PGDM (IBM), 2019-21
Strategic Management
IBM-308
Trimester – III, End-Term Examination: June 2020

Time allowed: 1 Hours 30 minutes

Max Marks: 50

Roll No: ___________

Instruction: Students are required to write Roll No on every page of the question paper, writing anything except the Roll No will be treated as **Unfair Means.** In case of rough work please use answer sheet.

Note: Answer all 3 questions at the end of the Case:

Hero Honda Motors (India) Ltd.: Is it *Honda* that Made it a *Hero*?

Hero Honda Rides Splendor to Become World's No. 1

India has finally got a world leader in manufacturing with "no problem." Hero Honda Motors Ltd. (HHM) has attained the distinction of being the largest two-wheeler company in the world in volume terms. With a new factory on the anvil, it is gearing itself for Operation One Billion, targeting $1 billion revenues in 2002-03. "Next year, we will enter the (dollar) billionaire's club (in revenues). After Operation Million for volumes in 2001-02, our slogan for the next year is Operation One Billion," said Mr. Pawan Munjal, Director & CEO, HHM. The distinction of being the largest two-wheeler company in the world came in calendar 2001, with sales rocketing past the one million mark in the first nine months of the current fiscal year. This performance was in conjunction with Splendor, launched in 1995, becoming the world's largest-selling bike.

Business Standard, January 2002

Things could not have possibly looked any better for Mr. Brijmohan Lal Munjal, the Chairman and Managing Director of Hero Honda Motors (HHM). Quarter after quarter, and year over year, HHM had continued to grow, delivering superb performance in India's two-wheeler marketplace. The company had come from nowhere to whiz past Bajaj Auto Ltd., the traditional leader of the pack in two-wheelers. Mr. Munjal had not only earned the crowning title of heading the largest two-wheeler company in the world, but also the personal glory of having presided over one of the most successful joint ventures in the country. Having built a storied legacy, he could rest easy. Or could he?

The spectacular track record of the company was being threatened by predatory moves made by its Japanese partner, Honda Motor Company. The first dark clouds appeared on the horizon in August 1999. Honda Motor Company Ltd. (HMC), HHM's joint venture partner, announced that it would be setting up a 100% subsidiary, Honda Motorcycle & Scooter India (HMSI) to initially make scooters and later, motorcycles as well. HHM's stock plummeted by 30% on the day of the announcement. It was apparent that the investors were no longer optimistic about the company's ability to continue its sterling performance record, especially in the face of competition from Honda. Was this a portent of things to come? Adding another dimension to an arena already fraught with significant complexity, reports from the marketplace clearly showed increasing intensity of rivalry. Not only were domestic rivals getting better equipped to challenge HHM for supremacy, there were foreign interlopers as well who seemed determined on giving HHM a run for its money. It was definitely not a time to rest on past laurels.

The Two-Wheeler Industry in India

History and Background

India had the largest population of two-wheelers (around 41.6m vehicles) in the world.[1] They accounted for almost 70% of the country's automobile market in volume terms. India was the second largest manufacturer of two-wheelers in the world.

The birth of the Indian two-wheeler industry can be traced to the small beginnings that it made in the early 1950s when Automobile Products of India (API) started manufacturing scooters in the country. Although API initially dominated the scooter market with its *Lambrettas*, Bajaj Auto Ltd., a company that later became a legend in the global scooter industry, overtook it fairly quickly. Although a number of government and private enterprises also entered the scooter segment, almost all of them had disappeared from the market by the turn of the century. Baja Auto Ltd. stood the test of time perhaps due to its initial association with Piaggio of Italy (manufacturer of*Vespa*) that provided the technological know-how for the venture.

The motorcycle segment was no different; with only three manufacturers—Royal Enfield, Ideal Jawa, and Escorts—there was hardly any significant compe- tition for the customer. While this segment was dominated by Enfield's 350cc *Bullet*, the only motor- cycle with a four-stroke engine at the time, Jawa and Escorts also had a fair share of the middle and lower end of the market.

