

The Many Faces of Honda

Richard P. Rumelt

July 10, 1995

There is something special about the Honda Motor Company. Like General Motors, IBM, and General Electric, this company has joined the elite club of firms that are used, or have been used, as exemplars of successful business strategy. General Motors' system of decentralized implementation of a centrally directed coherent product policy (1921-1980) was carefully studied by several generations of business-school students. IBM's commitment to a common operating system for all its computing platforms and its apparent ability to control the evolving hardware/software standards for the industry was source material for thousands of lectures on effective competitive strategy (1960-1984). And General Electric (1965-1980) was the central source for the "strategic management" concepts central to the planning style of the early 1980s—the PIMS-based relationship between market share and return, the use of a two-dimensional grid for allotting cash-flow and growth goals to business units, and the full delegation of strategy-making to relatively low-level "strategic business units."

But what is special about Honda is that it has served and continues to serve as the exemplar for *three* very different views of strategy:

- The first is the BCG Report [1975] story of Honda's cost advantage, developed (the story goes) by the successful exploitation of scale and learning, and of the "segment retreat" response of British and American competitors. Anyone who received an MBA between 1979 and 1985 was almost certainly exposed to this version of history.
- The second, explicated by Pascale [1984], offers a revisionist account of Honda's motorcycle success.' According to Pascale's interview with six Honda executives, the company's early scale in Japan came from its having a better product, flowing from design skills. Furthermore, Honda did not "target" specific market segments in the U.S., but rather showed an ability to experiment, to learn quickly from mistakes, to rapidly revise design problems, and thereby to discover opportunities.
- The third, described by Prahalad & Hamel [1989, 1990], couples Honda's success in motorcycles with its successful entry into the U.S. automobile market. Here the center of the story is Honda's remarkable ability to go from "nowhere" to prominence despite the earlier entry of very efficient competitors like Toyota and Nissan. Prahalad and Hamel have given the

names "intent" and "stretch" to the processes which underlay this success and the name "core competence" to the central skills and abilities that Honda built upon.

Before addressing the debate between the "design school" and the "process school" views of strategy, it might be useful to review the source materials. Here I will give a brief summary of the facts and issues presented by BCG, Pascale, and by Prahalad and Hamel.

The BCG Report

The BCG view is the most fully documented-it was published by the British government because the contract was with the Secretary of State for Industry. Indeed, this two-volume 368 page report still provides the most complete *published* view of a strategy boutique at work doing industry and competitive analysis. The purpose of the Report was to explain the decline of the British motorcycle industry and to suggest strategic alternatives for the future. What was the reason, according to BCG, for the decline of the British motorcycle industry? The Report provided a clear unambiguous answer to this question [1975: x]: "The loss of market share by the British industry over the last fifteen years resulted from a concern for short term profitability." That is, it identifies British myopia rather than Japanese strategic genius as the primary force at work. It is worth reviewing their reasoning at some length:

The success of the Japanese manufacturers originated with the growth of their domestic market during the 1950's. As recently as 1960, only 4 per cent of Japanese motorcycle production was exported. By the this time, however, the Japanese had developed huge production volumes in small motorcycles in their domestic market and volume-related cost reductions had followed. This resulted in a highly competitive cost position which the Japanese used as a springboard for penetration of world markets with small motorcycles in the early 1960's.

Meanwhile, the primary focus of the British industry was on maintaining short term profitability. The British found it impossible to match low Japanese price levels on small bikes profitably in the short term. They therefore responded to the Japanese challenge by withdrawing from the smaller bike segments which were being contested.

This was the fundamental strategic error. Long term commercial success in fact depended on achieving sales volumes at least equal to those of the Japanese and employing equally sophisticated low cost production methods... Short term profitability would obviously have suffered, but this approach would have secured a sound long term future... The long term result of the Japanese industry's historic focus on market share and volume, often at the expense of short term

profitability, has been the precise opposite: high and secure profitability. [1975: xiv]

The Report goes into great detail about the British strategy of "segment retreat." It shows that during the 1960's the British

response was essentially to withdraw from the smaller bikes in which the Japanese were competing so effectively. This led to a situation in which by the late 1960's the British industry was predominantly active only in large bikes where the Japanese were not yet represented.

