
LEHMAN TRIKES: A STORY WITHIN A STORY

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CASE DESCRIPTION

The primary subject matter of this case is strategic alliances. Secondary issues include business strategy, entrepreneurship and marketing. The case explores the dynamics of an alliance between Harley-Davidson and a small, entrepreneurial, niche market company, Lehman Trikes. The case is appropriate for senior level four undergraduate courses or level five graduate classes. The case may be taught in two class hours with 1-2 hours of outside student preparation.

CASE SYNOPSIS

As the world was in the midst of a crippling recession, on July 22, 2008, Harley-Davidson unveiled the new Tri Glide three-wheeled motorcycle at the annual dealer meeting in Las Vegas. At the same meeting Lehman Trikes, a small but rapidly growing leading manufacturer of three-wheeled motorcycles, announced that it would be the exclusive supplier to Harley-Davidson of the Tri Glide. Ron Hutchinson, senior vice president of product development for Harley-Davidson said, "This is a big deal. The three-wheeled market is a market that we believe has been effectively underserved because it has been done in the aftermarket." (Pitlick, Harley trikes to be built here, 2008) While the entrance of Harley-Davidson into the trike market would obviously legitimize and add enormous growth opportunities for the three-wheel segment of the motorcycle market, would it profoundly change Lehman's environment and business model? Dan Patterson, then CEO of Lehman Trikes, would later cryptically write of the event in the 2008 Third Quarter Report, "We are truly pleased to have Harley-Davidson as both a competitor and a business associate" (Lehman Trikes, 2008). Did this somewhat obscure statement reflect his concerns about the new supply agreement? With the active participation of Harley-Davidson in the trike market, would the three-wheeled motorcycle market emerge from a niche market status to become a primary market and entice the motorcycle market leaders to introduce complete and competitive trike products? Would Lehman Trikes, "The Leader of the Three World," remain able to dominate the trike market? How would Lehman's strategic supply agreement with Harley-Davidson evolve, and would their long term goals be consistent?

In analyzing the case students should focus on several key questions. Would the alliance between Lehman and Harley-Davidson meet both of their strategic goals and what were the benefits to each organization of the alliance? What were the risks a small organization like Lehman was taking in entering an agreement with a much larger partner versus the rewards they hoped to gain? Was Harley fair in their dealings with Lehman or did they take advantage of their much smaller partner? Historically, Harley limited supply of new product launches. In the midst of a recession, was this the best marketing strategy? And finally, how viable was Lehman's

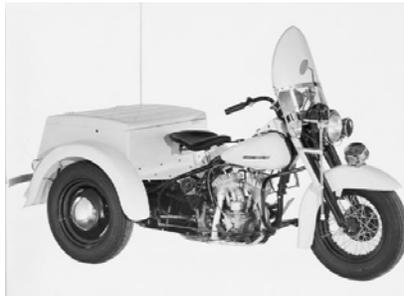


business model? In analyzing the case students should focus on several key questions. Would the alliance between Lehman and Harley-Davidson meet both of their strategic goals and what were the benefits to each organization of the alliance? What were the risks a small organization like Lehman was taking in entering an agreement with a much larger partner versus the rewards they hoped to gain? Was Harley fair in their

dealings with Lehman or did they take advantage of their much smaller partner? Historically, Harley limited supply of new product launches. In the midst of a recession, was this the best marketing strategy? And finally, how viable was Lehman's business model?

LEHMAN TRIKES HISTORY AND BUSINESS OVERVIEW

Lehman Trikes began in 1984, literally in John Lehman's garage in Alberta, Canada, with a project to build a three-wheeled motorcycle for his wife. With the help of friends, John fashioned a Chevrolet differential and a metal body onto a 1981 Honda CB900 motorcycle front end and engine. Three-wheeled motorcycles had been around for a long time, but never before were grafted to a modern front end. Harley-Davidson entered the market in 1932 with the box ended Servi-car for commercial and police use. It was discontinued in 1973. (Harley-Davidson, 2009)



Harley-Davidson Servi-car

In 1985, Lehman Industries began as a fiberglass fabricator of canoes and truck sleepers. Limited production of three-wheeled conversions of various Honda and Harley-Davidson motorcycles followed. Orders for the trikes began to pour in and in 1993 a new partnership between John Lehman and Larry Strilchuk resulted in the formation of Lehman Trikes, Inc. of Alberta, Canada. Production began in earnest in a factory in Alberta making conversion kits for Hondas, Harleys and later Suzukis. In 2002 Lehman Trikes completed its initial public stock offering and began trading on the TSX Canadian Venture Exchange under the symbol LHT.

