

The Turnaround at Harley-Davidson

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William Davidson (standing), Charles Thompson, and Vaughn Beals (seated) of Harley-Davidson after the buyout in 1981.

By the early 1980s the Harley-Davidson Motor Company had rolled within inches of the precipice over which many American manufacturers had plummeted in the latter third of the twentieth century. Significant market forces—including Japanese competition and a recession—and a long-term decline in quality, were pushing America's last motorcycle maker into bankruptcy.

In 1981, however, a group of executives who loved the company and its product closed ranks to rescue Harley-Davidson from decline. After taking ownership of the company from an indifferent corporate parent in a leveraged buyout, they persuaded Washington to impose a temporary tariff increase on Japanese-made motorcycles. The law gave the bikers-cum-owners the time they needed to completely remake their company from within. By adapting the successful quality control and production methods used by Japanese competitors, they reinvented their manufacturing process and improved their product. The executives gave middle managers and line workers greater decision-making power. Harley-Davidson then supported its revamped bikes with an ingenious marketing strategy that appealed to the extraordinary loyalty of its die-hard customers and enticed new converts as well.

By 1987 Harley-Davidson had regained from off-shore competitors the preeminent position in its market, proving that a traditional American manufacturer can compete, survive, and prosper in a global marketplace.

An Early Start

William S. Harley and Arthur Davidson—both in their twenties—built their first motorcycle in 1903, the year Henry Ford formed his motor company. Like Ford, they built a prototype in a crude wooden shed; unlike Ford, they sold only one machine that first year—their entire output. By 1910 the Harley-Davidson Motor Company was up and running, selling 3,200 bikes. Ten years later, having expanded into overseas markets, the duo sold 28,000 motorcycles.

As automobiles became easily affordable and popular, the motorcycle's market share diminished. By 1913 only two of the several dozen motorcycle manufacturers born at the turn of the century survived: Harley-Davidson and the Indian Motorcycle Manufacturing Company.

In an effort to raise funds during the Depression, Harley-Davidson sold the rights to manufacture its bikes in Japan to a pharmaceutical firm. The deal kick-started the Japanese motorcycle market and unwittingly laid the groundwork for competition that would nearly kill the Harley-Davidson Motor Company forty years

later. The company survived the Depression in the 1930s and rebounded during World War II, when it supplied about 88,000 motorcycles to the army. Along with many other leaders in American industry, Harley-Davidson prospered after the war, due in part to the destruction of Japanese and European manufacturing capability. And in 1953, when Indian closed, Harley became the last remaining U.S. motorcycle maker.

By that time Harley-Davidson Motor Company had become an American institution. With appearances in cult movies such as *The Wild One* and *Easy Rider*, Harleys would become cultural icons. The ungainly “Hogs,” as they were commonly known, had a macho, rumbling voice and distinctive roar: “A Harley sounds like nothing else on the road,” as one enthusiast put it. Rakish, powerful, crude, loud, and tough, the bike attracted leather-clad rebels who loved its bad-boy mystique. “The bike conveys a mechanical forcefulness—it’s not totally tamed,” rhapsodized the longtime design chief Willie G. Davidson. Over the years, pop culture figures ranging from Elvis Presley to actor Steve McQueen and the baseball slugger Reggie Jackson proudly rode Hogs.

The Market Leader Falls Prey to Foreign Competition

In the 1960s, reconstructed Japanese manufacturing firms seized a chunk of the international automobile and motorcycle markets. One of the most successful Japanese motorcycle exporters was Honda, whose lighter-weight bikes were backed by aggressive commercials that portrayed riders as “nice” people—for a change. Kawasaki and Yamaha soon took their share of the lightweight market.

In 1969 Harley-Davidson was acquired by the American Machine & Foundry Company (AMF) and the former family-owned company (which had only gone public in 1965) was soon caught up in the dynamics of a huge conglomerate. At first that seemed a boon, since AMF pumped \$60 million into its Harley division and boosted production to compete with the growing Japanese onslaught. Although volume exploded from 27,000 in 1969 to 60,000 in 1972, AFM’s Harley-Davidson struck a curiously cavalier attitude toward the burgeoning market for cheaper, less-powerful bikes, which was dominated by the Japanese imports. In fact, in 1978, instead of increasing their production of light motorcycles, Harley-Davidson stopped making them altogether.

