 shows the growth in earnings per share (EPS) for the first 24 years after

Harley-Davidson went public in 1986. EPS grew from \$.03 in 1986 to \$3.94 in 2006. A \$10,000 investment in Harley-Davidson stock at the end of 1986 would have been worth well over \$2,000,000 at the end of 2006. The company's primary financial statements are shown in Tables 2 and 3.

Figure 4. Growth in Earnings



### THE PAST AND THE FUTURE

Americans have long been attracted to the hometown team, the underdog, and the great comeback. The story of Harley-Davidson had all of these ingredients. The company was begun by four young men in a small wooden backyard shed. In its early years, the company grew steadily through the Great Depression and two World Wars. With the passing of its founders, management was taken over by the second generation of the founders who continued the company in the tradition of their fathers, but eventually sold the business to another company. During the 1960s and 70s, the company began to encounter strong international competition, and the company's quality control began to wane. As a result, market share and profits began to decline to a point where bankruptcy was looming. Facing a daunting task, a new wave of management took over the company. The new management team first gathered the support of their employees, then reached out to their customers and enlisted the help of their main creditor and even the United States Government. The company began a successful turnaround. How each wave of leadership impacted success, jeopardy, and success again was illustrated by Harley-Davidson's journey.

At the end of 2010, Harley-Davidson seemed solid and stable, but there were some important concerns about the future. The potential Chinese competition was a worry for all of the industry including Harley-Davidson. On the other hand, since the Japanese Harley clones had only modest success, it was not a given that the Chinese would do much better. A constant refrain

from the motorcycle industry was that the dated technology of the Harley air-cooled V-twin engine would not appeal to younger riders. The counter argument was that all other new motorcycle technology, such as ABS and ride by wire, were present in current Harley models. Also, the technology of the V-Rod line was as advanced as any other manufacturer's products. The efforts to offer the sportbike product to younger riders was abandoned when the Buell line was discontinued and MV Augsta was sold. To capture some of this segment, there was a push to more strongly position the entry level Harley, the Sportster, to appeal to women and the 18-35 year old male. This effort came in the form of cosmetic and important functional changes in some models of the line, and to the nature of some targeted marketing programs. Not being able to bring in younger riders was serious as the baby boomers diminished in numbers and their ability to ride. The trike was also reintroduced in an effort to extend the riding years of the older customer. As the domestic market matured, the upper middle class expanded in other countries. Efforts have been made to take advantage of this expanding global market and of one of the world's most recognized brands. While the brand has been exceptionally strong and durable, challenges lay ahead.

**TABLE 2. Harley-Davidson, Inc.**  
**Consolidated Statements of Operations**  
**Years Ended December 31, 2010, 2009, 2008, 2007, and 2006**  
**(In thousands, except per share amounts)**

	2010	2009	2008	2007	2006
Net sales from motorcycles & related products	4,176,627	4,287,130	5,578,414	5,726,848	5,800,686
Financial service revenue	682,709	494,779	376,970	416,196	384,891
Total revenue	4,859,336	4,781,909	5,955,384	6,143,044	6,185,577
Costs and expenses:					
Cost of goods sold	2,749,224	2,900,934	3,647,270	3,612,748	3,567,839
Corporate operating expenses	1,385,973	1,432,224	1,236,472	1,104,735	1,020,585
Restructuring expense & asset impairment	163,508	252,665	12,475	0	0
Total costs and expenses	4,298,705	4,585,823	4,896,217	4,717,483	4,588,424
Operating income	560,631	196,086	1,059,167	1,425,561	1,597,153
Investment income	5,442	4,254	11,296	22,258	27,087
Other expenses	175,604	21,680	4,542	0	0
Income before income taxes	390,469	178,660	1,065,921	1,447,819	1,624,240
Provision for income taxes	130,800	108,019	381,686	513,976	581,087
Income from continuing operations	259,669	70,641	684,235	933,843	1,043,153
Loss from discontinued Operations, net of taxes	(113,124)	(125,757)	(29,517)	0	0
Net (loss) income	146,545	(55,116)	654,718	933,843	1,043,153
Earnings (loss) per common share:					
Basic	0.63	(0.24)	2.80	3.75	3.94
Diluted	0.62	(0.24)	2.79	3.74	3.93
Cash dividends paid	0.40	0.40	1.29	1.06	0.63