The business grew rapidly, but over 90% of the customers were in the United States. With a weakening of the U.S. dollar and a subsequent strengthening of the Canadian dollar, manufacturing in Canada and selling in the U.S. continued to erode profits as the U.S. dollar continued to weaken. In 2003, a decision was made to relocate primary manufacturing to the U.S. In January 2004, a new manufacturing and assembly facility was opened in Spearfish, South Dakota. The location was chosen for its proximity to Alberta, its central location in the U.S.,

nonunion labor availability and economic development incentives provided by the community. It was a bonus to have nearby the world famous Sturgis Motorcycle Rally, which brings in as many as 500,000 motorcycle enthusiasts every August. Sturgis would be the venue for numerous later new product launches for Lehman Trikes. (Strilchuk C. , 2009)

In 2006, Lehman announced a supplier agreement, the first of its kind in the three-wheel industry, to provide conversion services for Harley-Davidson. Under the agreement, Lehman Trikes provide components, paint and conversion assembly under this agreement. In 2008, that agreement was expanded to include the exclusive production for Harley-Davidson of the Tri Glide product line. The Tri Glide was designed by Harley engineers and was to be built by Lehman to Harley's exacting specifications. Harley vice president Hutchison proclaimed, "We are on the brink of creating the largest subset in the industry. We expect to have very high volume potential of serving the needs of the wide variety of customers who haven't yet been able to participate in the freedom ... of the open road. With a growing baby-boomer population, there are many people who have health conditions, or other reservations about riding a two-wheeled motorcycle. This new product will fill that niche." (Pitlick, Harley trikes to be built here, 2008)



Lehman Trikes continues to develop products and relationships with other manufacturers. In July 2009, Lehman announced the unveiling of the new CrossBow with cooperation from Victory Motorcycles (Polaris). The CrossBow features an ultra modern design by Lehman with engineering participation from Victory. The CrossBow matches the powerful Victory V-Twin engine with the Lehman, "No-Lean" suspension, providing a smooth, comfortable ride and seamless styling. The CrossBow retail pricing starts at \$33,995. (Lehman Trikes, 2009)

The company's business model is based on four segments:

1. Sale of conversion kits to authorized dealers – accounting for almost 50% of sales and the highest margin line, trike conversion kits are sold to one of 122 Lehman trained dealers. Lehman extends a three year, unlimited mileage warranty to the conversions. The kits can be provided either painted or unpainted. The retail price of this option is \$12,000 - \$13,000 without accessories.

2. Lehman factory assembly of trikes from new O.E.M. motorcycles – approximately 30% of revenue derives from assembly of new models of motorcycles for Harley Davidson, Honda, Suzuki and Victory (Polaris). Lehman develops conversion kits specifically designed for each model of factory motorcycle. Lehman disassembles the new motorcycle, removing the stock rear-end and replaces it with the Lehman conversion kit designed for that specific model. One of the issues increasing the cost of this option is the very limited resale market for the rear-end assemblies once they are removed. Due to limited volumes, other than the Tri Glide, manufacturers have been unwilling to sell Lehman just the front end of the new motorcycles. The retail price of this option is \$18,000 - \$33,995 depending on the model converted and the accessories ordered.

3. Lehman factory assembly of conversions for dealer supplied, customer owned motorcycles – 20% of revenue is provided from conversions of motorcycles that are delivered

from a Lehman dealer for a customer's own motorcycle. The retail price of this option is \$12,000 - \$13,000 without accessories.

4. Conversion and assembly for Harley-Davidson of the new Tri Glide line of trikes

– Lehman assembles the Harley designed Tri Glide line to Harley's exacting design specifications. The Harley trike line for 2010 offers two models: the Tri Glide Ultra Classic and the new Street Glide Trike, a leaner, lighter, stripped-down hot-rod style trike. Harley provides the front end frame, engine and chassis structure specifically designed by Harley to handle the loads generated by the steering forces and weight of a three wheeled vehicle. For the Tri Glide and Street Glide, Lehman adds primarily outsourced components: a rear axle assembly and wheels, a luggage carrier, and fenders. Lehman paints the molded-composite body work to provide a near perfect color match to the front fender and tank. (Harley-Davidson, 2009) The retail price of the Tri Glide Ultra Classic is \$29,999 to \$32,339, depending on options and the price of the new Street Glide Trike starts at \$26,999. (Strilchuk C. , 2009)

