Two Sides of Management in Distribution System Integration: The Case of Harley-Davidson Japan

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Abstract: Many motorcycle dealers are family businesses, and they are rather oriented to short-term sales and do not operate only on logic without an emotional stake. Harley-Davidson Japan (HDJ) set up an authorized dealership system made up only of dealers with no capital relationship and did not directly manage dealers. This paper examines the period from 1991 to 2008, when Toshifumi Okui was the CEO of HDJ, during which time HDJ maintained top market share among large motorcycle companies in Japan and was a successful example of distribution system integration for other motorcycle manufacturers. For the dealers to implement HDJ’s intentions, the formal side of HDJ’s distribution system integration focused on the institutionalization of a “no control sales zero policy” and a “multilayer human relationship building policy.” However, critical to these were informal handwritten letters from the top-level management and the “Tokyo Court.”
1. Introduction

Channel research focusing on the distribution strategy among manufacturers has primarily taken two paths. Studies dealing with issues around selecting a structure that creates product distribution paths, or what has been termed channel structure selection theory (Aspinwall, 1962; Duncan, 1954; Phillips & Duncan, 1960), and studies dealing with issues of managing already formed channel organizations, or what has been called channel expansion organization theory (Mallen, 1964; Ridgeway, 1957). Among distribution strategies for Japanese firms, much observation has been done of distribution system integration, where manufacturers propose high rebates to retailers and retailers make sales of products from specific manufacturers a priority even at risk to their overall product line-up. This has had a major impact on the selection of channel structures and channel expansion by manufacturers (Shimaguchi, Takeuchi, Katahira, & Ishii, 1998). Kawagoe (1980) defined distribution system integration as “a set of actions for securing retailer cooperation in sales of the products by the manufacturer and the organizing of retailers so that manufacturers can realize their own policies as to those sales.”

However, it is not easy for manufacturers to organize retailers.\(^1\) Although retailers may have an agent relationship with manufacturers, they are also of course in a retail relationship. In

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\(^1\) When doing so, manufacturers may use implicit agreements with objectively observable, mutually beneficial patterns even though, in practice, it is highly likely that these have the same efficacy as contracts (Yamashiro, 2015b).
particular, when retailers with few management resources make up a manufacturer’s distribution network, retailers tend to engage in paternalistic management that is oriented toward short-term sales rather than future profit, thus making it even more difficult to use distribution system integration such that it reflects the intent of the manufacturer.

This paper uses the example of HDJ, which was successful in using distribution system integration in an authorized dealer system that has no capital relationships, and examines their method of management within this distribution system integration. Having peaked in the latter half of the 1980s, the Japanese domestic motorcycle market rapidly shrank, even in the larger engine size classes, leading HDJ to undergo distribution system integration starting in 1991. It should be noted that until 2008, the company had had ever increasing revenues and profits and was number one in Japan among large motorcycles (those with engines of 750 cc or above).

2. What is HDJ?

As a maker of large motorcycles, Harley-Davidson has a favorable brand image due to its product designs, customizability, and use in many films. With a history and story spanning more than a century, the products themselves have high customer appeal and brand power. Harley-Davidson Japan is a wholly owned subsidiary of US-based Harley Davidson and is the master distributor in Japan. In 1989, HDJ started with a capital of 40 million yen and less than 20 employees, taking over as master distributor from Balcom Co., Ltd. (“Balcom” below), which until that time had been the sole trading company importing Harley’s products into Japan.

HDJ’s authorized dealers have not been invested any capital of HDJ, and there were 150 such dealers in 2007 (two-thirds of which
also sell other motorcycle brands). They have average annual sales of 550 million yen and an average of 10.9 employees (Okui, 2008a, 2008b). Most of these dealers manage paternalistically. Managers in these dealerships are often stubborn, and it is not easy for HDJ to get them to come to an agreement since they refuse to budge if they are not emotionally swayed even if they understand something logically.

To overcome this situation, HDJ moved ahead with distribution system integration and implemented channel policies according to its own intentions. The success of HDJ’s distribution system integration can be plainly seen not only in their actual banning of stock resale and parallel imports but also in their organization of their customer community, where they call their dealers “chapters,” based on an annual event plan. Customer community activities increase the percentage of customer vehicle transfers and improve sales performance through the management of customer-to-customer interactions (Yamashiro, 2015a; Yamashiro, 2017a), and other motorcycle manufacturers have identified HDJ and dealer customer community activities as their success factors.

