



# THE NEWSMAKER

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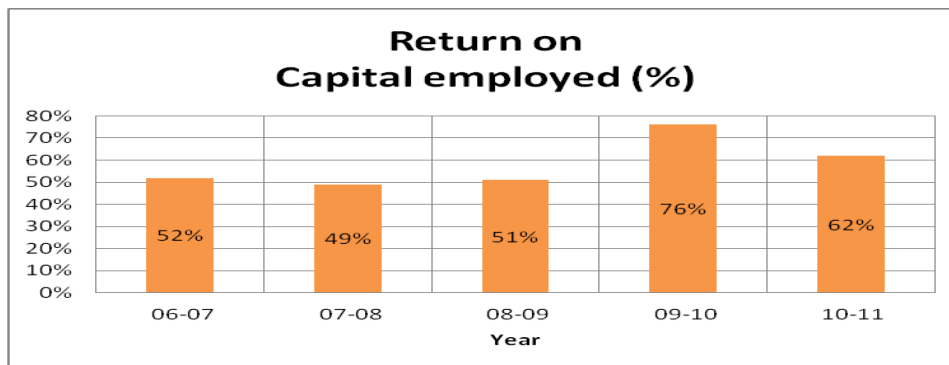
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### HONDA HOUNDS HERO

*by Suresh S.*  
**Director, DMS Financial Services Co. (P) Ltd.**

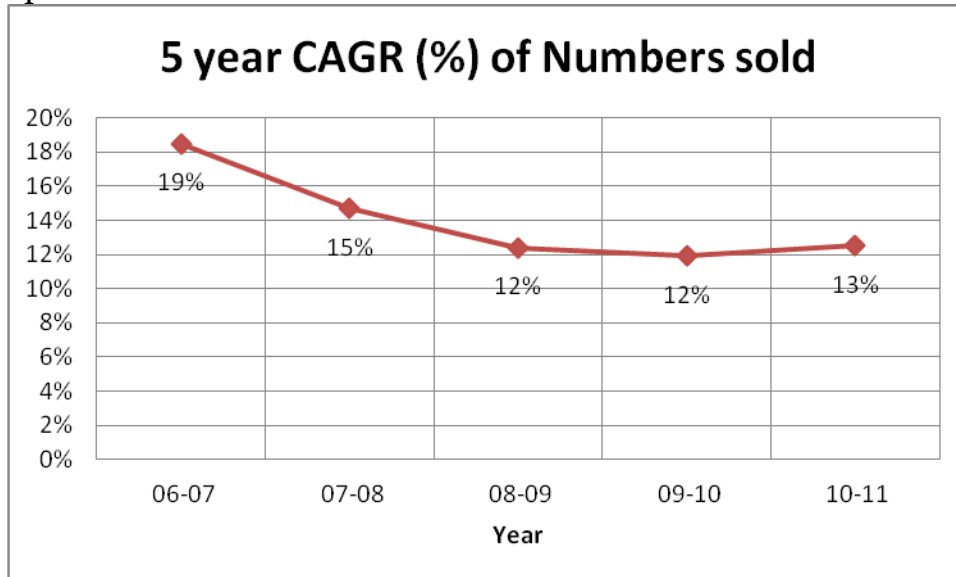
Will the one-time heart throb Honda Motors of Japan prove to be the undoing of Hero Honda now? With Sales for the quarter ended 30<sup>th</sup> June 2011 at 15.3 lakh numbers, the highest ever in its history for a quarter, and with four new product launches, Hero Motor Corp, the erstwhile Hero Honda Motors Ltd. seems to be allaying fears of any negative fallout after the Honda divorce.

But behind the hoopla the world's largest two wheeler company must indeed be ruing the separation. For a company which at one time enjoyed a Return on Capital employed at 65%, the highest in the country (in the year 2001), not all is well. Both the trend in CAGR of numbers of units sold and the Return on Capital employed looks stressed. **The last five years' CAGR of Sales in Numbers of units sold is just 12.5%.**



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Love frustrated and now on the rebound – the company which set records unparalleled in manufacture of bicycles and two wheelers is entering unrelated businesses such as 5-star hotels. The group has a healthy land bank due to having a host of manufacturing units spread across the country. Some part of this land bank may be identified to setting up hotels.



Against a 21.74% growth rate for the Motorcycle industry generally, Hero Honda grew at 35% between 1997 and 2001. The position of strength it enjoyed then in 2001 slowly got lost to competition thanks in no small measure to Honda of Japan.

### Salvo fired

- In Aug. '99 Honda Motor Company announced it would be setting up a 100% subsidiary Honda Motorcycle & Scooter India Ltd. to make scooters first and thereafter motorcycles. Hero Honda's share price plummeted 30% upon the announcement.
- Again in 2002, Honda Motor Company announced that it would form a new company HMSI to manufacture Scooters in India. It also announced that it would enter the Motorcycle segment in 2004, the year when the Hero Honda agreement with Honda would come up for revalidation.
- It became obvious that when the growth rate for scooters was just 4%, why would Honda expanding capacity by two times, unless it had clear intentions to enter on its own the Motorcycles market too?
- Hero was always the king in the Motorcycles segment. Whilst the CAGR for Motorcycles grew by 22% from 1996 to 2001, the Scooter production was stagnant and Mopeds fell by 29% in 2001-02. Honda of Japan was competing for Motorcycles!