Despite a challenging economy, Lehman Trikes reported 2008 Revenues of \$22.620 million, up 20 percent over 2007. First quarter 2009 revenues were \$6.382 million, an increase of 40 percent over the prior year first quarter. This is at a time when the motorcycle industry as a whole was down 32 percent. "That is pretty darn amazing in this economy," said Ken Hines, then Lehman Trikes executive vice president. "It's the trike, and trikes are being recognized as legitimate recreational, fun vehicles. Given the demographics, your trike buyers tend to be more affluent than the general population." (Pitlick, Leman Trikes Expanding, 2009)

EXTERNAL ENVIRONMENT

In most developed countries, including the United States, motorcycles are not a necessity and are primarily used as leisure or recreational vehicles. They are bought with discretionary income such as one would spend on luxury items or vacations. Discretionary spending will rise and fall with the economy and usually exaggerates both the highs and the lows. According to market research, the average Lehman Trike customer was 73.3% male; age 56 – 65 (45.5%). Average income was \$50,000 to \$70,000. On average, they have been riding motorcycles for over twenty years, but have been riding trikes for less than five years. Fifty percent of Lehman trike owners own Harley-Davidson trikes, thirty percent own Honda trikes and twenty percent own Suzuki trikes. The majority of trike owners (77%) primarily ride their trikes for recreation or day trips. Styling and reputation were the primary influences on their trike purchase. The average trike owner listens to country music and heard about Lehman Trikes through a dealer. (Lux, 2009)

According to the Bureau of Economic Analysis, in the second quarter of 2009 the U.S. Gross Domestic Product declined 2.5 percent. In the same quarter, the U.S. motorcycle market was down 40%. (Pitlick, Leman Trikes Expanding, 2009) The U.S. motorcycle market declined 2.6% in 2007 to a total value of \$10.2 billion and 1.05 million units in volume. Of that the three-wheel market is estimated to be a small fraction of one percent. The United States generates 15.9% of the global motorcycle market's revenue. Honda Motor Company generates over 40 percent of the U.S. motorcycle market volume. (Datamonitor, 2008)

Company	% Market Share
Honda Motor Company	40.2%
Harley-Davidson	24.0%
Yamaha Motor Co.	15.0%
Suzuki Motor Corp.	11.7%
Other	9.2%
Total	100.0%
Source: Datamonitor	

The U.S. and international motorcycle market for heavy bikes (+651cc engine size) is highly competitive. All of Harley-Davidson's major competitors are financially large and involved in numerous market segments beyond motorcycles. They all also offer more models including dirt bikes, small entry level bikes, sport bikes, and racing bikes as well as ATVs. Competition in the heavy weight segment is based on brand, price, styling and customer preference.

INTERNAL ASSESSMENT

Management – In 2007, Dan Patterson, a member of the Board of Directors since 2004, became President and CEO of Lehman Trikes. Patterson had previously been a Division President for Lockheed Martin. He would bring with him to Lehman, Ken Hines, his former Vice President of Business Development at Lockheed Martin. They would bring the professional management and systems learned in the aerospace industry to Lehman. Together, Patterson and Hines would oversee the complete transfer of company operations from Canada to the United States, forge relationships with Harley-Davidson as the official supplier of the Tri Glide, direct a significant expansion of the company and staff and develop the relationship with Victory Motorcycles. (Lehman Trikes, 2009)

On July 31, 2009, it was announced that Dan Patterson was stepping down as CEO to enter retirement. Simultaneously it was announced that Ken Hines, who had been serving as executive vice president running daily operations, was named president and CEO. (Lehman Trikes, 2009)

Operations – Currently Lehman is primarily involved in assembly of components and painting. Many components are outsourced for production based on Lehman designs and specifications. Conversion kits are assembled and shipped to conversion dealers. O.E.M. motorcycles are sourced direct from the manufacturer's factory for the assembly of trikes. This is very inefficient as there is little market for the rear wheels or rear assemblies which are removed when assembling the trikes. The Japanese manufacturers have been approached by Lehman to supply only the front end and engines but have so far declined. For the Tri Glide, Harley provides the specifications and the front ends (including engines). Harley has modified the design of the front end of the Tri Glide to have an increased rake and legs that are two inches longer. Subcontractors provide the bodies, the rear boxes, differentials, wheels and other minor components. Lehman completes final assembly and paints the rear ends to match the factory front ends.

