

HONDA MOTOR CO. LTD.

A CASE STUDY

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La industria automotriz se ha desarrollado rápidamente

en los últimos 50 años, siendo de manera fundamental

una expresión de la capacidad técnica y humana de la industria

automotriz se debe a la gran capacidad de innovación y

a la fuerte capacidad de desarrollo de la industria

automotriz y sus derivados en el mundo de hoy.

El mundo de hoy es un mundo de cambios y de

desarrollo constante.

La industria automotriz es una de las más

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Resumen

La industria automotriz se ha transformado radicalmente en los últimos 20 años debido, de manera fundamental, a una expansión de los mercados que no es debida, como podría creerse, a la globalización de los mismos -ya que la industria automotriz ha sido de forma tradicional multinacional- sino a la fuerte competencia que ya no admite nuevos participantes y sólo permite la supervivencia de los más fuertes. Esta expansión conlleva desarrollos tecnológicos y, al mismo tiempo, a la implementación de nuevas y audaces estrategias. El manejo financiero se convierte en la pieza clave de este ajedrez de 'grandes ligas'. Honda Motor Co. es, desde todo punto de vista, una empresa automotriz que se ha mantenido dentro de las más importantes, ejerciendo un liderazgo tecnológico y estratégico. En este caso de estudio, el autor recoge amplia información sobre Honda y la industria automotriz para que los profesores puedan plantear diversas preguntas relacionadas con los aspectos más relevantes del sector.

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Abstract

The car industry has changed dramatically in the last twenty years, not due the globalization that has changed many others, but because of new methods and strategies that have emerged from increasing competitiveness. Honda Motor is a well-known and established company and a good example of manufacturing, marketing and financial strategies in today's car-industry.

Palabras Clave: Multinational, transnational, structure, global companies, off shore production, monetary portfolio, hedging.

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Introduction

Established 50 years ago, Honda Motor Co. Ltd., is one of today's leading manufacturers of automobiles and the largest manufacturer of motorcycles in the world. The company is recognized internationally for its expertise and leadership in developing and manufacturing a variety of products, ranging from small general purpose to specialty sports cars that incorporate Honda's highly efficient internal combustion engine technology. More than ten million Honda engines were produced worldwide during the fiscal year ended March 31, 1999.

By following a corporate policy that emphasizes originality, innovation, and efficiency in every facet of the Company's operations—from product development and manufacturing to marketing—Honda strives to attain its goal of satisfying its customers. Though a worldwide commitment to achieve this goal, Honda and its many partners who share in this commitment have succeeded in creating a global network comprising 104 production facilities in 33 countries that supply Honda products to most industrialized countries around the world. New plants are being built in China with expected production of 10,000 Accord sedan units; and in Thailand with a joint venture plant to begin production of the Accord model to export to Australia and New Zealand (Honda, Annual report 1999).

Financial highlights¹

This annual report contains the consolidated financial statements of Honda Motor Co., Ltd., and its subsidiaries for the American and European Honda shareholders. It was prepared on the basis of accepted accounting principles in Japan, in accordance with the Japanese Commercial Code and related solely to Honda Motor Co., Ltd., wasn't consolidated with any of its subsidiaries. From this statement we can deduce that information related with some aspects of technology and core business are not disclosed; moreover, some of the information contained in the 1999 Report, is global, not detailed. Hence, we have to find clues in other specialized publications.

The 1999 Fiscal year was a very difficult year for Japanese Economy. Compared with the buoyant American and European economies, the Asian markets were in a continuous depression. The Japanese economy, one of the strongest in Asia, was also marked by a weak capital investment and soft consumer demand. Despite this, Honda reports utilities for the third consecutive year.

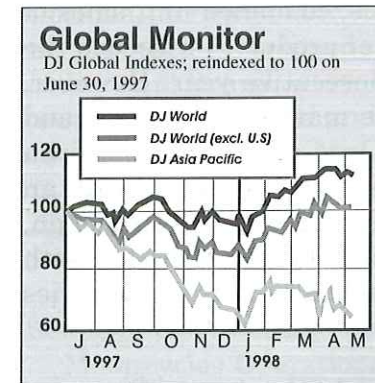
Japan's recession and the Asian economic crisis continue to batter Japanese automakers, most of whom reported declined exports and domestic production in May. Even Honda Motor Co., which has weathered the crisis better than most, found its exports to the region falling for the first time since August 1996 (Shuchman, 1998, p.1).