Historically much of the damage came from the doings (undoings) of Honda of Japan:

Although Honda Motor of Japan tied up with Hero to form Hero Honda Motors in 1984 the shots were called by Honda.

- When the license raj was liberalised, Honda Motor of Japan used its options very well. It wanted to foray into Two wheelers (in Scooters and Motorcycles ) and Power. It could not forge a tie-up with Bajaj. It moved to Kinetic (Firodia group) of Pune. Kinetic Engineering was having a 44% share of the moped markets being the pioneer in Mopeds and was offered a choice between Scooters and Mopeds. KEC and Honda of Japan entered into a 50:50 partnership called Kinetic Honda Motors Ltd. for producing Scooters. KEL preferred to choose Scooters based on the popularity of Scooters then.
- Honda was close to tying up a venture for Power products and so the only product left out was Motor cycles.
- Hero Motorcycles was the last choice for Honda of Japan for Motorcycles. Hero was already strong on Bicycles and it had a strong presence in Mopeds. Hero surmised that if the venture with Honda could prove a success, they would be able to dominate the two wheeler market in India and it would have the potential to beat Bajaj Auto.

The trump card was R & D:

- Honda agreed to: ( i)provide technical know-how to Hero (ii) set up manufacturing facilities and (iii) take responsibility for R&D efforts
- In return Hero Honda agreed to: ( i) pay lump sum fee of \$ 500000 and (ii) pay 4% royalty on net ex-factory sale price

In 2009-10 Royalty payment to Honda formed 2.6% of Sales. The lack of transparency in the divorce has kept away from public view the terms of Royalty post-split.

### **Hero with a weak spot**

Whilst Hero got to launch the CD-100, India's first 4-stroke engine, where its most outstanding feature was the fuel efficiency of 80 kms/litre, it never got the command over the R & D:

- The CD-100 series came from a single platform – the CD-100 bike suited the rural and semi-urban customer, the CD-100 SS for the urban and the Splendour for the middle-aged, office goer. The product development costs were spread over these volumes making for economies of scale.
- Honda had decided to centralise its R&D in three places and India was not one of them. Every time there were changes prior approval was taking time and competition began to introduce super-rich features with the 4 –stroke variant and at lower costs from TVS-Suzuki and Baja-Kawasaki.
- Hero Honda started introducing product launches twice every year to compete with Bajaj and TVS Suzuki. This however was critically hinging on Honda's R&D support as Hero had not set up its R&D in India.

Hero's strategies of masterminding the indigenisation and exploring other JVs were exemplary:

- By 1996 95% of the motorcycle was manufactured from locally procured parts, which percentage was considered very impressive by Honda of Japan.
- The collaborative agreement Hero Honda entered into with Daimler A.G. for 50-65 cc motorcycles and with BMW for 650 cc motorbikes which fizzled out did not give Honda a sense of comfort.
- Hero Honda managed to stave off the sting of the earlier agreement in the 1994 renewal. It reduced royalties (Rs. 200 per vehicle) and secured promises of fast-track transfer of technology.

The next blow came as the joint venture between the Kinetic group and Honda called as Kinetic Honda Ltd. was dissolved. Honda would need to go alone to make scooters.

### **TVS – story with a difference**

In sharp contrast TVS-Suzuki had a JV but TVS was much insulated:

- ✓ With the exception of the two-stroke Suzuki Max 100R, none of the company's fast moving products had major Suzuki contributions.
- ✓ TVS Suzuki's bread and butter product – moped – was fully Indian.
- ✓ TVS Scooty, an enormously successful launch was non-Suzuki.
- ✓ The Suzuki parent had its stamp of contribution mainly in the two stroke motorbikes, but with the decline of 2 stroke engines in India and the successful launch of a pure Indian breed - TVS Victor, the TVS management were confident to go it alone.

Contained in the Board of directors commentary in the Annual report for 2010-11 are these concerns on the R & D front:

- Domain knowledge through Honda would now not be available which will reduce the customisation at design stage
- Capabilities will now need to be enhanced across levels
- Design infrastructure needs to be beefed up significantly

The 'splendour' is likely to fade with the ride turning rough in the years ahead!

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### **Wooring Employees**

(adapted from an article in The Economic Times, Mumbai dated 6<sup>th</sup> May 2011 titled 'REWARD MACHINE' by Devina Sengupta)

Some noteworthy examples of what all companies do to retain talent, particularly in the IT/BPO sectors:

Some of these are ( i) providing constant changing roles, (ii) letting employees map their own growth in the company and (iii) decide their career trajectory.

- For example **Mphasis** restructured role options. The earlier structure required an employee to stay in a role for a minimum of three years. Now it has been shortened to 28 months.
- At **Essar**, the GenEssar program identifies top performers from the lot of young blood who do exceptionally well after mapping their skills.
- **Infosys Technologies** on the basis of a survey permits employees to work by remote as employees wished to work only for a part of the week and devote the rest of the time to other pursuits.
- At **HCL** the employees are encouraged to come up with new business and operation ideas which the company can draw on. In this program called Make A Difference Jamboorie, employees are considered as stakeholders in the company.
- At **Adobe India**, the company provides ownership of products that are commercialised. The company has now observed that due to this there has been a significant increase in the number of patents it has been applying for every year.

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### **Services offered by DMS Financial Services Co. (P) Ltd.**

- **Management consultancy**
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- For details, please contact 044-24995672.**