The winds of change began to take hold in the mid-'80s when the Indian government started permitting foreign companies to enter the Indian market through minority joint ventures. Under these relaxed regulations, the two-wheeler market witnessed a veritable boom with four Indo-Japanese joint ventures; namely, Hero Honda, TVS Suzuki, Bajaj Kawasaki, and Kinetic Honda all lining up to target the Indian consumer market for motorcycles. Confronted with a larger array of choices, the consumers were regaining their influence over the products that they bought. In keeping up with these higher customer expectations, the industry accelerated the launch of new models, and every company was trying to outdo the other in terms of styling, price, and fuel efficiency. The technological expertise that the foreign companies brought to the marketplace helped increase the overall quality and reliability of the products quite significantly. The old-guard companies soon found themselves under pressure to improve their offerings and bring their products on par with their global counterparts.

The Indian Consumer

Two-wheelers had become the standard mode of transportation in many of India's large urban centers. Increasing urbanization, saturation of cities, and the lack of adequate roads helped to propel demand for two-wheelers. The two-wheeler was typically a prized possession in the average Indian household. It was normally used to transport both people and goods, substituting for a car that was prohibitively expensive. While a two-wheeler normally cost around Rs. 40,000 [1 U.S. $ = 49 Rupees (Rs.)], an entry-level car was priced around Rs. 300,000. Two-wheelers had long road lives, and were often used for even 15 years, passed down from one generation to the next. However, in global terms the market was far from mature. Industry watchers reported that India had a penetration rate of 10% as of the late 1990s (107 two-wheelers for every 1000 adults), far below the penetration rates of other developing countries. It was clear that the manufacturers had a lot of ground to cover.

There were indeed visible signs that the companies were gearing up to address this growing market. While the production and sales of motorcycles grew substantially (CAGR of 22% between 1996 and 2001), the performance of the other two segments of two-wheelers was poor. Scooter production grew by only 0.5%, while the production of mopeds fell by 29% during 2001-02

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The Legend of Hero Honda

The Hero Group

The Munjals, owners of the Hero Group and promoters of HHM, had made a modest beginning as suppliers of bicycle components in the early '40s. Currently, the group's bicycle company, Hero Cycles, manufactured over 16,000 bicycles a day and had sold over 86 million bicycles in aggregate as of 2002. It had been acknowledged as the world's largest bicycle manufacturer in 1986 when it overtook the U.S. manufacturer, Huffy. Despite the lack of significant process automation, the company had been able to achieve among the highest levels of employee productivity and efficiency on a global basis. Although a publicly traded company, the family was extensively involved in day-to-day management of operations, as well as setting strategic direction.

Much of the company's strategy was anchored to the fundamental principle of providing products of superior value at reasonable prices to the consumer. This basic belief was reflected in the company's approach to product innovation, quality, and reliability. Over time, the group had nurtured an excellent network of dealers to serve India's expansive markets. This network was not just focused on the high-density urban centers, but also encompassed rural outlying regions that typically did not attract the attention of large manufacturers. The company truly believed in its mission of bringing transportation to the masses.

Over the years, the Hero Group had entered multiple business areas, largely related to the transportation industry. The group evolved into a fairly integrated set of operations that spanned multiple areas of raw material processing, such as steel rolling, to the manufacture of subassemblies and components. Many of these ventures were owned and controlled by members of the Munjal family or operated by very close friends and associates. Thus, the company had seemingly established control over all facets of production and marketing. **Exhibit B** shows the portfolio of Hero Group businesses.

Honda Motor Company of Japan

Honda Motor Company had surprisingly similar origins like its counterpart in India. Founded in 1946 as the Honda Technical Institute by Mr. Soichiro Honda, the company produced its first bicycle engine a year later. There had been no looking back from that time on as the company grew to dominate the global automotive market, with over 100 plants in 33 countries selling 11 million product units as of 2002. The engine was the centerpiece of Honda's global expansion. It had parlayed this expertise into a wide range of products such as lawnmowers, generators, scooters, motorcycles, and cars.

Honda called its global strategy "glocalization" to signify its approach of building plants locally to meet local demand. Within this web of localized operations, the company had been able to leverage synergies in R&D and manufacturing by regionalizing its operations, consolidating local strategy at the regional level. It had worked quite well. The reach of wholly owned subsidiaries was augmented through astute management of select joint ventures, although not a preferred mode of entry for the company. In many cases, the company was motivated to enter into joint ventures either because of regulatory constraints or because of a desire to access local market knowledge that was not easily available.