HDJ moved forward with distribution system integration, which has enabled flexible organization management of the 150 dealers nationwide in line with HDJ’s intentions. Both formal and informal channels played a major role in the advancement of distribution system integration. The formal channel denotes their institutionalized “no control sales zero policy” and their “multilayer human relationship building policy,” while the informal side indicates handwritten letters from the top-level management and the “Tokyo Court.”

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2 Touring events are primarily held in customer communities; however, these events are different than typical motorcycle touring in that chapters are managed by companies (HDJ and dealers). All chapters hold a touring event once per month. In addition, dealers hold original touring events such as those for women and beginners or even overseas tours.
3. Formal Management

HDJ was established in 1989, and Toshifumi Okui (originally general manager of Toyota Motors’ Beijing office) was appointed CEO in 1991, after which he worked in that role for the 19 years that is the subject of this study. Okui began distribution system integration in 1992.

The two major policies of this distribution system integration were the “no control sales zero policy” and the “multilayer human relationship building policy.” The “no control sales zero policy” banned stock resale\(^3\) and parallel imports to unify the sales network in authorized channels through HDJ. It removed the vested interests of dealers that had profited from both stock resale and parallel imports up until that time. The “multilayer human relationship building policy” was an attempt to tamp down the violent objections caused by the first policy and build harmonious relationships between dealers and HDJ. The “no control sales zero policy,” which created objections, and the “multilayer human relationship building policy,”\(^4\) which eased those objections, were tandem formal management efforts. In a manner of speaking, they were formal management methods.

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\(^3\) Stock resale is a way of transferring inventory from business to business. For example, some consumers may want a certain Harley vehicle, but if a dealer does not have inventory of that vehicle, they can contact a dealer that does have the vehicle and buy it from them. By doing so, purchases made to transfer inventory increase. This normalizes a certain number of stock resales for a single vehicle, which results in multiple interim margins by the time a vehicle arrives at the dealer’s location that then sells it to the end consumer, driving up the purchase price of vehicles and reducing the profit margin.

\(^4\) This paper does not cover the topic in detail; however, these two policies were the foundation for the dealer policies that enabled the flexible organization management that was the intent of HDJ (stock inventory system, the group CSR system, central HDJ management of dealer quotes, store reform, and store innovations and dealer development policies).
3.1. No control sales zero policy

In an effort to achieve distribution system integration where stock resale and parallel imports had been going on, HDJ began work on the “no control sales zero policy” in 1992. The intention behind the policy was to shift the structure of the sales network to have Harley vehicles sold only through authorized channels domestically and to disallow the sales outside of authorized channels beyond HDJ’s control.

Under the former sales network of Balcom, dealers had approximately 200 stores nationwide that could purchase Harley vehicles through stock resale. However, under the distribution system integration that began in 1992, HDJ weeded out dealers by taking advantage through allocations made as a master distributor and through the binding force of agreements with authorized dealers. HDJ presented new standards for authorized dealers of Harley-Davidson although dealers opposed them, and those dealers that could not promise to follow those agreements had their agency licenses revoked. Consequently, the number of dealers that sold Harley-Davidson vehicles fell by half, with 35 authorized dealers under agreement and 65 letter shops in the authorized network, for a total of 100 stores in the authorized sales network.

Authorized dealers under agreement are those dealers (also known as “parent” dealers) that comply with HDJ dealer standards (brand policies, dealer size, location, sales, customer community activities, etc.). Authorized letter shops, conversely, are those dealers (also known as “child” dealers) that have ties to authorized dealers registered with, and recommended by, HDJ. In short, those dealers that were authorized under the former sales network of Balcom and that sold Harley vehicles as stock resales became authorized letter shops.

The ban on stock resale in particular was a major blow to existing
dealers. Motorcycle dealers are often family-controlled organizations with little capital and must be aware of cash flow on a daily basis. It is thus not easy to deny requests from motorcycle dealers to provide a Harley vehicle in inventory for stock resale, and letting go of easy profits that had heretofore been available was a tough pill for dealers to swallow. Accordingly, even though HDJ banned stock resale, many dealers still secretly engaged in the practice at the time HDJ was newly established.

The logic behind easing objection against the ban on stock resale was that only direct sales had no interim margins because of the ban and that non-authorized motorcycle dealers could not purchase and sell Harley vehicles, which would increase profit margins by the maintenance of inventory for direct sales at each authorized dealer. However, dealer profit does not immediately rise by the halting of stock resales; hence, HDJ needed to convince dealers emotionally rather than logically after working on the human relationships.