Consolidated Honda net sales show a total of \$51,688 (millions); increasing 3.9% over the previous year; this is a result of higher net sales in North America. It isn't too bold

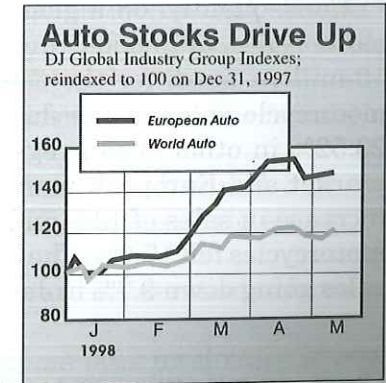
¹ Current report, originally had exchange rates in ¥ = \$0.0083 (US\$1=¥120.55), the mean of the telegraphic transfer selling exchanges rate and the telegraphic transfer buying exchange rate prevailing on the Tokyo foreign exchange market on March 31, 1999. For the Reflective, and in favor of coherence, we use the currency Exchange value in US\$.

to say the American market was a principle supporter of the Japanese automobile industry; but Europe had much to do with this also, mainly because of power supplies. Consolidated operating income also had a good year with \$4,552 million, increasing 18.7% from the previous year; yen depreciation partially supports this. Motorcycle production fell 17% between 1998 and 1999 while car production grew 28% in the same period. Financial services Operating Income/ Net Sales, an item not detailed, plummeted from originally 15% to 32%. Revenues from Honda's financial services and other business sectors are derived from all business not directly related to automobile or motorcycle operations, and include revenues from power products and related parts as well from financial and trading subsidiaries. Nevertheless, revenues according to Honda's report for the current fiscal year show an increase of 12.7% in this area.

The exchange rate is a factor on Honda's profit sheet, although without a strong product line and effective strategies, the company would have little cause to rejoice. Japan's yen continues to weaken against the dollar, so revenue earned in dollars yield more yen. With an effective exchange rate hedging, a Japanese company can increase operating profit by well over 10%. Honda did. So did Sony



Source: *Baseline*



Source: *The Wall Street Journal*

Corp., another company coping relatively well with Japan's downturn (Clark, 1998, p.3).

Each one-yen drop against the dollar adds an estimated \$55 million to Honda's bottom line. Honda will get an extra boost from the currency effect this fall when it plans to export 60,000 Accords to the U.S.—roughly the same amount that Yoshino expects sales to drop in Japan this year (Thornton, 1998, P.3).

Tokyo - Japan's auto makers say they don't plan to capitalize on the weakness of the yen by lowering prices in the U.S. just now. Instead, they say they'll take the windfall that the weak yen provides from their American sales to help cover losses in Southeast Asia and at home" (Shuchman & White, 1998 p.1).

However, Honda Motor Co. announced a 6.9% year-to-year drop in group net income in the April-to-June quarter (1999), becoming the most recent Japanese multinational to report that a strong yen hurt its profit.

Still, a stronger yen cut into revenue. The yen averaged 121 yen per dollar during the quarter, compared with 136 yen per dollar during the period last year. A stronger yen cuts into the profits of a company like Honda by hampering its price competitiveness overseas and lowering the yen value of revenue in other currencies.

Consequently, on a global basis, combined unit sales of motorcycles, automobile and power products² exceeded the 10-million mark for the third consecutive year. However, motorcycle sales in the Japanese market fell 16.21% and 23.52% in other Asian regions. Once again, the American market and European market saved the situation with an increase in sales of 14% and 7% respectively. Even though, motorcycles fell 17.9%. The car market didn't do better; with sales going down 9.7% in Japan and 8.3% in Asian countries

² Power products Item includes electric plants, home machinery, and relevant parts.

and 4% in Europe; once again, the American market partially saved the situation with an increase of 9.7%. A total drop of -0.4% in this area is the final balance.

Power line products, plummeted 20% in Japan, and 10% in other Asian countries U.S. sales increased 4.1% and a surprisingly strong increase in European countries of 32%, made a 19% gain possible in power line products for the period.

In Japan, the total automobile market declined 6.5% to 5.86 million units during the period under review. This contributed to a decline in Honda's unit sales to 690,000 units - or 8.9% - from the previous fiscal year (Webb, 1998).

In contrast, sales in the strong and stable U.S. economy exceeded over a million units for the second consecutive year; Accord and Civic models continued to bolster Honda's brand image. The locally designed model, the Acura boosted sales in the near-luxury sedan.

The boost in sales in United States probably has to do with GM labor problems.

Detroit - U.S. sales of cars and light trucks eased 6.6% in August to 1,234,511 vehicles from a year earlier, reflecting continued fallout from the summer strikes against General Motors Corp (White 1998 p.1).