The reason for the decline in commercial performance of the British industry in the 1970s is that during this time the Japanese have finally entered this large bike segment. As in every other segment where the British had previously faced serious Japanese competition, this caused profitability to decline... now, response in the superbike segment took the form of a failure to introduce new models... While British volume remained at roughly 30,000 units, the Japanese volume in the large bikes (>450cc) in the USA increased from 27,000 to 218,000 between 1969 and 1973. This cemented the poor market and commercial position of the British. [1975: x]

The cost data provided by BCG must have stunned the British: Motorcycle factories in the UK produced (on average) 14 motorcycles per worker per year, whereas Honda produced the equivalent of about 200 motorcycles per worker per year. The data showed Honda's labor cost per bike to be approximately one-tenth that of UK manufacturers, despite the fact that Honda paid 45 percent *higher* wages. At the same time, Honda's capital costs per bike were approximately one-fourth that of a UK manufacturer, despite investing almost four times as much capital per worker.

How could such enormous cost differences have appeared? The Report instructs that relative cost is determined by two key variables: technology and scale. It goes on to say that [1975: xi] "the rate of technological learning tends to be related over time to accumulated production experience as the company develops and applies lower cost methods in the course of conducting its business. The competitor with the highest annual model volumes can benefit from methods which embody up-to-date technology and which rely on scale effects for their cost superiority." Note the careful phrasing of this conclusion-it relates learning to scale and does not treat scale as a pure decision variable, but recognizes that scale itself may be the result of history and other factors (including product quality). BCG's argument is that differences in growth, or in demand, can be converted into sustained cost differences by aggressively exploiting the dynamics of technological advance, learning, and scale. Thus, a competitor who is strategically asleep will simply take a product design advantage as increased profit, whereas a strategically alert firm will use such a situation to build

scale, drive technology, and accumulate learning, thus generating a sustainable cost advantage.

The BCG report laid out the fundamental economics of the industry and placed the blame for failure at the feet of those who ignored these fundamentals. Fifteen years later, Chandler [1990: 284-6] drew similar conclusions about the general pattern of capitalism in Britain:

Why, then, did British entrepreneurs, the heirs of the First Industrial Revolution, exploit to such a limited extent the opportunities of the new technologies of the Second Revolution? entrepreneurial failure ... was the failure to make the three-pronged investment in production, distribution, and management essential to exploit economies of scale and scope.

The BCG report dealt chiefly with the Japanese and the British as groups. Its specific treatment of Honda noted that

It is often said that Honda created the market in the United States and elsewhere-for what we have called secondary uses of motorcycles, through their extensive advertising and promotion activities; and it is true that Honda presented the attractions of motorcycling as a "fun" activity in a new way, and with a level of media support not previously attempted by motorcycle manufacturers. However, the success of this campaign depended in the last resort on the fact that the lightweight machines that were then the company's primary product *were* fun and easy to ride, did not give the mechanical problems that had traditionally been associated with motorcycles, and were cheap to purchase. In the same way, Honda's successful move into super bikes in 1969 received heavy advertising support, but was made possible by a product, the CB750, which was technically ahead of its competitors, and offered features which were at that time unique

In the infrequent instances where Honda have found themselves selling a model at a price disadvantage which threatened to impact on their sales volumes, they have been prepared to introduce special price cuts ... An example of this behavior was a \$200 special discount maintained throughout a season on a 250 cc off-road bike in order to match-and in fact undercut-Yamaha's model in this range

And in new markets where Honda are developing an 'selling and distribution' system¹ the company is prepared to sustain losses in the marketing channel for as long as is necessary to establish the kind of system they require. In the UK, for instance, their market development programme from 1963-1970 led to a lack of profitability through these years, but

¹A "selling and distribution" system

also saw them through to a position of market leadership, backed by a thoroughly competent and efficient s and d system. [1975: 18-19]

Thus, the Honda described by the BCG report is especially skilled at product design and innovation, is willing to forego profitability in order to build volume and market position, puts great store in building model volumes and has been thus able to achieve extremely low unit costs.

