Honda (A)

The two decades from 1960 to 1980 witnessed a strategic reversal in the world motorcycle industry. By the end of that period, previously well-financed American competitors with seemingly impregnable market positions were faced with extinction. Although most consumers had an initial preference to purchase from them, these U.S. manufacturers had been dislodged by Japanese competitors and lost position despite technological shifts that could have been emulated as competition intensified.

The Japanese invasion of the world motorcycle market was spearheaded by the Honda Motor Company. Its founder, Soichiro Honda, a visionary inventor and industrialist, had been involved peripherally in the automotive industry prior to World War II. However, Japan’s postwar devastation resulted in the downsizing of Honda’s ambitions; motorcycles were a more technologically manageable and economically affordable product for the average Japanese. Reflecting Honda’s commitment to a technologically based strategy, the Honda Technical Research Institute was established in 1946. This institute, dedicated to improvements in internal combustion engines, represented Honda’s opening move in the motorcycle field. In 1947, Honda introduced its first A-type, 2-stroke engine.

As of 1948, Honda’s Japanese competition consisted of 247 Japanese participants in a loosely defined motorcycle industry. Most competitors operated in ill-equipped job shops, adapting clip-on engines for bicycles. A few larger manufacturers endeavored to copy European motorcycles but were hampered by inferior technology and materials that resulted in unreliable products.

Honda expanded its presence in the fall of 1949, introducing a lightweight 50cc, 2-stroke, D-type motorcycle. Honda’s engine at 3 hp was more reliable than most of its contemporaries’ engines and had a superior stamped metal frame. This introduction coincided closely, however, with the introduction of a 4-stroke engine by several larger competitors. These engines were both quieter and more powerful than Honda’s. Responding to this threat, Honda followed in 1951 with a superior 4-stroke design that doubled horsepower with no additional weight. Embarking on a bold campaign to exploit this advantage, Honda acquired a plant, and over the next two years it developed enough manufacturing expertise to become a fully integrated producer of engines, frames, chains, sprockets, and other ancillary parts crucial to motorcycle performance.
Motorcycle manufacturers in the Japanese industry tended to minimize risk by investing in one winning design and milking that product until it became technologically obsolescent. Beginning in the 1950s, Honda began to depart from this pattern—seeking simultaneously to (1) offer a multiproduct line, (2) take leadership in product innovation, and (3) exploit opportunities for economies of mass production by gearing designs to production objectives. Most notably, in 1958 Honda’s market research identified a large, untapped market segment seeking a small, unintimidating motorcycle that could be used by small-motorcycle businesses for local deliveries. Honda designed a product specifically for this application: a step-through frame, automatic transmission, and one-hand controls that enabled drivers to handle the machine with one hand while carrying a package in the other. The 50cc Honda was an explosive success. Unit sales reached 3,000 per month after six months on the market. Deciding to make this the product of the future, Honda gambled, investing in a highly automated 30,000-unit-per-month manufacturing plant—a capacity 10 times in excess of demand at the time of construction.

Honda’s bold moves set the stage for a yet bolder decision—to invade the U.S. market. The following section depicts the sequence of events as taken from a Harvard Business School case on the motorcycle industry.1

In 1959 . . . Honda Motor Company . . . entered the American market. The Japanese motorcycle industry had expanded rapidly since World War II to meet the need for cheap transportation. In 1959, Honda, Suzuki, Yamaha, and Kawasaki together produced some 450,000 motorcycles. With sales of $55 million in that year, Honda was already the world’s largest motorcycle producer. . .

In contrast to other foreign producers who relied on distributors, Honda established a U.S. subsidiary, American Honda Motor Company, and began its push in the U.S. market by offering very small lightweight motorcycles. The Honda machine had a three-speed transmission, an automatic clutch, five horsepower (compared with two and a half for the lightweight motorcycle then sold by Sears, Roebuck), an electric starter, and a step-through frame for female riders. Generally superior to the Sears lightweight and easier to handle, the Honda machines sold for less than $250 retail, compared with $1,000–$1,500 for the bigger American or British machines.