AMF appeared willing to cede this turf because the imports really didn’t challenge Harley-Davidson’s main business; heavyweight motorcycles with engine capacities of over 750 cc. As late as 1974 Harley-Davidson had no competitors in the super-heavyweight market (bikes powered by larger engines with 850 cc capacities). Having had the heavyweight market to itself for so long, Harley-Davidson had grown complacent, and the bikes reflected the inattention. Responsibility for quality control seemed to have been lost in AMF’s bureaucratic maze. Consequently, Hogs in the 1970s began to acquire a deserved reputation for poor quality. As *Forbes* noted in 1983: “AMF had run unit sales up but also threatened to run the company into the ground by not investing enough in new tooling.” Things became so bad that the company had to set up “hospitals,” way stations where bikes that had come off the assembly line incomplete were patched up and shipped off to dealers. Despite the quality problems, Harley-Davidson continued to rack up impressive sales figures. As the popularity of mopeds and lighter-weight machines pushed the overall market for two-wheel motorized bikes to new heights, the company sold a record 50,000 bikes in 1979. But these numbers were deceiving.

By 1981 Harley’s quality problems began having an impact on sales as Japanese competitors set their sites on the heavyweight market. The company’s sales fell a precipitous 18 percent to 41,000, and even Harley’s share of the U.S. super-heavyweight class fell below Honda’s 33.9 percent to 29.6 percent. Harley-Davidson’s domestic market share plunged to 5 percent. Even Hog cultists were buying Japanese bikes.

Convinced it could do little to reverse the company’s declining fortunes, AMF began looking for a buyer. It found scant interest. But back at the Harley-Davidson division, senior manager Vaughn Beats still believed in his product. He and his colleagues realized that the company could only survive in the hands of loyal managers who truly grasped the nuances of the motorcycle business. They foresaw that a sale to an outside buyer would be disastrous. “An experienced, closely knit management team would have been replaced by people who didn’t know the motorcycle business at all—and the long-term values of the company would have gone down the drain,” he said.

Enlisting the aid of Citibank, Beals and his team of twelve Harley-Davidson executives, including Richard Teerlink, the blunt, jovial chief financial officer, began negotiations to acquire the company. In June 1981, they reclaimed the firm's ownership. In a classic leveraged buyout (LBO), they pooled \$1 million in equity and borrowed the rest of the \$81.5 million purchase price from a consortium of banks led by Citibank. One of the most important members of the team was the design chief William G. Davidson. Willie O., as he is known both inside and outside the company, was the heart and soul of the operation. A grandson of company founder Arthur Davidson, Willie G. largely created Harley-Davidson's retro look, which became very popular. He was a graduate of The Art Center College of Design in Pasadena, California, and had joined the company in 1963. Willie O. let his hair and gray beard grow long and wore leathers, jeans, a beret, and a skull-and-crossbones lapel pin. His presence not only lent an air of authenticity to the firm, it also provided a connection between a faceless corporation and masses of customers. "Harley riders are kind of folk artists," Willie O. said. "A lot of them are untrained designers who'd rather talk about their motorcycle than almost anything. And I'm happy to listen because I'm of the same breed."

In June 1981, Harley-Davidson's new band of proprietors rode from the factory in York, Pennsylvania, to the company's headquarters in Milwaukee, Wisconsin, to publicize the company's new vigor. But the joyride came to a screeching halt soon after they returned to corporate headquarters. The LBO had come at exactly the wrong time. As the proud owners motored across Ohio, Indiana, and Illinois, a bitter and protracted recession was hitting Harley-Davidson's traditional customers particularly hard. Blue-collar workers were laid off in large numbers, and sky-high interest rates quelled their ardor and ability to borrow the \$8,000 purchase price. In 1982, estimated sales of all motorcycles in the United States fell 18 percent to 935,000, the first downturn since 1975. With Japanese-made bikes in corresponding weight classes costing 25 percent to 50 percent less than Harley-Davidson bikes, the company's condition quickly slipped from stable to critical. In 1980 Harley-Davidson had posted its first operating loss in fifty years. But the slow bloodletting quickly turned into a hemorrhage; in 1982 Harley-Davidson spilled \$25 million in red ink.

To complicate the situation, the LBO had left the company without the financial resources to weather the economic slide. On May 26, 1982, less than a year after the LBO, Harley-Davidson announced a drastic austerity program. In a stroke, it laid off 426 workers, cut officers' salaries up to 12 percent, froze workers' salaries, suspended contributions to employees' savings plans, and slashed production. By the end of 1982 the company had winnowed its workforce a staggering 40 percent, to 2,200.