Interestingly, Lehman does not buy the Harley-Davidson supplied components. Once a Tri Glide is completed, it is shipped to Harley on a Harley trailer and Lehman bills Harley for labor, paint, other Lehman supplied components and profit. Lehman maintains a seven day inventory of components and is running a five day/ two shifts per day work week, and there are plans to increase production capacity by 30% in the near future. (Jafrum, 2009)

In November 2009, Lehman Trikes received the internationally accepted quality standard certification, ISO 9001:2008. "This certification provides testament to the quality and reliability of our products...", said Ken Hines, president and CEO.

Marketing - The sale of conversion kits to dealers has provided the largest profit margin for Lehman. In an informal competitor study conducted by students at Black Hills State University (BHSU, 2006), it was determined that the majority of conversion kits were being assembled in mom and pop garages. The decision was then made by Lehman to differentiate themselves by tightening their dealer requirements. As quoted from Lehman's website, "Lehman Trikes has proudly partnered with premium dealers to support our customers and products. Every Lehman dealer must meet the most demanding requirements in the trike industry so that we can provide our customers with the most enjoyable experience." (www.Lehmantrikes.com, 2009)

Lehman provides first year trike owners with a one year free membership to their Lehman Pride group. This group was created to enhance communication among Lehman trike owners. Lehman is proud of the fact that they are the only trike manufacturer with an owner's group. After the first complimentary year, members pay a \$35 annual fee to remain a member. The members receive the Pride Matters Magazine, which is the official magazine of Lehman Pride and is issued three times per year. To further support Lehman trike owners, the magazine offers information on "rallies, chapter and national events, member stories, technical tips, new products and accessories, and financial services." (www.Lehmantrikes.com, 2009) Lehman's website states, "Pride Matters is more than just a name, it is the oath we ride by. It doesn't matter what you ride or where you ride, always ride with pride." (www.Lehmantrikes.com, 2009) By having an accurate database of Lehman trike owners, Lehman has the opportunity to maintain regular contact with their current customers and possibly future customers. In May, 2009, Lehman had a list of over 2,000 in their Pride Owners group. (Lux, 2009)

Lehman has been successful in maintaining a premium price point for their products. The goals of Lehman are a consistent (reliable) product, brand leadership, and a premium price point. (Strilchuk C. , 2009) A brief overview of the strengths and weaknesses pertaining to Lehman Trikes follows:

Strengths: Lehman's strengths include strict dealer standards, thereby having more control over who represents the Lehman Brand. Currently there are 122 dealers worldwide, with 112 in the U.S. and the remainder in Canada, England, Germany, Japan and Guam. (Strilchuk C. , 2009) Lehman has been recognized by their competitors, customers, and Harley-Davidson for having state-of-the-art painting capabilities, thereby giving them a competitive advantage. Currently, the relationship that Lehman maintains with Harley and Victory place them in a very competitive position. In addition, they have established relationships with the leading manufacturers in the industry. The belief of Lehman and those in the industry is that the three

wheeled trike will provide aging baby boomers the opportunity to spend more years on the road after they are no longer capable of handling a traditional motorcycle.

Weaknesses: The contract with Harley-Davidson is currently a three year contract, with pricing renegotiated annually; Lehman is in the second year of the contract. The production demands of Lehman require that as volume increases, they expand their workforce and facilities to comply with the contract with Harley-Davidson. This short time frame potentially puts Lehman in a compromising situation. An additional weakness for Lehman is the size of the trike market. As the baby boomers move into their older years, there is no guarantee that future generations will have the same attraction to motorcycles and, accordingly, trikes as did previous generations. Is the current market for motorcycles and thus trikes going to disappear as the baby boomer generation passes through? This is a consideration for both Lehman and Harley-Davidson. Lehman's lack of diversification is also a weakness. Two other leading trike companies, Motor Trike and Champion, are diversified into the motorcycle trailer business.

COMPETITIVE ASSESSMENT

Lehman is the market leader in the trike industry. (Strilchuk C. , 2009) A conglomeration of the mom and pop shops make up the largest potential in the conversion kit market. Three companies would be considered competitors in the conversion kit market: California Side Car, Motortrike and Champion. Lehman has maintained a diversified product line with conversion kits, factory assembly, factory conversion and their agreement with Harley-Davidson. Currently the agreement with Lehman and Harley-Davidson is the only such agreement in the industry. Lehman was selected after an exhaustive search by Harley. Obviously Harley had been looking at the proliferation of trikes in the past 15 years and realized this could be a profitable niche. (Hines, 2009) According to Ken Hines, Lehman does not have any serious competitors. Hines believes the Japanese companies have been threatened by the previous mishaps with three-wheeled all terrain vehicles and, therefore, they do not appear to be a threat to Lehman.