Honda followed a policy of developing the market region by region, beginning on the West Coast and moving eastward over a period of four to five years. In 1961 it lined up 125 dealers and spent $150,000 on regional advertising. Honda advertising represented a concerted effort to overcome the unsavory image of motorcyclists that had developed since the 1940s, given special prominence by the 1953 movie The Wild Ones, which starred Marlon Brando as the surly, destructive leader of a motorcycle gang. In contrast, Honda addressed its appeal primarily to middle-class consumers and claimed, “You meet the nicest people on a Honda.” This marketing effort was backed by heavy advertising, and the other Japanese exporters also invested substantial sums: $1.5 million for Yamaha and $0.7 million for Suzuki.

Honda’s strategy was phenomenally successful. Its U.S. sales rose from $500,000 in 1960 to $77 million in 1965. By 1966, Honda, Yamaha, and Suzuki together had 85% of the U.S. market. From a negligible position in 1960, lightweight motorcycles had come to dominate the market.

The transformation and expansion of the motorcycle market during the early 1960s benefited British and American producers as well as the Japanese. British exports doubled between 1960 and 1966, while Harley-Davidson’s sales increased from $16.6 million in 1959 to $29.6 million in 1965. Two press reports of the mid-1960s illustrate these traditional manufacturers’ interpretation of the Japanese success:

“The success of Honda, Suzuki, and Yamaha in the States has been jolly good for us,” Eric Turner, chairman of the board of BSA Ltd., told Advertising Age. “People here start out by buying one of the low-priced Japanese jobs. They get to enjoy the fun and exhilaration of the open road and frequently end up buying one of our more powerful and expensive machines.” The British insist that they’re not really in competition with the Japanese (they’re on the lighter end). The Japanese have other ideas. Just two months ago Honda introduced a 444cc model to compete, at a lower price, with the Triumph 500cc. [Advertising Age, December 27, 1965]

“Basically we do not believe in the lightweight market,” says William H. Davidson, son of one of the founders and currently president of the company (Harley-Davidson). “We believe that motorcycles are sports vehicles, not transportation vehicles. Even if a man says he bought a motorcycle for transportation, it’s generally for leisure time use. The lightweight motorcycle is only supplemental. Back around World War I, a number of companies came out with lightweight bikes. We came out with one ourselves. We came out with another one in 1947 and it just did not go anywhere. We have seen what happens to these small sizes.” [Forbes, September 15, 1966]

Meanwhile, the Japanese producers continued to grow in other export markets. In 1965, domestic sales represented only 59% of Honda’s total of $316 million, down from 98% in 1959. Over the same period, production volume had increased almost fivefold, from 285,000 to 1.4 million units. In Europe, where the Japanese did not begin their thrust until the late 1960s, they had captured a commanding share of key markets by 1974.

In short, by the mid-1970s the Japanese producers had come to dominate a market shared by European and American producers 20 years earlier. . .

It was often said that Honda created the market for the recreational uses of motorcycles through its extensive advertising and promotional effort.

The company achieved a significant product advantage through a heavy commitment to R&D and advanced manufacturing techniques. Honda used its productivity-based cost advantage and R&D capability to introduce new models at prices below those of competitive machines. New products could be brought to market very quickly; the interval between conception and production was estimated to be only 18 months. Honda was also reported to have a “cold storage” of designs that could be introduced if the market developed. . . .

Since 1960, Honda had consistently outspent its competitors in advertising. It had also established the largest dealership network in the U.S. On average, Honda dealers were larger than their competitors. In new markets, Honda had been willing to take short-term losses in order to build up an adequate selling and distribution network.

In 1975, the Boston Consulting Group was retained by the British government to diagnose the British motorcycle industry and the factors contributing to its decline. The remainder of this case, reflecting on Honda’s strategy, consists of excerpts from that report:2

The market approach of [Honda] has certain common features which, taken together, may be described as a “marketing philosophy.” The fundamental feature of this philosophy is the emphasis it places on market share and sales volume. Objectives set in these terms are regarded as critical, and defended at all costs.

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The whole thrust of the marketing program . . . is towards maintaining or improving market share position . . . . We have seen some ways in which this goal is pursued. It is worth adding, as an example of how pervasive this objective is . . . that in an interview with a Honda personnel director, we were told that the first question a prospective Honda dealer is asked is the level of his market share in his local area. “I don’t know why, but this company places an awful lot of emphasis on market share” was the comment . . . . We shall return to the reasons why market shares are critical for commercial success in the industry.