Improving Quality by Mimicking Japanese Manufacturers

There was no guarantee that a rising economic tide would carry the firm back to fiscal health. To further exacerbate their financial woes, lack of quality had been a persistent problem. Throughout the years, the company's factory managers and line workers had been given responsibility for producing quantity, not for monitoring quality. As a result, by 1980, more than half of the Hogs rolling off the assembly line failed inspection and required repairs. By contrast, only 5 percent of Japanese bikes failed inspection. As *Cycle World* magazine noted: "Some of the hardware found on Harley Davidsons looked as if it were hammered out of iron ore by rock-wielding natives along the shores of the Milwaukee River." Dealers had to place cardboard and padding under bikes in the showroom to absorb the oil leaking from various tubes and parts. And some long-time Harley vendors became so disillusioned with their products that they began selling Japanese bikes. "At first, we found it hard to believe we could be that bad—but we were," said Vaughn Beals in 1982.

Beals and his colleagues quickly realized they had to conduct major surgery to save the patient. "We were trying to work within a production system that was basically flawed," he said. Ironically, the managers found their cure-all in Japanese factories. When the company's top executives and union leaders representing Harley-Davidson employees toured the Honda motorcycle plant in Marysville, Ohio, in 1982, they were shocked and amazed by what they saw: a neat assembly line, good labor relations, and a lean management staff (the plant had only thirty supervisors among the 500 employees). Most surprisingly the factory managed to achieve high productivity despite the near complete absence of computers. (Harley-Davidson had recently invested in expensive computer technology in an attempt to improve factory management.) Beals had an immediate insight into what separated Harley-Davidson from its Japanese competitors. "It wasn't robotics or culture or morning calisthenics and company songs; it was professional managers who understood their business and paid attention to detail," he told Peter Reid, the author of *Well Made in America*.

Tom Geib, Harley's senior vice president of operations, had conducted research on Japanese manufacturing practices and reached a stark conclusion. "We have to play the game the way the Japanese play it—or we're dead." Paradoxically, the Japanese had learned their game from an American: Dr. Edwards Deming, the father of the total quality management movement. Deming and Joseph Juran developed the programs and introduced them to Japan in the 1940s to help rebuild the country's industrial infrastructure after World War II.

Deming's strategy rested on the so-called productivity triad. The triad's three components were Just in Time (JIT) Inventory, Employee Involvement (EI), and Statistical Operator Control (SOC). With JIT Inventory, manufacturers keep just as many parts on hand as needed for immediate use instead of keeping large pools of components and tools lying around the facility. Under JIT, factories could turn over inventory twenty to thirty times a year; by contrast, Harley-Davidson only did so four times a year. In 1981, before the executives toured a Japanese plant, the company had started a pilot JIT program based on the Japanese concepts. Almost immediately Harley-Davidson realized savings on storage and inventory costs, thus leaving the company with more cash available to meet debt payments. The reduction of inventory cleared space on the factory floor, thereby eliminating assembly-line bottlenecks. Under Harley-Davidson's brand of JIT, which they called Materials as Needed (MAN), defective parts could be spotted before they were widely used. Since inventory came in smaller batches, adjustments could be made before the next supply of components arrived. The adoption of MAN let Harley cut its inventory by 75 percent and allowed its two assembly plants to operate without stockrooms.

The second major initiative borrowed from Deming—via the Japanese competitors—was greater employee involvement. In an early example of what would now be called "empowerment," Harley-Davidson sought to dissolve the distinction between blue-collar and white-collar workers. Top managers and line workers joined together to redesign the assembly lines and factory floors. "No changes were implemented until the people involved understood and accepted that change," said Tom Gelb. Given a stake in the crucial decisions that would affect the company's future, employees became problem solvers on the line.

Workers were also trained in a third Deming technique: Statistical Operator Control (SOC). In 1983 and 1984 Harley-Davidson managers were instructed by a group of University of Tennessee professors turned consultants in methods of SOC, which prescribes that assembly-line workers not simply perform tasks robotically; it recognizes that the company's employees had the greatest familiarity and intimacy with production. Aside from monitoring the process, employees were encouraged to discover kinks and problems in the process, question its efficacy, and propose solutions. Workers began to use control charts to analyze data and monitor quality. As Richard Teerlink said: "Top management must recognize that it has the responsibility and obligation to provide an environment in which an employee feels free to challenge the system to achieve success."

Harley-Davidson had recognized the need for change and had quickly implemented it. By the end of 1982 costs had dropped to such low levels that the company only needed to sell 35,000 bikes to break even, rather than 53,000 just two years before. However, Harley-Davidson sold a disappointing 27,000 bikes in 1982. Meanwhile, the company found itself confronted with another problem. In the early 1980s Yamaha and Honda, engaged in a furious war for the U.S. market share, began cutting their prices rapidly and flooding the market with their products, bringing in many more bikes than they could sell.

