SWATCH AND THE GLOBAL WATCH INDUSTRY[1]

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In early June 1999, the management of the Swatch Group could be satisfied with the company's accomplishments over the last 15 years. Thanks to its 14 brands and unusual approach to marketing, and with 116 million finished watches and movements produced in 1997, the Swatch Group had helped resuscitate the Swiss watch industry and become, in value terms, the world's largest watch manufacturer. Despite an enviable track record, there was a growing sense of anxiety over the future of the company in an industry that seemed to be in a perpetual state of change.

EARLY HISTORY

Until 1957, all watches were mechanical. The aesthetics of the exterior visible elements (dials, hands and case) as well as the reliability and accuracy of a traditional timepiece depended on the meticulous care and precision that had been

dedicated to its manufacturing and assembling processes. Mechanical watches consisted of between 100 and 130 components that were to be fitted together in the ébauche (winding stem, gear train) and regulating parts (mainspring, escapement, balance wheel). Most expensive watches contained at least 15 jewels (very hard stones such as synthetic sapphires or rubies that had been drilled, chamfered and polished), which were inserted in places that were most subject to metal wear. The tiny dimensions of a watch case did not leave much room for approximation, and watchmakers were required to have a great deal of micro-mechanical engineering expertise, craftsmanship spirit, patience, experience and ingenuity.

By most accounts, the first reliable pocket watch was invented in 1510 by Peter Henlein, a locksmith from Nuremburg, but the promising art of watchmaking in Germany was rapidly killed by the Thirty Years War (1618 to 1648). Starting in the late 1500s, the development of the watchmaking industry in Europe traced its roots to the flight of protestant Huguenots who were driven out of France by a series of religious persecutions. The Huguenots found refuge in Geneva, bringing with them skills in numerous handicrafts. For centuries, Geneva had been a centre of ornate jewelry making, but it was left with little industry after John Calvin's famous *Sittenmandate* edicts against luxury and pleasure had progressively put an end to the goldsmiths' activities in the city. Looking for a new source of income, and with their knowledge of metals, skills in jewelry making and artistic flair, many Genevan goldsmiths embraced the watchmakers' profession.

As they were becoming more and more numerous, watchmakers decided to regulate their activities, and incorporated into a guild in 1601. The development of the industry in Geneva and the surrounding Jura mountains was rapid. By 1686, there were 100 masters in Geneva; 165 in 1716; and 800 in 1766 employing some 3,000 people. By 1790, Geneva exported more than 60,000 watches throughout Europe. Many of the Genevese moved north along the French frontier in the Vallée de Joux, Neuchatel and La Chaux-de-Fonds (see Exhibit 1).

The emergence of the watch industry in Switzerland was a blessing for the local farmers who could extract only modest agricultural revenues from their mountainous terrain. In fact, many families—who had been educated through a close-knit system of community schools—were looking for an additional source of income, particularly during the long and snow-filled winters. Thanks to advances in new machine powered watchmaking tools, individual Swiss families began to specialize, some in the production of single components, others in assembly. The small size of watches and watch components allowed for relatively easy transportation from mountain farms and villages to commercial centres.

Swiss watches were sold exclusively through jewelry and up-scale department stores, which were also fully responsible for repair and after-sales services. Watches were purchased as lifetime investments and were often handed down from generation to generation. Swiss watches found ready acceptance throughout Europe and later in the U.S., in part because of their promotion by jewellers who saw them as a source of ongoing revenues through their repair services.

In the 18th and 19th centuries, English competitors were a constant challenge for the Swiss who undertook serious efforts to overcome early British supremacy. First, the Swiss invested in education and training, establishing several watchmaking academies at home and watch-repair schools in major foreign markets. Second, and to strengthen their image internationally, they created a "Swiss made" label, which would become by 1920, an important symbol of quality, style and prestige. Third, the Swiss significantly improved process technology, setting up the world's first mechanized watch factory in 1839. British watchmakers made no attempt to mass manufacture watches until much later. Seeing mass production techniques as a threat to their craft, they persuaded Parliament to pass a law barring the use of specialty production tools in the British watch industry, and devoted

Exhibit 1 Watch Production in Switzerland

Source: FH, Federation of the Swiss Watch Industry.

themselves to the production of very expensive marine chronometers. As a result, the British watch industry steadily declined during the 19th century, while the Swiss industry was on its way to achieving world dominance, thanks to significant advances in design, features, standardization, interchangeability of parts and productivity. In 1842, Adrien Philippe introduced complicated watches featuring perpetual calendars, fly-back hands and/or chronographs. Other early Swiss names included Beaume & Mercier (1830), Longines (1832), Piaget (1874), Omega (1848), Movado (1881) and Rolex (1908).