In September, 2009, a blog posting by Jafrum discussed the perceived benefits of a three-wheeled motorcycle. The author's belief was that the increased size and stability of a three wheeled motorcycle as opposed to a two-wheeled motorcycle improves the feeling of safety. Added comfort and storage options come from the larger size of a three-wheeled motorcycle as well. To summarize the benefits of the three-wheeled motorcycle, the blogger stated, "For some people they simply want to be able to continue to enjoy the 'wind in your hair' feeling of a motorcycle but have some physical limitations that prevent them from riding a two wheeled motorcycle." (Jafrum, 2009)

California Sidecar (located in Arlington, VA) is considered to be one of the largest and most respected conversion manufacturers in the U.S. The trike conversion models they supply are Honda GoldWing GL 1800, Honda GoldWing GL 1500 and the Honda Valkyrie. According to triketraders.com, "California Sidecar conversions have an excellent record of performance, durability and safety and are one of the more affordable conversions on the market today!!" (www.triketraders.com, 2009)

Champion Trikes (located in Garden Grove, CA) is considered to be the “best overall bang for your buck as far as quality, durability, reliability, simplicity, style and performance.” The range of conversion kits extends further than that of California Sidecar, with models ranging from Honda GoldWing GL 1800, 1500 to Honda VTX, Harley Davidson FLST Softail, Harley Davidson FL Touring Series and the Yamaha Road Star. (www.triketradars.com, 2009)

Motor Trike (located in Troup, Texas) states the following about their trikes, “Superior strength, light weight – the closer you look, the more you will experience the differences that our engineering, manufacturing, and quality make in your trike.” The slogan for Motor Trike is “Motor Trike – Experience the Difference.” Motor Trike provides the broadest range of conversion kits, offering the “Trog” for the Harley Davidson conversion. Motor Trike is proud of the fact that they manufacture and test their products in house and are always available for tours. (Motortrike, 2009)

The latest addition to the three-wheeled market is the Can Am Spyder developed by BRP who are also the makers of Ski-Doo, Sea-Doo and Lynx snowmobiles. The Spyder is designed with three wheels, having two wheels in the front and one wheel in the back. Lehman does not perceive the Spyder as direct competition, given that it provides a uniquely different experience and different capabilities than the Lehman trike. “We see the product as broadening the market of three-wheel vehicles rather than carving out a piece of the market which already exists. While there is bound to be some overlap, we have really not needed to provide direct comparisons to those products as they have attracted a different buyer.” (Strilchuk C. , 2009)

HARLEY-DAVIDSON

Harley-Davidson Inc. (NYSE: HOG) is the parent company for a group of companies: Harley-Davidson Motor Company, Buell Motorcycle Company, MV Augusta and Harley-Davidson Financial Services. The company manufactures heavyweight motorcycles (engines of 651+cc) and parts, brand labeled general merchandise and clothing. The company was founded in 1903 by the Davidson brothers and William Harley. The company is headquartered in Milwaukee, Wisconsin, has 10,000 employees, and has eight unionized manufacturing facilities, the largest of which is in York, PA. In the United States, Harley sells through an independently owned network of 684 dealers. There are 74 independently owned dealers in Canada. (Harley-Davidson, 2009)

Harley-Davidson provides its dealer network with management training programs, service training, dealer software, advertising and promotional programs. Floor plan and customer financing are offered through Harley-Davidson Financial Services. The company also offers motorcycle insurance services to both dealers and riders. Harley’s 2009 model-year product line includes 35 models ranging from sport bikes to touring bikes to custom motorcycles. Retail prices range from \$6,999 for an 883 Sportster to \$35,999 for a Custom Ultraclassic Electraglide. (Harley-Davidson, 2009)

The agreement between Harley-Davidson and Lehman Trikes was hardly a relationship of equals. In 2008, Harley Davidson had revenues of \$5.594 billion, while Lehman Trikes had 2008 revenues of \$22.6 million. In a difficult year for Harley-Davidson, shipments of

motorcycles in the United States declined 13 percent from 2007, while the overall U.S. heavyweight market declined 7 percent. The stock markets judged Harley's performance harshly. The company's share price declined 63.7 percent in 2008 reflecting Harley's performance in a very challenging macro-economic environment. (Harley-Davidson, 2009)

