The Harley-Davidson LBO

The 1981 leveraged buyout of Harley-Davidson looks perfect, as if it had been done to serve as an example for MBA students. While structured at the time when the leveraged buyouts were still relatively new, it had everything mapped out for success: audacious financial structuring, company turnaround and entrepreneurial adventure.

The Birth of a Mythical Brand

The first Harley-Davidson was manufactured in Milwaukee in 1903 by Bill Harley and two brothers, Arthur and Walter Davidson. It was not perfect as the riders still had to pedal the slopes, but that did not discourage its creators. They had a stellar reputation as skilled mechanics and soon they were selling their bikes to friends, relatives and neighbors. Three years later they built their first factory and the third Davidson brother, William, joined in.

Walter Davidson, a CEO, convinced the rest to focus on powerful motorcycles. The goal was to win races to help promote the brand and attract press attention. Indeed, Harley-Davidson motorcycles did well at those events and Walter himself won a few races. Sales grew fast and in 1908 Harley-Davidson was supplying Detroit police department.

Four years later, it was already 200 retailers all over the country, not to count numerous contracts with police forces and the US army. 20,000 Harleys were sold to the US army in 1917 and they were supplied during the Second World War as well. American soldiers liberated France, using WTA model, which was another good publicity stunt for the brand.

Eventually Harley-Davidson became a part of American culture, it was a household name. It was loved for a specific sound of the engine, rebellious image, and the distinctive design. Movie stars like Marlon Brando and James Dean were loyal fans and the whole movie Easy Rider looked like one long Harley-Davidson commercial.

In 1953, due to insolvency of Indian Motorcycle, Harley became the only motorcycle manufacturer in US, compared to 110, when Harley was founded. Harley roared and controlled more than 60 % of the US motorbike market in all segments.

The Problems

In the sixties the company went public in 1965, the double objective being raising of capital and allowing the heirs to monetize their equity stake. In 1969 the company was acquired by AMF group, whose owner was a die-hard Harley fan.

AMF group heavily invested in Harley without any clear strategy. As a result, the quality of motorcycles deteriorated, hurting the sales and the brand. Harley-Davidson could no longer compete with the Japanese brands which were simply better.

When the Japanese brands entered the US market in the fifties, Harley-Davidson could not care less, since there was a clear division of the market – the Japanese were focused on small motorcycles, while Harley still led the medium and high-powered segment. However, the Japanese swamped the market, taking, for example, Honda sales from 500 to 77 million in 1965.

In the seventies the Japanese brands took a second phase of development and with this aggressive strategy the Harley were doomed. A joint venture with Italian brand Aermacchi to manufacture smaller motorcycles was a total failure. No matter the solution, the company's strategy only made things worse, plunging Harley deeper and deeper into the world of difficulties. AMF Group hired Goldman Sachs to find a buyer.

The LBO

Given the difficulties that Harley was facing, very few buyers were interested in the company. They believed Harley to be an oddity, since many American brands had disappeared by then. Nobody could compete with eh Japanese. AMF did not receive a single offer for the Harley. And the idea of LBO was born. In 1981 the managers of Harley-Davidson, led by Vaughn Beals, decided to buy out a company themselves. When Harley-Davidson w s finally sold to those managers, it was valued at 81.5 million and 87 % of its amount was financed by Citibank.

Vaughn Beals, an aeronautics MIT graduate, was confident he could restructure the company. A motorcycle trip was organized between the New York and the Millwaukee, which was a great success.

The Management, Post-LBO

The first thing Beal did was to give Harley's managers and engineers a tour of Honda factory. They discovered that the production, while less modern was better organized and the motorcycles were produced to order, so it was easier to add last minute inventions or improvements. The space was clean, the atmosphere relaxed and friendly: all the engineers knew the workers' first names. And with all that only 5% of Honda motorcycles did not pass a quality check, while for Harley that number was 50.

To turn the company around, Beals had to introduce some radical methods: 50% % of the workforce were laid off and the rest accepted a 9% pay cut. The new engines were conceived, they passed quality checks easier which saved a lot of money for the company. As for design, Harley returned to its original rebellious image, making chrome parts more visible. Showrooms across US were refurbished as well to reflect a new change.

As a result, the turnover increased by 130% within 5 years and by 1985 Harley was the leader in the high-powered motorcycles segment, leaving Honda behind. Harley-Davidson regained its reputation of reliability and quality.

Despite all this, Citibank decided not to renew in 1984 the facilities granted to finance the LBO. But Beals found a new lender, Heller Inc., a lending institution specialized in medium-sized companies. However, Vaughn Beals and the other shareholders were deeply affected by the Citibank's drastic decision, it made them realize how fragile was the success of LBO. So, they decided to monetize part of the value they had created and accelerate the return of Harley-Davidson to the public market. The initial public offering was arranged in two steps, the first being introduced in 1986 and the second in 1987, on both occasions with a much higher valuation than that of the competitors.