We were also told by representatives of [Honda] that their primary objectives are set in terms of sales volume rather than short-term profitability. Annual sales targets—based on market share penetration assumptions and market growth prospects—are set, and the main task of the sales company is to achieve these targets. The essence of this strategy is to grow sales volume at least as fast or faster than any of your competitors.

A number of more specific policies follow from this general philosophy, and our descriptions of each of the Japanese competitors provide ample examples of these policies:

1. Products are updated or redesigned whenever a market threat or opportunity is perceived.
2. Prices are set at levels designed to achieve market share targets and will be cut if necessary.
3. Effective marketing systems are set up in all markets where serious competition is intended, regardless of short-term cost.
4. Plans and objectives look to long-term payoff.

The results of these policies for the Japanese competitors have, of course, been spectacularly successful. Over the last fifteen years, the rates of growth of the four major Japanese companies have been as shown in Table A.

**Table A** Growth of Japanese Production

<table>
<thead>
<tr>
<th></th>
<th>Production in 1959 (000 units)</th>
<th>Production in 1974 (000 units)</th>
<th>Average Annual Growth Rate (% p.a.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Honda</td>
<td>285</td>
<td>2,133</td>
<td>14</td>
</tr>
<tr>
<td>Yamaha</td>
<td>64</td>
<td>1,165</td>
<td>21</td>
</tr>
<tr>
<td>Kawasaki</td>
<td>10</td>
<td>355</td>
<td>27</td>
</tr>
<tr>
<td>Suzuki</td>
<td>96</td>
<td>840</td>
<td>16</td>
</tr>
</tbody>
</table>

Source: Japan Automobile Industry Association.

**Selling and distribution systems** We have so far discussed market share as a function of the product features and prices of particular models. Market share across all cc classes is also influenced by what we shall call the selling and distribution system (s and d system). Within the s and d system we include all the activities of the marketing companies (or importers) in each national market:

- Sales representation at the dealer level
- Physical distribution of parts and machines
- Warranty and service support
• Dealer support
• Advertising and promotion
• Market planning and control

We also include the effects of the dealer network established by the marketing companies:

• Numbers and quality of dealers
• Floor space devoted to the manufacturers’ products
• Sales support by dealers

The sales and distribution system supports sales of the manufacturer across the whole model range, and its quality affects market shares in each cc class where the manufacturer is represented. Table B compares the sales and distribution systems of the four full-line Japanese manufacturers in the USA, and shows that high market shares both overall and in each cc class go with high levels of expenditure on sales and distribution and with extensive dealer networks.

The interaction between product-related variables and sales and distribution-related variables is complex. The better the product range in terms of comprehensiveness, features, and price, and the more sophisticated the sales and distribution system of the sales company, the easier it will be to attract good dealers. This is because good products, which are well supported at the marketing company level, lead to good retail sales. Equally, good dealers themselves improve retail sales, and active competition between dealers can lead to retail discounting which acts as a volume-boosting price cut to the public. The manufacturers’ products and sales and distribution system therefore influence sales both directly, at retail, and proximately, through their effect on the dealer network.

In particular cc categories, each manufacturer’s position is substantially influenced by its specific product offerings. For example, Kawasaki are strong in the 750cc and over class due to the Z-1, and Yamaha have been weak due to its poor 750cc model. Outstanding products obtain market shares that are unusually high for a manufacturer, and weak products lead to atypically low market shares. For products of average attraction, however, market shares seem to move towards some equilibrium level. For each manufacturer, this level in the USA appears to be:

<table>
<thead>
<tr>
<th>Manufacturer</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Honda</td>
<td>40–50%</td>
</tr>
<tr>
<td>Yamaha</td>
<td>15–25%</td>
</tr>
<tr>
<td>Kawasaki</td>
<td>10–15%</td>
</tr>
<tr>
<td>Suzuki</td>
<td>9–12%</td>
</tr>
</tbody>
</table>

As overall market leaders, the Japanese have dominated pricing in the motorcycle industry. It is therefore appropriate to begin this analysis by examining the extent to which the experience curve concept appears to explain the performance of the Japanese. Unfortunately, it is impossible directly to determine unit cost performance data for competitors, since the data are not publicly available. Sources can be found, however, for unit price and production volume data. Over the long term, price behavior is a useful guide to movements in the underlying costs, and so an experience curve analysis on prices can be extremely revealing.