**TABLE 3. Harley-Davidson, Inc.**  
**Consolidated Balance Sheets**  
**December 31, 2010, 2009, 2008, 2007, and 2006 (Amounts are in thousands)**

	2010	2009	2008	2007	2006
<b>ASSETS</b>					
Current assets:					
Cash & cash equivalents	1,021,933	1,630,433	568,894	402,854	238,397
Marketable securities	140,118	39,685	0	2,475	658,133
Accounts receivable, net	262,382	269,371	265,319	181,217	143,049
Finance receivables, net	1,779,458	1,436,114	3,822,426	2,356,563	2,101,366
Inventories	326,446	323,029	379,141	349,697	287,798
Deferred income taxes	146,411	179,685	123,327	103,278	73,389
Other current assets	389,878	282,421	128,730	71,230	48,501
Discontinued operations	0	181,211	238,715	0	0
Total current assets	<u>4,066,626</u>	<u>4,341,949</u>	<u>5,526,552</u>	<u>3,467,314</u>	<u>3,550,633</u>
Finance receivables, net	4,238,111	3,621,048	817,102	845,044	725,957
Property & equip., net	815,112	906,906	1,056,928	1,060,590	1,024,469
Deferred income taxes	213,989	177,504	288,240	54,376	42,986
Goodwill	29,590	31,400	60,131	61,401	58,800
Other assets	67,312	76,711	79,672	167,881	129,305
Total assets	<u><u>9,430,740</u></u>	<u><u>9,155,518</u></u>	<u><u>7,828,625</u></u>	<u><u>5,656,606</u></u>	<u><u>5,532,150</u></u>
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>					
Current liabilities:					
Accounts payable	225,346	162,515	303,277	300,188	283,477
Other short-term debt	1,037,143	704,083	2,242,115	484,936	479,709
Discontinued operations	0	69,535	77,941	0	0
Current part of l-t debt	751,293	1,332,091	0	1,119,955	832,491
Total current liabilities	<u>2,013,782</u>	<u>2,268,224</u>	<u>2,623,333</u>	<u>1,905,079</u>	<u>1,595,677</u>
Long-term debt	4,673,245	4,269,372	2,331,278	1,131,954	930,694
Postretirement benefits	536,847	509,804	758,411	244,082	249,042
Shareholders' equity					
Common stock	3,382	3,368	3,357	3,352	3,343
Add. paid-in capital	908,055	871,100	846,796	812,224	766,382
Retained earnings	6,336,077	6,324,268	6,458,778	6,117,567	5,460,629
Accum. other comp. income (loss)	(366,222)	(417,898)	(522,526)	(137,258)	(206,662)
Treasury stock	(4,674,426)	(4,672,720)	(4,670,802)	(4,420,394)	(3,266,955)
Total shareholders' eq.	<u>2,206,866</u>	<u>2,108,118</u>	<u>2,115,603</u>	<u>2,375,491</u>	<u>2,756,737</u>
Total liabilities and shareholders' equity	<u><u>9,430,740</u></u>	<u><u>9,155,518</u></u>	<u><u>7,828,625</u></u>	<u><u>5,656,606</u></u>	<u><u>5,532,150</u></u>

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Harley-Davidson, Inc. manufactures and sells heavyweight motorcycles as well as a line of motorcycle parts, accessories, general merchandise and related services. It also provides wholesale and retail financing and insurance programs primarily to Harley-Davidson dealers and customers. The company operates through the following segments: Motorcycles & Related Products and Financial Services.