Pascale's "Honda Effect"

According to Pascale [1984: 51], the BCG portrait of Honda

exemplifies the "strategy' model." Honda is portrayed as a firm dedicated to being the low price producer, utilizing its dominant market position in Japan to force entry into the U.S. market, expanding that market by redefining a leisure class ("Nicest People") segment, and exploiting its comparative advantage via aggressive pricing and advertising.

Pascale's "revisionist" story was drawn from a meeting with Japanese executives who had been responsible for Honda's 1959 entry into the US. In his words [1984: 51], "The story that unfolded ... highlights miscalculation, serendipity, and organizational learning-counterpoints to the streamlined "strategy" version related earlier."

One of the key elements of the story are the personalities and skills of the company's leaders, Sochiro Honda and Takeo Fujisawa. Honda was an eccentric inventor with a strong ego and deep technical skills. He was capable of rapidly developing a new type of four-stroke engine with twice the power per pound of competing models and also capable of tossing a geisha out of a second story window and stripping naked before his engineers to assemble a motorcycle engine [Pascale, 1984: 51]. Honda's technical genius enabled the company to produce powerful yet lightweight engines, and his passions led to company to pour resources into building machines that would win races. The 50cc Supercub, introduced in 1958, was affordable, according to this account, because of its small light engine. The booming demand and subsequent large scale production facilities were the result of a better product.

The second key element of the story is the entry into the U.S. According to Mr. Kawashima, who became the first president of American Honda, the small Japanese team arrived in the U.S. with only weak English language skills, and a vague plan to compete with European exports in the 250cc to 300cc size range. Under very tight budget constraints, the team struggled to get dealerships and found that U.S. driving speeds and distances were breaking clutches on the mid-sized bikes. While engineers at home worked to solve this problem, the entry team discovered interest in the 50cc

Supercubs they were using for personal transportation. As demand grew, the entry team reinvested profits back into the U.S. business (the Japanese government placed restrictions on movement of funds from yen to dollars).

Pascale's message, called the "Honda Effect," was that

Western consultants, academics, and executives express a preference for oversimplifications of reality and cognitively linear explanations of events... [there is] a tendency to overlook the process through which organizations experiment, adapt, and learn... How an organization deals with miscalculation, mistakes, and serendipitous events *outside its field of vision is often crucial to success over time.* [1984: 57]

Competence, Intent, and Stretch

In the last five years Prahalad and Hamel² have had a strong impact on how strategy is defined and taught. They have introduced the concepts "core competence," "strategic intent," and "stretch" to the language of strategy. In doing this they have broken with the old strategy dictum "build on your strengths," and instead used as exemplars firms which have created new resources and new strengths in the pursuit of some long-term "intent." One of their exemplars is Honda. They say

Companies that have risen to global leadership over the past 20 years invariably began with ambitions that were out of all proportion to their resources and capabilities... We call this obsession "strategic intent." Did Honda strove to become a second Ford-an automotive pioneer Did Komatsu, Canon, and Honda have *detailed, 20-year "strategies "for attacking Western markets?"* [emphasis added] Are Japanese and Korean managers better planners than their Western counterparts? No As tests of strategic fit become more stringent, goals that cannot be planned for fall by the wayside. Yet companies that are afraid to commit to goals that lie outside the range of planning are unlikely to become global leaders. [1989: 66]

Prahalad and Hamel claim that firms reaching for global leadership must use one of four basic approaches to innovating: building layers of advantage, searching for loose bricks, changing the terms of engagement, and working with collaborators. Honda, they explain, used the "loose bricks" approach to innovating around existing entry barriers:

²In Hamel, Gary and C.K. Prahalad, "Strategic Intent," *Harvard Business Review*, (May-June) 1989, pp. 63-76, and in Prahalad, C.K. and Gary Hamel, "The Core Competence of the Corporation," *Harvard Business Review*, (May-June) 1990, pp.79-91.