Forging a Partnership with Honda Motor Company

HMC came to the Hero group as the last choice for its motorcycle venture in India. The market for motorcycles was not booming in any sense of the term in the early '80s. Many Indian consumers still believed that motorcycles were more accident prone and less safe for Indian roads. The market had been largely carved among three Indian firms with various levels of old imported technology. It was against this backdrop that the Hero group sought to throw its hat into the ring as a means of consolidating its position in the two-wheeler market. Since it had a flourishing bicycle business and a fairly strong moped business as well, the Munjals felt that entering into a joint venture with a company that enjoyed a worldwide reputation would help them achieve their goal of dominating the two-wheeler market in India. It was indeed a golden opportunity for Mr. Brijmohan Lal Munjal to achieve the distinction of "*beating Bajaj*," a seldom-vocalized desire that he had harbored.

The Deal Is Done

The negotiations between HMC and the Hero group had by all accounts gone quite smoothly. Although there had been some lingering resentment that HMC had come to Hero as a last resort, Mr. Brijmohan Lal Munjal had tried to maintain the enthusiasm amongst the members of the Munjal family, emphasizing the benefits of the alliance they were about to enter. The negotiations culminated in an agreement that was signed in June 1984 creating a joint venture firm called Hero Honda Motors Ltd.

Honda agreed to provide technical know-how to HHM and assist in setting up manufacturing facilities. This included providing the design specifications and responsibility for future R&D efforts relating to the product lines that the company would offer. For these services, HHM agreed to pay Honda a lump-sum fee of $500,000 and a 4% royalty on the net ex-factory sale price of the product. Both partners held 26% of the equity with another 26% sold to the public and the rest held by financial institutions. HHM became a public company listed on the Bombay Stock Exchange (BSE).[2]

Rubber Hits the Road

The manufacturing plant which was established in Dharuhera in the state of Haryana started manufacturing the CD-100 model motorcycle in 1985. The CD-100 was powered by India's first four-stroke engine, the unique selling point that put Hero Honda in the driver's seat in the marketplace. Soon, the CD-100 set the standards for fuel efficiency, pollution control, and quality. Perhaps the most appealing characteristic of the CD-100 was its fuel efficiency (approximately 80 km/litre), an attribute highly valued by the Indian consumer. As the CD-100 was the only one with a four-stroke engine at the time, it became a runaway success. Interestingly, it was Mr. Munjal who persuaded HMC to launch the 100cc vehicle instead of the 70cc version that HMC had originally planned to offer. Given his long experience with the manufacture of bicycles and mopeds, he really understood the intricacies of the Indian marketplace very well. "*Our bicycle and moped manufacturing background gave us insights into the customer psyche that the running cost of the vehicle had to be low*," he recalled in a press interview focusing on the rationale behind the CD-100. The organization had since spearheaded many "firsts" for the auto sector in India, being the first two-wheeler manufacturer to implement an ERP across the functions, and the first to implement initiatives such as six-sigma.

Under the stewardship of Mr. Munjal, HHM had grown consistently, earning the title of the world's largest motorcycle manufacturer after having churned out 1.3 million vehicles in 2001. Its motorcycle volumes nearly quadrupled during the period 1997-2001, a feat unparalleled in the Indian two-wheeler industry. While the motorcycle market grew at an average 21.74% per annum between 1997 and 2001, Hero Honda averaged a growth rate of 35.46% a year. In 2001-02, it again doubled volumes from 0.76 million in 1999-2000 to 1.3 million. However, there were several significant bumps on the road along the way.

HHM managed to dampen some of the negative impact of these years through astute marketing and by leveraging its knowledge of customers and markets. It had built an expansive network of dealers who were extremely loyal to the company. Much of this network was culled from Hero Group's bicycle operations. The company instituted modern programs and incentives to motivate its dealer network.

best dealers were chosen to visit the Japanese operations of Honda each year. They formed an extended family and HHM was perceived as being very supportive of its dealers. As of 2000, the company had close to 400 dealers across the country. It was this well-penetrated dealer network that allowed the firm to actively market its products in rural India, a significant departure from other firms that concentrated solely on the urban market. The challenge of rural marketing would have been quite difficult without intimate knowledge of the dramatic differences, not only between the urban and rural consumer, but also the various shades of gray that differentiated rural consumers in one region from another.