Frustrated, Harley-Davidson in September 1982 asked the International Trade Commission (ITC) for relief from these allegedly predatory trade practices. Harley wasn't asking for a permanent injunction against foreign competition. "All we're asking for is a little breathing room," Beals said at the time. The very survival of the only U.S. motorcycle maker hung in the balance. Politicians representing districts with Harley-Davidson operations rallied behind the company, and Senator Robert Kasten of Wisconsin became the first U.S. Senator to testify before the ITC on behalf of an industry. "What has occurred here is a truly massive buildup of Japanese inventory that bears no relationship to U.S. market needs," Kasten said.

The ITC found the arguments compelling and recommended slapping punitive tariffs on Japanese bikes. On April 1, 1983, Ronald Reagan signed off on the ITC's recommendations. The existing 4.4 percent import duty on Japanese motorcycles with engine capacity at or greater than 700 cc was immediately boosted to a whopping 49.4

percent in 1983. The measure called for tariffs to return slowly to the original level: falling to 39.4 percent in 1984, 24.4 percent in 1985, 19.4 percent in 1986, 14.4 percent in 1987, and back to the original 4.4 percent in 1988. Some Japanese manufacturers found a way around the surcharge by assembling their bikes in American plants instead of shipping them whole. But the tariff hit hard in the beginner's bike category, which was supplied exclusively by Japanese producers, and some blamed it for an industry-wide slump that took hold in the mid-1980s.

Rehabilitating the Image of an Improved Product

Even if the tariff made certain Japanese bikes more expensive, it didn't directly solve Harley-Davidson's problems. The company still had to convince the public of its renewed credibility—they needed some intense marketing. The company launched a nationwide promotion campaign in 1983 called the SuperRide program, in which, among other things, some six hundred dealerships invited people to see—and test—the new products for themselves. Over three weekends, 40,000 potential new customers accepted the invitation.

“Our relationship with cyclists is one of the differences between us and our Japanese competitors,” said Vaughn Beals. Many Harley customers, he said, weren't just buying a motorcycle; they were buying “the Harley experience.” Legions of these Hog owners delighted in wearing Harley-Davidson T-shirts and leather goods; some smaller percentage of them went to the length of having the company's name and logo permanently tattooed onto their skin. Perhaps in the absence of that special relationship, Harley could not have saved itself. About 75 percent of Harley riders made repeat purchases. Given that loyalty, Harley concentrated much of its new marketing efforts on customers who already owned its bikes.

In 1983 Harley-Davidson started the innovative Harley Owners' Groups—or HOGs. Each new buyer received a free one-year membership in a local riding group, a subscription to a bimonthly publication, *Hog Tales*, and a six-month subscription to *American Iron*, a magazine for motorcycle enthusiasts. Other privileges included admission to open houses and private receptions at motorcycle events, insurance, emergency roadside service, rental arrangements on vacation, even support groups for female riders. As the Harley-Davidson marketing vice president Kathleen Lawler-Demitros said: “It humanized the company and not only gives customers direct access to the Harley family, but also it allows them to feel like one of the family.” The HOGs proved immensely popular. As sales rose from 27,000 in 1983 to 43,300 in 1987, HOGs registered 73,000 members.

Repairing a Broken-down Financial Vehicle

By the mid-1980s the quality programs and marketing efforts began to show up on the bottom line. After eking out a small gain of \$973,000 in 1983, the firm reported profits of \$2.6 million in 1984. The company was making and selling fewer bikes than before—in 1985 the 23,000 cycles produced represented just 3.86 percent of the total market—but it was making them better and faster. Customers noticed the difference. As Michael O'Farrell, president of the Oakland (California) Hell's Angels chapter, said in 1985: “It's amazing the difference. They don't beat you to death anymore, and your kidneys are still intact.”

While it had made believers out of hard-core bikers, Harley-Davidson hadn't won over hard-core bankers. Since the buyout, the company had routinely drawn above and beyond the initial credit line from Citibank. Despite the company's apparent turnaround, the financiers didn't share the executives' sunny view of the future. In late 1984 Citibank let it be known that it would no longer grant advances above the agreed upon credit limit. On the eve of a great comeback, the company was suddenly on the brink of bankruptcy. In a series of browbeating meetings, Harley-Davidson coaxed Citibank to write off \$10 million of the loan. Citibank correctly reasoned that such a move would make its client a more attractive risk to other bankers. With a reduced debt load, Harley-Davidson was then able to round up new lenders, led by Chicago-based Heller Financial, Inc., which replaced Citibank's loan on December 31, 1985.