When Honda took on leaders in the motorcycle industry, for example, it began with products that were just outside the conventional definition of the leaders' product-market domains. As a result, it could build a base of operations in underdefended territory and then use that base to launch an expanded attack. What many competitors failed to see was Honda's strategic intent and its growing competence in engines and power trains. Yet even as Honda was selling 50cc motorcycles in the United States, it was already racing larger bikes in Europe-assembling the design skills and technology it would need for a systematic expansion across the entire spectrum of motor-related businesses.

Honda's progress in creating a core competence in engines should have warned competitors that it might enter a series of seemingly unrelated industries-automobiles, lawn mowers, marine engines, generators. But with each company fixated on its own market, the threat of Honda's horizontal diversification went unnoticed. [1989: 70]

Thus, Prahalad and Hamel provide us with a third vision of Honda. In their view the company's direction is deliberate and managed, but they reject BCG's approach of placing market share, volume, learning, and cost at the center of the story. In addition, they reject the efficacy of a detailed strategy for competition. Instead, they see Honda as pursuing a long-term vision of global leadership in internal combustion engines, constantly building competencies in design and manufacturing, and competing through innovating around competitors' product offerings. And their story rests on an extension of myopia from British Motorcycle manufacturers, to Western automobile companies, marine engine companies, and others.

Discussion

The debate, involving BCG, Pascale, Mintzberg [1990], Ansoff [1991], and Gould [199? (this journal)], among others, is (1) about which version the Honda story is true, (2) about which corresponding definition of strategy is most descriptive, and (3) about which definition of strategy should be recommended to managers. Note that the answers to these three issues may be independent (one version of the Honda story may be true yet another view of strategy may be more descriptive of *most* companies.)

It is useful to note that all involved parties use arguments that assume that someone (else) is myopic: the British, Western managers, Design School theorists, Emergent School theorists, or Honda itself. For example, whereas BCG's story was primarily about British myopia, Pascale's shows a certain myopia in Honda-the entry team imported a fixed mix of motorcycles before finding out anything about U.S. driving conditions, the system of distribution, etc. It may be that this assumption is what is really central about the traditional strategy field, whether it wears the clothing of design or process. Because absent myopia, we are firmly in the territory of game

theory where strategy should be the computation of one's best response to others' best responses, and so on. It is the presumption of myopia (or inertia, or boundedness) that enables the presentation of strategy as either deliberate or emergent rather than simply as the equilibrium in a multi-player game.

All three descriptions of history agree on a number of key points: (1) Honda possessed a superior competence at engine design which was continually translated into products that outclassed those of competitors; (2) Honda had experienced success with the Supercub in Japan before it entered the U.S. market; (3) Honda was successful in its entry into the U.S. market and, over time, extended that success from smaller bikes to larger bikes. The key element of controversy is intentionality: Did Honda knowingly and purposefully translate its early product success in Japan into high-volume low-cost facilities? Did Honda "plan" its entry into the U.S. market? In particular, did Honda enter knowing that 50cc bikes were a "loose brick?" Did Honda anticipate the segment retreat strategies of British firms? Did Honda deliberately lose money to build share in order to generate the scale to ultimately deliver the best quality at the lowest cost? Did Honda "understand" that its competence was engine design and both expand and diversify in ways that enhanced and built upon this "core competence?"

Pascale's evidence clearly shows that Honda did not enter the U.S. market with a strategy of selling Supercubs and gradually moving up market. His data show that Honda knew little about the U.S. market, that the initial intention was to push mid-sized bikes, and that the success of the Supercub in the affluent U.S. took the entry team by surprise. Furthermore, Pascale argues that the Supercub was inexpensive because its unique lightweight high-power engine design permitted the simplification of the whole vehicle, not because of its rate of production (as BCG claimed).