But the worst was yet to come. In the midst of a worldwide recession and selling a product line heavily dependent upon discretionary income, Harley Davidson reported second quarter 2009 revenues decreased 30% globally from the prior year and decreased 35% in the U.S. This is compared to a quarterly sales plunge of 48% in the U.S. overall heavyweight motorcycle market. Harley-Davidson's net income for the second quarter was down to \$19.8 million from \$222.8 million in the prior year. "It is obviously a very tough environment for us right now, given the weak consumer spending in the overall economy for discretionary purposes," said Keith Wandell, the new CEO of Harley-Davidson. (Reed, 2009)

Additionally, Harley was executing a strategy for dealing with the economic downturn. This included a wholesale restructuring of management including a new CEO, COO and CFO as of April 2009. The cost structure was addressed by reducing 300 nonproduction positions and 1200 hourly production jobs. The Harley-Davidson Financial Services (HDFS) business of Harley-Davidson raised \$600 million from unsecured notes and applied for the U.S. Federal Reserve Bank's Term Asset-Backed Securities Loan Facility (TALF) program to be able to continue to supply financing for Harley's dealers. (Harley-Davidson, 2009) HDFS wrote down \$72.7 million in a credit loss provision on motorcycle loan receivables caused by rising credit losses resulting in a second quarter loss of \$62.7 million for HDFS. (Reed, 2009)

Harley-Davidson Income Statement Selected Data			
(In \$ Millions)	2009	2008	2007
Total revenue	\$4,781.9	\$5,971.3	\$6,143.0
Cost of revenue	3,353.8	3,957.7	3,816.8
Gross profit	1,428.1	2013.6	2,326.3
Selling & admin expense	979.4	984.6	900.7
Non Recurring expense	252.7	-	-
Income from operations	196.1	1,029.0	1,425.6
Interest expense	21.7	4.5	-
Income before taxes	178.7	1,033.9	1,447.8
Income taxes	108.0	379.3	513.9
Net income	(55.1)	654.7	933.8

Against this challenging economic backdrop, in the summer of 2008, Harley-Davidson chose to launch the Tri Glide simultaneously to all 684 U.S. dealers. The problem was that early demand far exceeded supply. Harley-Davidson customers interested in a three-wheeled motorcycle had long wanted a true Harley designed and Harley backed warranty on a trike. Following the launch, a leading Harley dealer was allocated only eight Tri Glides through May of 2009 with orders for twenty five. (Burgess, 2009) Both Harley-Davidson's and Lehman Trike's preparation for and reaction to the launch of the Tri Glide seemed cautious and tentative. Nonetheless, from 2008 through 2009, Lehman expanded their number of manufacturing employees 40% from 100 to 140 and anticipated additional hiring in the future. (Fugleberg, 2009) This is important to note because Lehman is a nonunion shop. In 2007, Harley-Davidson went through a painful three week strike by the machinists union. The resulting three year

agreement was for a 12% wage increase eventually reaching a maximum hourly wage of \$27.89. (Moore, 2007) Clearly Harley had the production capacity and expertise to produce the Tri Glide. Why would Harley-Davidson have chosen to outsource production of the Tri Glide line to Lehman-Trikes?

(In \$ Millions)	2009	2008	2007
Cash	\$1,630.4	\$593.6	\$402.8
Net receivables	1,885.2	419.6	2,641.1
Inventories	323.0	400.9	349.7
Total current assets	4,341.9	5,377.9	3,467.3
Total assets	9,155.5	7,828.6	5,656.6
Current liabilities	2,268.2	2,603.8	1,905.1
Long-term debt	4,114.0	2,176.2	980.0
Total liabilities	7,047.4	5,713.0	3,281.1
Shareholder equity	2,108.1	2,115.6	2,375.5

(Harley-Davidson, 2010)

LEHMAN TRIKE'S STRATEGY

For a relatively small company, Lehman is pursuing multiple strategies including product development, market development, market penetration, and strategic alliances. All strategies are basically focus strategies with the niche market focus of large engine trikes. Lehman's continued product development efforts are evidenced by the summer 2009 launch of the Victory Cross Bow. Lehman's product development is closely tied to the motorcycle manufacturer's release of new models. Lehman's vision is "To be the world's dominant three wheel motorcycle provider with unique culture and ethical practices that benefit our stakeholders." Their stated six ambitious goals:

- *Enhance brand recognition and loyalty.*
- *Expand production to meet anticipated sales.*
- *Increase product quality while decreasing costs.*
- *Increase shareholder value.*
- *Fully develop the North American market.*
- *Set and maintain the standards for the industry.* (www.Lehmantrikes.com, 2009)

Lacking in promotional resources, Lehman is largely looking to Harley-Davidson to develop the trike market. With Harley's direct participation in the trike market, the market gained immediate legitimacy and expanded to those riders who had been waiting for a Harley product with a Harley manufacturer's warranty. Lehman's dealer network also plays a role in market development as well as market penetration. Lehman's own promotional activities at events such as rallies also contribute to market development and market penetration.

Lehman's strategic alliance with Harley-Davidson is unique to Harley as well as the industry. As already mentioned, Lehman has entered into discussions with the major Japanese motorcycle manufacturers in an attempt to structure an agreement similar to the one with Harley, but so far to no avail. There are two key impediments to gaining the Japanese manufacturers' commitment to the trike market: their disastrous experience with three-wheeled ATVs and the accompanying law suits, and simply the current relative lack of volume in the trike market.

In 1987, the Japanese ATV manufacturers voluntarily agreed to discontinue manufacturing three wheeled ATVs for the US market citing the design flaws of the three-wheeled ATVs, which made them dangerous. Nonetheless, lawsuits continued as the manufacturers were not required to recall the over 2.4 million vehicles already sold. The Japanese aversion to litigation, no doubt, affected their assessment of the viability of the current trike market. (All Terrain Vehicles)

LEHMAN TRIKES FINANCIAL STATUS

Lehman Trikes financial status continued to show significant improvement in 2009. For the fiscal year ended November 30, 2009, Lehman reported revenues of \$33.4 million, a 48% increase over the same period in 2008. While revenue was up significantly, cost of goods sold was up 60% over prior year, reflecting the changing mix of the business model and the resulting lower margins on the Harley-Davidson trike business. “This is the cost of volume,” said Ken Hines, Lehman President. (Hines, 2009) Nonetheless management showed tight control of expenses, down 20% from the prior year. The resulting Comprehensive Income for the period was \$636.4 thousand, up significantly over the \$570.9 loss of 2008. The Balance Sheet also reflected improvement with cash up significantly to \$177.6 thousand from a prior year position of only \$12 thousand. Despite revenue growth of 48%, inventories were actually down 22% reflecting the fact that Lehman does not run the Harley provided components through cost of goods sold nor inventory. “We continue to improve cash management, inventory control and profitability,” said the CEO Ken Hines. (Lehman Trikes, 2009)

Lehman Trikes Selected Income Statement Data			
(In \$ Thousands)	2009	2008	2007
Net revenue	\$33,384.2	\$22,619.8	\$18,856.8
Cost of goods sold	28,442.5	17,674.8	13,357.2
Gross profit	4,941.8	4,944.9	5,499.5
General & admin expense	2,017.9	2,359.7	2,664.9
Selling & distribution	1,105.6	1,898.9	1,816.9
Interest	408.5	547.6	610.4
Total expenses	4,305.4	5,338.8	5,621.7
Other expense (plant closure)	-	(165.0)	(998.2)
Net Income (Loss) before income taxes	636.4	(558.9)	(998.2)
Income taxes	-	(12.0)	(0.1)
Net Income (Loss)	636.4	(570.9)	(998.3)
Lehman Trikes Selected Balance Sheet Data			
(In \$ Thousands)	2009	2008	2007
Cash	\$177.6	\$12.4	\$85.4
Receivables	1,771.2	2,249.0	1,401.7
Inventories	4,726.1	6,039.6	3,846.3
Total current assets	6,875.9	8,478.9	5,440.9
Total assets	10,224.2	12,044.0	9,019.0
Current debt	7,020.3	8,813.0	4,510.4
Bank debt	2,731.5	4,008.8	3,049.5
Accounts Payable	2,203.7	3,045.1	1,248.6
Total liabilities	7,344.9	9,801.1	6,913.4
Shareholder equity	2,879.2	2,242.9	2,105.6
(Lehman Trikes, 2010)			

Lehman was at a critical juncture in the continued development of their business model. The contract with Harley-Davidson to build the Tri Gide proved to be a boon for the overall business, even in the midst of a global recession, one which had a profoundly negative impact on the overall heavy motorcycle market. During this period, the growth of the Harley-Davidson agreement supply side (the “Harley side” as it became known internally) of the business more than offset the decline in sales volume of the non-Harley side. While new employees, primarily in manufacturing, were being hired to support the Harley business, employees on the Lehman trike assembly side were being laid off. As Lehman’s sales mix increasingly favored the Harley business, there was a subsequent decline in the relative mix of the non-Harley assembly side of the business. Lehman’s growth was becoming increasingly dependent upon the contract with Harley.