Japanese price performance In Figure A, price experience curves are drawn for the Japanese motorcycle industry as a whole, based on aggregate data collected by MITI. These curves show price reduction performance of a consistent nature for each of the size ranges of motorcycle considered, the rate of price reduction being most rapid of all in the largest range, 126–250cc, which is following an experience curve slope of 76%. The other slopes are more shallow, at 81% and 88%, but there is no
mistaking the fact that real prices are descending smoothly over time. These experience-based price reductions clearly go a long way towards explaining the historical competitive effectiveness of the Japanese in the marketplace in small and medium motorcycles.

Table B  The Selling and Distribution Systems of Japanese Companies in the U.S.A.

<table>
<thead>
<tr>
<th>Sales Company</th>
<th>Est'd Total S&amp;D Expenditure by Sales Company 1974 ($m)</th>
<th>Advertising Expenditure 1972 ($m)</th>
<th>Dealers 1974 Numbers</th>
<th>Units Sold per Dealer</th>
<th>1974 % Share of Total Market (units)</th>
<th>Lowest % Share of any cc Class</th>
<th>Highest % Share of any cc Class</th>
</tr>
</thead>
<tbody>
<tr>
<td>Honda</td>
<td>90–100</td>
<td>8.1</td>
<td>1,974</td>
<td>220</td>
<td>43</td>
<td>34</td>
<td>61</td>
</tr>
<tr>
<td>Yamaha</td>
<td>40–45</td>
<td>4.2</td>
<td>1,515</td>
<td>135</td>
<td>20</td>
<td>4</td>
<td>34</td>
</tr>
<tr>
<td>Kawasaki</td>
<td>30–35</td>
<td>2.2</td>
<td>1,018</td>
<td>127</td>
<td>13</td>
<td>9</td>
<td>19</td>
</tr>
<tr>
<td>Suzuki</td>
<td>25–30</td>
<td>3.0</td>
<td>1,103</td>
<td>98</td>
<td>11</td>
<td>5</td>
<td>16</td>
</tr>
</tbody>
</table>


For the purposes of strategy development . . . it is [helpful] to look more closely at price performance in the larger bike models. The Honda CB 750 has been the pacesetter in superbikes in terms of both market penetration and pricing. In Figure B, price experience curves are plotted for this product and for two other large Honda bikes. The prices of other Japanese manufacturers have been broadly comparable to Honda’s in the equivalent size range (they usually tend if anything to price at a slight premium relative to Honda), so that we may use Honda as a good “benchmark” for the Japanese competition in big bikes in general.

Figure A  Japanese Motorcycle Industry: Price Experience Curves, 1959–1974

Source: MITI.
Figure B  Honda Large Bikes: Price Experience Curves

It is clear from Figure B that price performance in the large bikes has been consistent with that in small: real prices have declined along experience curve slopes in the region of 85%–87%. This has also been true of the price in the United States, when converted into yen terms.

An interesting feature of the curves is that the prices in the United States are so much higher than [those] of the same products in Japan. As shown in Table C, the premiums are high across almost the entire range of bikes and are far larger than seems necessary, even allowing for the extra costs
incurred for duty, freight, and packing in shipping bikes from Japan to the United States. This certainly suggests that there is no possibility that the Japanese are “dumping” their products in the U.S. market: quite the reverse. Furthermore, it may well indicate that competitive though the Japanese have been in the United States, based on the downward trends in their real price levels over time, there may well be plenty of scope for them to be even more competitive in the future if seriously challenged in that market. They could simply reduce their margins on exports to the United States to levels more in line with those enjoyed in their domestic business.