Just months after Citibank threatened to send Harley-Davidson packing into Chapter XI, Harley-Davidson made the ultimate statement about its state of health. The rejuvenated firm turned to the public debt and equity markets in June 1986, raising \$90 million by selling \$20 million in common stock and \$70 million in subordinated notes. The following year, when Harley-Davidson switched its listing from the American Stock Exchange to the New York

Stock Exchange, the company's executives thundered down the canyons of lower Manhattan astride a gaggle of Hogs.

In 1987 *Forbes* noted, "Today Harley's prospects look much brighter. . . . It finished the year with sales of \$295 million and profits of \$4.3 million almost double the year before." The company had indeed come a long way in six years. Between 1981 and 1987 annual revenues per employee doubled, productivity rose 50 percent, and the percentage of bikes that were ready-to-ride as they came off the assembly line rose to 99 percent. It wasn't just a matter of numbers. Newly confident in the changed company, the Harley-Davidson executives made good on their prior promise that government aid should be a temporary crutch, not a permanent prosthetic. On March 17, 1987, the company, acting on its own volition, formally asked the U.S. government to rescind the tariffs on Japanese motorcycles about a year before they were supposed to expire. The *New York Times* celebrated the move as "a masterful stroke of public relations."

To celebrate its renaissance, the company on June 18, 1988, threw itself a huge eighty-fifth birthday party in Milwaukee, complete with a concert by the Charlie Daniels Band. In the week before the bash, more than 40,000 Harley lovers rode to the Brew City on ten different routes from across the United States. Each rumbling phalanx was led by Harley-Davidson executive: Vaughn Beals, Richard Teerlink, and Willie G. rode at the head of massive biker gangs.

Harley-Davidson once again led the pack. As the economy improved, sales continued to rebound. By 1989 Harley-Davidson had regained its preeminence, cornering 59 percent of the market for heavy-weight motorcycles, easily outracing second-place Honda, which held 15 percent. Sales of the expensive bikes—a fully loaded Hog runs well over \$15,000—grew to 41,000 in 1989. Investors who had expressed faith in the company by purchasing its stock were rewarded handsomely. As earnings grew at a 57 percent annual clip between 1986 and 1990, the stock, which was first traded at \$11 a share, split and doubled several times over. By June 1990 the stock rose tenfold from its initial offering price.

The Harley-Davidson Owner

Over the course of the 1980s the profile of the Harley rider changed dramatically. While the bikes had always had their share of celebrity riders, the company traditionally drew its customers from the working and middle classes. But as prices continued to rise and the company staked out its position at the high end of the market in the 1970s and 1980s, its energetic marketing began to attract a different class of buyers. That year, 40 percent of Harley-Davidson owners were white-collar workers compared with 31 percent of all motorcycle owners. In 1985 the average Harley-Davidson rider had an annual income of \$35,700, compared with the industry average of \$22,500.

In the late 1980s this trend continued. Harley's revamped high-quality image and higher prices turned the bikes into yuppie status symbols. Groups of brokers, lawyers, and accountants got together on the weekend to burn rubber, creating the phenomenon known as Rolex Riders, or Rich Urban Bikers (RUBs). In 1989 the company held a promotional fashion night at Bloomingdale's. The typical buyer in 1990—a thirty-five-year-old male—had a household income of \$45,000, far above the national average. By 1990, one-third of new Harley buyers were professionals or managers, and 60 percent were college graduates.

Even so, Harley-Davidson wasn't content with its comeback. For its executives regarded it as a work in progress, a living and evolving example of the importance of maintaining quality. In the early 1990s management teams from dozens of other firms flocked to Milwaukee, Wisconsin, and York, Pennsylvania, to examine first-hand the healthy vital signs of what ten years before had been a basket case. And the firm continued to employ the productivity triad to great effect. "We didn't realize it right away, but we found out through experience that all three of these practices are interdependent, so you must do all of them to achieve the best quality and productivity," said Vaughn Beals. In 1990 the company was turning over inventory twenty times a year and had cut inventory levels by 75 percent and space requirements by 25 percent since 1981.

Harley's new paradigm—continuous quality improvement—requires a great amount of time and attention early in the manufacturing process. It was devised to nip problems in the bud before they developed into crises. It recognized that the rapid pace of change in technology, economies, and lifestyles requires executives to maintain a constant state of vigilance. "Change is here to stay. It's never going to go away," said Richard Teerlink. "Get used to it."