When asked what he worried about most for the future, CEO Ken Hines quickly responded, “The Harley contract ... it comes up for repricing every year and the threat of them opting to not execute the full term of the contract will keep you up at night.” (Hines, 2009) What should Lehman do? The Harley relationship was becoming the major engine for growth, but at the expense of the non-Harley business. As the Tri Glide side of the business continued to grow faster, would Lehman face an increasing risk of over dependence on the Harley contract? Should Lehman redouble their efforts to sign a similar agreement with one or more of the Japanese manufacturers? Another strategic possibility Hines mentioned was for Lehman to build a Lehman branded trike of their own design, maybe with the cooperation of an engine manufacturer. Is the market too immature and undeveloped to consider this strategy? What would this do to the relationship with Harley?

From Harley-Davidson’s standpoint, were the supply agreement with Lehman Trikes and the sales of the Harley trikes meeting their expectations? If the trike market continues to flourish, should Harley-Davidson acquire Lehman, or should they simply let the contract with Lehman expire and begin producing trikes themselves?

EPILOGUE

Harley-Davidson’s third quarter financial results showed some improvement. Sales of Harley-Davidson motorcycles declined 21% compared to prior year third quarter, an improvement from the 30.1% decline in the second quarter. However, net income declined 84.1% from the year-ago quarter, reflecting lower motorcycle shipments and the effect of the economy. Harley management also announced its “go-forward” business strategy. A key element of this strategy was to focus efforts and resources on the Harley-Davidson brand by leveraging Harley’s unique strengths and through continuous improvements, to improve productivity and profitability. Taking a chapter out of the U.S. automaker’s restructuring efforts, as part of the new focus strategy Harley also announced that they would be discontinuing the Buell product line and divesting the MV Augusta business. They also announced a “two-path” study to restructure their York, PA manufacturing facility, which would require major concessions from the unions, or to relocate those operations to a new non-union plant in Kentucky. (Harley-Davidson, 2009)

On December 3, 2009 Harley-Davidson announced that the unions at their largest factory in York, PA had agreed to job cuts of 50%, more work-rule flexibility, and a seven-year agreement. The agreement also created a new category of “casual” workers who would earn 30% less and would work as needed, depending on seasonal production and covering absences. From a workforce of 1,950 hourly workers, the restructured workforce would consist of 750 full-time unionized employees and 250 unionized “casual” employees. The agreement also called for job classifications being cut from 60 down to five allowing workers and teams to do more and significantly different tasks. In addition to productivity savings of up to \$150 million a year, “The agreement is designed to allow York to resize and become more flexible and efficient”, said Harley spokesman Bob Klein. (Maher, 2009)

In a major blow to Lehman Trikes, on January 16, 2010, officials announced that “Harley-Davidson will no longer use the Spearfish based manufacturer to assemble its trikes. Harley-Davidson officials said the move was due to the motorcycle company’s restructuring its York operations.” Offering further explanation, Lehman CEO Ken Hines said, “Harley-Davidson has advised us they will be moving the trike assembly in-house to their York, PA production facilities for the 2011 models”. Julie Chichlowski of Harley-Davidson said, “Our decision to move trike assembly is based purely on the restructuring of Harley-Davidson’s York operations, which now provides the opportunity for us to build trikes in house and streamline trike assembly and distribution.” (Pioneer Staff Reports, 2010) For Lehman Trikes, the alliance with Harley had truly become a “Story Within a Story.”

With the Harley-Davidson business being the growth engine of the past two years for Lehman Trikes, will they be able to recover from this major loss of business? The timing of the recovery of the economy and the resultant impact on freeing up discretionary spending will have a significant impact on Lehman’s future business model. Can Lehman restructure their manufacturing operations to reflect a lowered critical mass of sales to less than half the volume at the time of the Harley announcement? The economy and significant management decisions facing Lehman Trikes will have a profound impact on their future.

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