Table C  Honda Price Premium, USA vs. Japan

<table>
<thead>
<tr>
<th>Model</th>
<th>Japan Price ¥000</th>
<th>$ Equiv.</th>
<th>U.S. Price ($)</th>
<th>Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>CB 750</td>
<td>395</td>
<td>1411</td>
<td>2024</td>
<td>43%</td>
</tr>
<tr>
<td>CB 550</td>
<td>355</td>
<td>1268</td>
<td>1732</td>
<td>37%</td>
</tr>
<tr>
<td>CB 450</td>
<td>303</td>
<td>1082</td>
<td>1471</td>
<td>36%</td>
</tr>
<tr>
<td>CB 360</td>
<td>253</td>
<td>904</td>
<td>1150</td>
<td>26%</td>
</tr>
<tr>
<td>CB 350</td>
<td>275</td>
<td>982</td>
<td>1363</td>
<td>39%</td>
</tr>
<tr>
<td>MT 250</td>
<td>218</td>
<td>779</td>
<td>965</td>
<td>24%</td>
</tr>
<tr>
<td>MT 125</td>
<td>158</td>
<td>564</td>
<td>743</td>
<td>32%</td>
</tr>
<tr>
<td>CB 125</td>
<td>166</td>
<td>593</td>
<td>640</td>
<td>8%</td>
</tr>
</tbody>
</table>

Premium allowing for freight, duty and packing

CB 750, U.S. retail price 1975 = $2112
Price to dealer = $1584 (75% of 2112)
Price to distributor = $1373 (65%)

Japan list price = ¥440,000 or $1517 (equivalent)
Price to distributor = $986 (65%)
Ocean freight to LA = 60
Duty = 63 (3% U.S. Retail Price)
Packaging costs = 40

Thus, indicated price to U.S. distributor for equal manufacturer’s margin to that on bikes sold in Japan = $986 + 163 = $1149

Thus, premium in U.S.A. even after allowing for freight, duty and packing = (1373/1149 - 1) × 100 = 20%

Note: The versions of the smaller bike models shipped to the States may be slightly more expensive than their Japanese equivalents (extra lighting, etc.). The versions of the larger bikes are, however, reported to be identical in both markets.

Japanese cost performance  The implication of the downward trends in real prices for the Japanese is, of course, that there have been underlying experience-based cost reductions: that the decline has not been accounted for simply by a reduction in margins. . . However, the major Japanese manufacturers have been continuously profitable, and this suggests that cost reductions have indeed taken place in parallel with real price reductions. On the other hand, all the Japanese
motorcycle manufacturers also make a significant proportion of products other than motorcycles (in 1974 about 35% of Honda’s turnover, and about 40% of Suzuki’s, was accounted for by cars; of Yamaha Motor’s turnover about 40% was in products such as boats and snowmobiles). It is, perhaps, reasonable to question whether these products are sufficiently profitable to “subsidize” the motorcycle business.

... It seems clear that ... none of [the three major Japanese] manufacturers is subsidizing the motorcycle business from other businesses. Indeed, Honda was actually losing money in its car business in 1974, which suggests that their motorcycle business that year may have shown returns of the order of 20% (BIT) compared with the 12.4% return earned by the company overall. The overall inference from this profit performance must be that each manufacturer has indeed achieved an experience curve effect on costs in parallel with those achieved on price. The existence of this experience curve effect in the motorcycle industry has important strategy implications.

Competitive Strategy Implications

As we have discussed, failure to achieve a cost position—and hence cost reductions over time-equivalent to your competitors’ will result in commercial vulnerability. At some point your competitors will start setting prices which you cannot match profitably, and losses will ensue. The strategic importance of the experience curve is that it explains clearly the two possible long-term causes of uncompetitive costs:

- Relative growth: failure to grow as rapidly as competitors, thereby progressing more slowly than them along the experience curve.
- Relative slopes: failure to bring costs down the characteristic experience curve slope achieved by competitors. . . .

Summary

From the perspective of the writers of the BCG study, a fundamental cause for the Japanese success was their high productivity. The motorcycle industry was exhibiting the effects that differences in growth rates, volume, and level of capital investment among competitors can have on relative costs. The high rates of growth and levels of production achieved by the Japanese manufacturers resulted in their superior productivity. In terms of value added per employee, Honda outperformed Western competitors by as much as four times. Even the smaller Japanese competitors were able to outperform their Western counterparts by a factor of two or three.

The BCG report also countered the common argument that the relatively inexpensive Japanese labor was the primary source of competitive advantage. The Japanese competitors in fact had higher labor costs than companies in the West. Their relative high growth and scale caused total costs to drop quickly enough to support regular pay increases and price decreases at the same time.

Essentially the argument presented by BCG was that the Japanese emphasis on market share as the primary objective led to high production volume, improved productivity, low costs, and in the long term to higher profitability than their competitors.