In the European car division, sales declined 4.2% to 250,000 units. In other regions, which include Asia and Oceania, Africa/Middle East and Latin America, Honda's motorcycle sales dropped 23.52%, to 3.07 million units; while India and Brazil were favorable, Southeast Asia and particularly Thailand and Indonesia, were major factors to the decline.

In other regions Honda's car sales declined 8.3% to 210,000 units, due primarily to the economic slump in Southeast Asia.

Some indexes can be taken under consideration to forecast financial moves facing Y2K:

Motorcycles Operational Income over total sales is now 9.4 % lower than the 1995 level of 9.9% compared with the latest fiscal year 1998, 11.4% plummeted to 10.58%

Automobiles Operational Income/total Sales = 15.0, is the highest since 1995, increasing an astonishing 28% over the last fiscal year (1998) 6.7

Capital expenditures/Assets=4.7% decreased 27%

Total net income/sales = 4.9% Increased 14%

Honda motor: A MNE Automobile business

The automobile business constitutes the 80.1% share of consolidated net sales. In the 1999 fiscal year, Honda's automobile business generated \$41,386 million in net sales, increasing 5.0% from the previous fiscal year. Sales in North America contributed seriously to this performance.

"Honda is really an American company," says Nori Hiwakata, an auto analyst at Morgan Stanley Japan, Tokyo. "More than 70% of its operating profit comes from the U.S. market, including exports to the U.S." Sales in Europe also are strong, but the U.S. market is Honda's savior (Clark, 1998, p.3).

Global Automobile sales amounted to 2.33 million units, a decline of 0.4% from the previous fiscal year; if new models (green production) succeed in getting the American favor, it may be possible for Honda to maintain a high profile in the industry, and increase its share of market.

The European market is also a Promised Land. Honda expects the new factory in England could be his keystone to developed a huge and growing market. In 1999 fiscal year, Honda of the U.K. Manufacturing Limited (HUM) produced 114,000 automobiles, up 1% from the previous fiscal year. Production for the 2000 fiscal year will be approximately 130,000 units, a 14% increase from the previous fiscal year.

The real problem for Honda's future as a major company is the Asian Market. The continued financial crisis in Southeast Asia affected Honda's motorcycle output in the Asian region, which declined 29.0% totaling 2.42 million units.

On the other hand, the yen showed some signs of an increase in value; probably, the next fiscal year we'll find the market with a strong Yen, and as a consequence, an American market showing signs of recession and a weaker dollar.

Plants in other countries, such as India and Brazil as well as Vietnam, showed steady increases in production.

Automobile production in the regions totaled 123,000 units, a slight decline of 1.6% from the previous fiscal year.

Three new automobile plants in Brazil, India and Turkey began operations in the 1998 fiscal year, and the production at each plant reached near annual capacity during the 1999 fiscal year.

Honda Cars Manufacturing (Thailand) Co., Ltd., Honda's biggest automobile plant in the region, expanded exports of automobiles and component parts. In May 1998, it began shipments of stamped parts of the Accord to Japan, followed by exports of a completely built-up (CBU) Accord models to Australia and New Zealand. In April 1999, Honda Engineering Asian Company Ltd., was established in Thailand as Honda's fourth regional engineering base to boost local content and the manufacturing of production equipment for both domestic and export markets.

Honda's new joint venture company in Indonesia, P.T. Honda Prospect Motor, integrates all Honda-related Indonesian automobile business, which were conducted by four separate companies, including vehicle assembly, engine and component manufacturing, and wholesale distribution. The new company is capitalized at \$70 million, with 49% held by Honda.

Japanese factories manufactured 1,218,000 units for the 1999 fiscal year, including a complete knockdown (CKD) for export, a decrease of 8.0% from the previous fiscal year. A weaker demand for passenger cars in the domestic market affected Honda's overall automobile sales, a decline of 8.9% over the previous fiscal year. Exports from Japan decreased a 3.9%, however, exports to North America increased 3.4%,

while exports to Asian countries dropped 57.2% (Honda Motor Co. 1999).

In May 1999, Honda announced it would construct a comprehensive new \$400 million automobile manufacturing facility in Lincoln, Alabama, in the United States, to produce minivans or sport utility vehicles as well as engines. Production is scheduled to begin in the spring of 2002. The new plant is expected to reach its full capacity of 120,000 vehicles and 120,000 engines by 2003, with an expected 1,500 employees (Honda Motor Co. 1999) and (Kerwin & Naughton, 1999 p.3).