The influence of the Hero group was quite visible in the way the supply chain was organized at HHM. The company had built an extensive network of primary and secondary suppliers for components and subassemblies. Since the Indian government had stipulated that the joint venture must indigenize production within a fairly short period of time, developing the supplier network was deemed crucial. By 1996, over 95% of the motorcycle was manufactured from locally procured parts, a rate of localization that even Honda at times thought would be difficult to achieve..

Honda did not seem to be concerned about the rate at which foreign sources were replaced with Indian suppliers. However, HHM shareholders had expressed some concerns. The preferred provider network of suppliers was filled with either Hero family companies or firms that were run by promoters who were closely aligned with Munjal family interests, and this posed a potential conflict of interest. Since HHM was a publicly traded company, it was felt that the profitability impact of outsourcing to allied firms would affect shareholder returns. The flip side of this sourcing approach was the reliability of the network and its ability to respond quickly to environmental change. There was very little inventory in process or waste due to supply chain bottlenecks, which resulted in better margins. Of course, this also ensured that many among the Munjal family were gainfully engaged.

Renegotiating the Venture in 1994

As 1994 rolled around, the sentiments amongst the Munjal family were mixed but largely negative. Some felt that while Hero had ploughed a lot into making HHM a success, HMC had not contributed as much. There was a lack of new product innovation and much uncertainty surrounded the negotiations at that time. Even routine design changes were taking too long, and HMC's R&D engineers did not appear cooperative on this count at all. The impending negotiations paralyzed HHM, and it had to sit on the sidelines while its competitors roared past. Archrival Bajaj had introduced a new four-stroke engine for its motorcycle line and usurped the lead that HHM had carefully nurtured. In the meantime, HMC had negotiated new ventures with other Indian partners for manufacturing automobiles and power equipment. Mr. Munjal would have liked very much to have been part of the automobile venture, but did not allow this disappointment to color the relationship.

Perhaps in protecting its own destiny, Hero had been evaluating alternative product lines and market approaches right from 1986. It entered into a collaboration agreement with Steyr Daimler Puch, an Austrian subsidiary of Daimler A.G., to manufacture motorcycles in the 50cc-65cc range. This business was organized under the Hero Motors banner and targeted both Indian and foreign markets. Hero Motors was successful in exporting completely knocked-down (CKD) kits for assembly in Spain, Iran, Mauritius, Vietnam, Bangladesh, and Egypt. Bolstered by these initial successes, Hero Motors even entered into discussions with BMW of Germany to manufacture 650cc bikes. Although these talks eventually fizzled out, they could hardly have inspired any trust or confidence at Honda headquarters.

It was 1995 by the time the joint venture agreement was renegotiated and extended until 2004. HHM was able to negotiate far more attractive terms from HMC with respect to royalties. They were able to persuade HMC to accept a paltry Rs. 200 per vehicle in 1995. Licenses to manufacture future models were dealt with on a case-by-case basis using a mix of lump sum payments and royalties. By 1999, the proportion of royalty payments to sales revenues had declined considerably from a high of 4% at founding to about 0.5%. Honda displayed new willingness to share its R&D and product suites in a more timely fashion. Subsequent to the 1995 contract renewal, Honda licensed HHM to manufacture *Street*, a model that was based on Honda's recent global hit called the *Dream*, which had sold over 25 million worldwide. In addition to the reduced royalties and fast-track transfer of technology, HMC agreed to increase the extent of components and subassemblies purchased from Hero's supplier net- work.

With the emergence of significant competition from similarly positioned offerings from Bajaj and TVS-Suzuki, Hero Honda had become more aggressive in terms of its marketing with new product launches and market segmentation. The company had announced new product launches (two every year) to continue this effort. This phenomenal rate of new product introductions was, of course, solely dependent on HMC's continuing its R&D support, since HHM had not explored setting up R&D facilities in India. HHM had also undertaken significant expansion of its distribution network.