3.2. Multilayer human relationship building policy

From the time that distribution system integration started, the “multilayer human relationship building policy” was the most important of dealer policies and formed the basis for the other policies. HDJ dealers all used non-HDJ capital and were therefore not under HDJ’s command, which made it impossible for HDJ to force them to do as they intended as they might have done with subsidiaries. Even if HDJ proposes something to dealers that has logical merit, dealers will not go along unless they have emotional consent. Accordingly, HDJ first needed to build relationships with dealers. Communication from HDJ to dealers was done at various levels (top-to-top, group-to-group, and person-to-person).

Top-to-top communication occurred when the top-level management at HDJ visited the heads of all dealerships nationwide
in an attempt to forge relationships between them. According to the dealers, visits by Okui were felt to be “different than visits in the past, as the CEO himself came to see us.” These dealers also noted that “they showed us how we would make money in the future as a Harley-Davidson dealer.” In actuality, while there was still strong resistance to the “no control sales zero policy,” Okui held firm and was able to convince dealers regarding how much their profits would grow with this policy.

Group-to-group communication was done in nationwide dealer meetings. These began in 1993, with HDJ dealers from around Japan gathering in Tokyo for three days of meetings sponsored by HDJ. In these meetings, they discussed the latest trends in the motorcycle industry, provided examples of dealer best practices, and shared their goals. Meetings with dealers from around the country took place five times throughout the year, with a kickoff meeting, spring meeting, summer meeting, fall meeting, and year-end meeting. It was through these meetings that dealers built strong horizontal ties and shared among themselves new sales methods, effective sales closes, and attractive, low-cost store designs.

Person-to-person communication was done between HDJ salespeople acting as communicators and dealers. The role of communicators is to follow up on how various HDJ policies are being adopted by dealers, build relationships with dealers, and support and develop dealers. As a rule, communicators go out and meet all dealers monthly and work to implement dealer policies. Communicators take with them market data, CRM data, and other materials and build relationships by providing visibility into useful information. Moreover, a system of holdback margins was implemented in conjunction with assessments to push dealers to follow HDJ policies. The holdback margin system rewards dealers based on assessments that use clear standards as to how well dealers are following HDJ policies. It is one incentive for dealers to
follow HDJ’s instructions.

In this manner, HDJ communicated with dealers at various levels (top-to-top, group-to-group, and person-to-person), built relationships with dealers at every level, and worked to convince dealers on logical and emotional levels. In addition, HDJ repeatedly relayed the same messages in different ways and from different levels to communicate important messages that dealers would not otherwise do anything about even if they understood them logically. Moreover, HDJ not only talked verbally with dealers but worked to provide the results of communication in other forms by sharing with them minutes of what they had discussed in meetings and distributing audio records of meetings on CD.

HDJ created a foundation for distribution system integration through the “no control sales zero policy” and by building relationships at various levels. Because of these two policies, HDJ was able to infuse further dealer policies.

4. Informal Management

Despite dealer cooperation with HDJ that was preserved through the “no control sales zero policy,” there was still some opposition to policies such as stock resale and parallel import bans that broke down the existing profit structure. It was very difficult to implement policies that destroyed the present profit structure to achieve reforms prior to the results of these reforms becoming clear. It was not enough to discuss the logic of the reforms or to convince dealers on an emotion level to go along with HDJ in these reforms.

It should be noted that in addition to the aforementioned formal management policies implemented within the organization, HDJ also used intimate, top-to-top communication as a means of informal management and to exert power in ways not possible with formal management.
HDJ head Okui sends handwritten messages to dealer executives as necessary, bringing them closer in a way not possible through normal business-to-business interactions and enabling both reprimand and encouragement. Currently, receiving such a handwritten message is rare, and dealer executives that are recipients of them are reportedly highly moved. In addition, Okui has a “Tokyo Court,” which is held in HDJ headquarter in Tokyo irregularly as informal discussions feared among dealers. In these meetings, executives at dealerships that have not taken action as requested by HDJ are called to HDJ headquarters, where they are strongly pressured to make improvements and on occasion to have their agency license revoked as the last resort. In addition, if dealers were found to have engaged in stock resale despite repeatedly being told of the ban on the practice, HDJ would publicly rebuke the offending dealers in their national meetings. Dealers still found to be continuing with the practice after these measures would have their agency license revoked.

This type of informal management allows for the use of arm-twisting that is not possible through formal methods and also covers areas that cannot be covered by formal management means. It plays a major role in controlling dealers.

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