In Canada, the second line at Honda of Canada Manufacturing will produce an additional 160,000 units annually by 2001. Honda will invest \$30 million to this increase in production. Another \$30 million will be invested in the Ohio plant to increase production to 110,000 units to match the increase in total vehicle production capacity in the U.S. and Canada to 1.01 million units by 2001 (Honda Motor Co. 1999).

Including the \$400 million investment for this plant, Honda's cumulative investment in the United States will reach approximately \$4.8 billion. As for North America, the total investment will exceed \$5.7 billion. Honda has also decided to sell additional Accord sedans built in Mexico, approximately 7,000 units per year, to alleviate an acute shortage of Accords (Honda Motor Co. 1999).

...Technology is changing, margins and prices are both falling, and stock prices are low. So the deals are coming. It is all about getting the \$600 billion global parts business ready for the 21st century. In a consolidating auto industry, giants such as GM, Ford, and Toyota want to manufacture and sell vehicles around the globe, and they need parts makers that can keep up with them (Galuszka, Kerwin, Muller, and Bernstein, 1999 p.2).

The new scenario, lead by a small group of parts makers, in the service of a small group of automakers, creates a challenge

for today's leaders: how to compete in a global economy based on the concept of the "Good, Beautiful, and Cheap"?

Motorcycle business

Motorcycle Business share of consolidated net sales is 11.2%. When the fiscal year ended on March 31, 1999, Honda sold 4.11 million motorcycles worldwide. Honda's overseas motorcycle production covers approximately 80% of its global output.

Honda's motorcycle unit sales for the fiscal year decreased 19.3% from the previous fiscal year, while revenues from its motorcycle business decreased 8.6%, to \$5,815 million.

Sales declines in Asia and Japan were largely responsible for these decreases. Revenues from motorcycle sales accounted for 11.2% of the total consolidated net sales and operating revenue.

In North America, unit sales of motorcycles grew 14.1% to 146,000 units. Net sales increased 9.3% to \$763 million.

In Europe, both Honda's motorcycle unit sales and net sales climbed to 390,000 units and \$1,574 million—up 7.1% and 10.8% respectively.

In other regions (all regions except Japan, North America and Europe), despite higher sales in Latin America, mainly in Brazil, Honda's motorcycle sales decreased 23.5%; net sales decreased 19.9% to \$2,496 million. These decreases were due primarily to the impact of the economic crisis in Asian countries.

Honda's worldwide facilities structure

Honda's worldwide production is located in the following countries:

Japan is the core management of the company and its first production center; however, it imports power

products from India, motorcycles from Taiwan and USA, automobiles from the USA as well as power products. However, Japan exports motorcycles to U.S.A. and exports CKD vehicles to the USA, South America and Asian markets.

United States of America produces motorcycles and automobiles that are exported to Asia, Australia, Europe, Canada and Brazil.

Canada exports automobiles to Asia, Caribbean Countries, United States, South America and Australia.

United Kingdom currently exports automobiles to Europe
France produces power products to all of Europe.

Italy has a mixed production of Motorcycles and power products.

Spain produces motorcycles to the European market.

Brazil's plant production exports to fulfill the neighboring motorcycle markets of Uruguay, Argentina, Bolivia, Peru, Chile and Colombia.

Mexico produces automobiles power products and motorcycles that are exported to USA and Argentina.

Plants in the United States produce automobiles, motorcycles and power products for the Asian Market and Australia; it also covers South America and Mexico markets with automobiles and power products.

India exports motorcycles and power products to the Middle East and Asian markets.

Thailand exports automobiles, motorcycles, and power products.

Indonesia's plant exports motorcycles to Greece and power products and motorcycles to Vietnam and China.

Taiwan production of motorcycles is exported to Europe, South America, and Africa.

Japan produces cars, motorcycles and power products, that are exported to China, Vietnam, Thailand and Australia, but imports cars, motorcycles and power products for the local market.

Financial management

As one can see the amount of currency managed by Honda is large and quite variable: From Sterling Pounds, Marks and Francs, to Rupiah, Australian Pounds, and Canadian dollars. Do not forget Mexican pesos, Liras, Drachma, and almost every other known currency. However, at the end it is all hedged to Yens.

This financial policy works perfectly in the current market; but if signs of recovery are consistent, in the next fiscal year, we could face a very different scenario, with a strong Yen and a weaker dollar facing a depressive economy.

In the past, Honda has been able to reduce production costs by as much as 30%. But that leaves little to cut. More than 80% of Honda's cars are built from the same bases, and many share as much as 60% of the same parts. (Thornton, 1998, P.4)

For Honda Motor, the possibility of confronting that situation is more advantageous due its structural characteristics. Honda's projecting the future of the company better than any other in the car maker category.

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