On the other hand, the Pascale story only covers the initial entry of Honda into the U.S. In the two decades that followed, Honda, and *other* Japanese motorcycle manufacturers, did come to dominate the market, and did establish low-cost high-quality positions in almost every product segment. Does that mean that there must have been a deliberate strategy to do these things? Not necessarily. A "strategy" explanation of events is not always about intentionality, but is sometimes simply about the forces at work that permit sustained asymmetric positions to be maintained.³

³Quite a few years ago I wrote [1978: 197] "As a descriptive tool, strategy is the analog of the biologist's method of 'explaining' the structure and behavior of

In this case, the question is about the momentum of history: according to the BCG cost-experience model, or the Prahalad & Hamel core competence model, once a firm has a good head-start at doing something, and as long as it exploits the benefits of that head-start, it is very hard to catch up with that competitor. Both BCG and Prahalad & Hamel invoke the myopia of U.S. and British firms to explain why their initial head-starts were not fully exploited, whereas the Japanese home-market head-start was extensively built upon.

Again, on the intentionality issue, it is clear that neither BCG nor Chandler suggests that British companies consciously and deliberately adopted the strategic plans of "segment retreat" or "fail to invest." It is understood that these consistent patterns of behavior were the product of myopia or the constraints imposed by the socio-political environment. However, the BCG report (as do later cases on Honda) does claim that Honda followed a coherent strategy. Nevertheless, it is possible to use the same data to argue that just like "segment retreat," Honda's strategy of "innovate, build market share, use specialized tooling to exploit the benefits of high volume production" is merely the product of simple business heuristics and does not flow from a coherent vision of how to march towards global leadership. The unfortunate fact is that the data provided by B G and by Prahalad & Hamel are not sufficient to prove intentionality (it appears to be implicit in the writers' assumptions), and the data provided by Pascale are not sufficient to disprove to existence of a coherent logic covering the expansion of the motorcycle business from 1960 through 1980.

So where does that leave the debate? My own view is that the "process/emergent" school is right about good process being non-linear. A great deal of business success depends on generating new knowledge and on having the capabilities to react quickly and intelligently to this new knowledge. Thus, peripheral vision and swift adaptation are critical. At the same time, I believe that the "design" school is right about the reality of forces like scale economies, accumulated experience, and the cumulative development of core competencies over time. These are strong forces and are not simply countered. But my own experience is that coherent strategy based upon analyses and understandings of these forces is much more often imputed than actually observed. Finally, I believe that strategic thinking is a necessary but greatly overrated element of business success. If you know how to design great motorcycle engines, I

organisms by pointing out the functionality of each attribute in a total system (or strategy) designed to cope with or inhabit a particular niche."

can teach you all you need to know about strategy in a few days. If you have a Ph.D. in strategy, years of labor are unlikely to grant you ability to design great new motorcycle engines.

REFERENCES

- Ansoff, H. Igor, "Critique of Henry Mintzberg's 'The Design School: Reconsidering the Basic Premises of Strategic Management'," *Strategic Management Journal*, 12, 1991, pp. 449-461.
- Boston Consulting Group, *Strategy Alternatives for the British Motorcycle Industry*, London: Her Majesty's Stationery Office, 1975, 2 vols.
- Hamel, Gary and C.K. Prahalad, "Strategic Intent," *Harvard Business Review*, (May-June) 1989, pp. 63-76.
- Mintzberg, Henry, "The Design School: Reconsidering the Basic Premises of Strategic Management," *Strategic Management Journal*, 11, 1990, pp. 171-196.
- Mintzberg, Henry, "Learning 1, Planning 0: Reply to Igor Ansoff," *Strategic Management Journal*, 12, 1991, 463-466.
- Pascale, Richard T., "Perspectives on Strategy: The Real Story Behind Honda's Success," *California Management Review*, 26, 1984, pp. 47-72.
- Prahalad, C.K. and Gary Hamel, "The Core Competence of the Corporation," *Harvard Business Review*, (May-June) 1990, pp. 79-91.
- Rumelt, Richard P. "Evaluation of Strategy: Theory and Models." In Schendel, Dan E. and Charles W. Hofer, eds., *Strategic Management: A New View of Business Policy and Planning*, Boston: Little Brown, 1979, pp. 196-211.