The going was good for HHM, and the financial results followed. The company had reported flawless quarter-on-quarter growth for 18 consecutive quarters between 1997 and 2001. Hero Honda's quarterly sales during the period grew 303.28% and its net profit jumped from Rs. 16.28 crore[3] to Rs. 98.34 crore. HHM hardly required any incremental working capital over the seven-year period following the renegotiation. In fact, its working capital was lower in 2001 than in 1994 by Rs. 1160m, despite sales having grown by approximately 7X during this period. Return on average capital employed (ROACE) at 65% was among the highest in the country. Hero Honda was among the few Indian companies that enjoyed the distinction of generating a positive economic spread for an extended period of time. Between 1995 and 2001, the economic spread (difference between Weighted Average Cost of Capital(WACC) and ROIC) expanded from 16.5% to 65.4%. This performance had not been lost on the investors who helped the share rise among the ranks of established blue chips. **Exhibit E** charts the performance of HHM shares. However, just as things appeared to be set for a smooth sailing, storm clouds appeared.

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Storm Clouds and Silver Linings

Competition began to intensify in the late '90s as many of the foreign joint ventures in the Indian motorcycle industry reached maturity. Players such as Kawasaki and Yamaha were helping their local companies mount a credible assault on Hero Honda. Closer to home, HHM partner HMC was forced to dissolve Kinetic Honda Ltd., the venture it set up with Kinetic Engineering to manufacture scooters. This left a void in HMC's product suite in India and it was poised to enter the scooter market on its own. Both of these developments were cause for significant alarm.

HMC, having extricated itself from the KHL venture, announced plans to set up a new company, Honda Motor Scooters India Ltd., for the sole purpose of manufacturing scooters for the Indian mar- ket. At that time, it also announced that it intended to enter the motorcycle market in 2004, ominously the very year when the HHM joint venture agreement would come up for its next revalidation. This announcement shocked the top brass at Hero Group. Mr. Munjal put on a brave face and announced that Honda had made its plans public only after Hero signed off on its plans. This led to further speculation as to why Mr. Munjal would give his blessings to a venture that would place the destiny of HHM in peril.

HMSI was indeed a troubling development for the Munjal family and the shareholders of HHM. However, Mr. Munjal was looking for the silver lining in what was apparently a huge storm cloud brewing. He announced that HHM had negotiated three key concessions from Honda. First, Honda agreed to delay entry into the motorcycles segment until 2004. It also agreed to form a four-person committee with two members from HHM to examine any new motorcycles that it would release post-2004. Lastly, it offered an opportunity to HHM to share in the equity as a minority holder in HMSI. These assurances were followed by a visit by Mr. Yoshino, the CEO of Honda from Japan, for the launch of Honda's first scooter in India. At the launch ceremony, he addressed the simmering problems that were perceived by HHM and its investors. He observed, "*By 2003 the two companies will together be selling 25% of the world's projected seven million market for two-wheelers*."[5] The President and CEO of HMSI, Mr. Takiguchi painted a similar scenario in his interview with a leading news magazine. He said, "*The discussion in 2004 will not be on whether to continue with the joint venture. We will sit and discuss about the products which both the companies—Hero Honda and HMSI—should build on.*'"[6] However, in the same breath, he also observed, "*Our strategy will be to offer motorcycles which keep up with the overall* *market trend in the post-2004 scenario*."[7] It was anybody's guess what that statement truly meant.

Honda was already bolstering its dealership network and had plans to set up over a 100 dealerships by the end of 2002. It was also spending Rs. 1 billion to set up a manufacturing plant that would double HMSI's existing capacity.[8] Given the rate of growth of scooters that was in the 4% range, it was difficult to imagine how Honda would be able to use the capacity effectively without stepping onto HHM's turf.

Q.1. Using the Stakeholder Framework, discussed in the course, do you think Hero Motors understood their key stakeholder expectations and delivered on them? Provide facts from the Case to validate your submission 10 Marks

Q2. Compare the growth and expansion of Honda, and Hero, and comment on which of these were more realistic and productive from a Strategic point of view and specifically within the context of the Indian 2 wheeler market 10 Marks

Q.3. What in your view helped Hero, a newcomer to the Indian powered 2 wheeler market, to become the Industry leader in a fairly short period of time? 10 Marks