The U.S. watch industry appeared in the middle of the 19th century. Local production consisted of high-volume, standardized products manufactured in machine-driven factories. U.S. watches—such as the US$1 *Turnip* pocket watch introduced under the Ingersoll brand name by the Waterbury Clock Company—were cheap but also of very poor quality. Anyone who wanted a "real" watch bought Swiss.

In the early 20th century, the hard economic times (collapsing sales and soaring unemployment) following the First World War, led to a profound reorganization of the Swiss watch industry. Almost 2,500 distinct watchmaking firms grouped together into three associations, namely the Federation of the Swiss Watch Industry (FH) in 1924, the Ebauches SA in 1926, and the group Union des Branches Annexes de l'Horlogerie (UBAH) in 1926. The associations agreed to co-ordinate activities (for example, watch components had to be bought from members of the associations only) and maintain high prices. The Swiss Laboratory for Watchmaking Research

(CEH) was also founded in 1924, with the objective of strengthening the country's technological advantage. Finally, and in response to the world depression at the time, the Swiss government pushed several important watch assembly firms to form a holding company, ASUAG, in 1931.

Postwar Competitive Changes (1945 to 1970)

By 1945, the Swiss accounted for 80 per cent of the world's total watch production, and 99 per cent of all U.S. watch imports. Swiss watch production was divided among nearly 2,500 distinct companies, 90 per cent of which employed fewer than 50 people. Despite the 200-year dominance of Swiss watchmaking companies, much would change in a short period of time.

U.S. Competitors

The main source of competition for the Swiss arose from two American watchmakers, Timex and Bulova. Using a combination of automation, precision tooling and simpler design than that of higher-priced Swiss watches, U.S. Time Corporation introduced in 1951 a line of inexpensive (US$6.95 to US$7.95), disposable, yet stylized and highly durable Timex watches, whose movements had new hard alloy bearings instead of traditional and more expensive jewels. Hard alloy metals allowed for the creation of durable watches at lower costs than jewelled lever timepieces. They also allowed U.S. Time to more effectively automate its production lines, further lowering costs.

Traditional jewellers were very reluctant to carry the brand for a variety of reasons. Its prices and margins were slim compared to those offered by the Swiss, while the watches' riveted cases could not be opened, thereby eliminating the possibility for jewellers to generate aftersales repair revenues. Locked out of jewelry stores, Timex had no choice but to innovate in its marketing and distribution strategy. Their first extensive worldwide advertising campaign on television, "Took a licking and kept on ticking," was to become a legend in marketing history. Consumer demand soared after John Cameron Swazey, a famous news U.S. commentator, was featured in live "torture tests" commercials emphasizing the watch's low cost and incredible durability. The disposable aspect of Timex watches (no local repair involved) pushed the company to develop new distribution channels, including drugstores, discount houses, department stores, catalogue showrooms, military bases and sporting goods outlets. By 1970, Timex (having changed its name from U.S. Time) had established a manufacturing and/or marketing presence in over 30 countries and become the world's largest watch manufacturer in terms of units sold.

Bulova was the leading U.S. manufacturer of quality, jewelled-lever watches. Integrating the highly accurate tuning fork technology bought from a Swiss engineer in 1959, after the main Swiss companies had turned down the technology, Bulova introduced *Accutron* in 1962. Five years later, *Accutron* was the best selling watch over $100 in the U.S. Bulova also formed a partnership with Japan's Citizen Watch Company to produce the movements for the *Caravelle* line, designed to meet the low-cost/high quality challenge imposed by Timex. By 1970, Bulova had expanded its international presence all around the world, and become the largest seller of watches, in revenue terms, in both the United States and the world overall.

Japanese Competitors

Like the U.S. industry, the Japanese watch industry was highly concentrated. In 1950, three main competitors, K. Hattori (which marketed the Seiko brand), Citizen and Orient accounted for 50 per cent, 30 per cent, and 20 per cent of the Japanese market respectively. Their positions were protected by the 70 per cent tariff and tax sales imposed on all imported watches by the Japanese government.

As the Japanese market became saturated in the 1960s, Hattori and Citizen moved aggressively into other Asia Pacific countries. After first exporting from Japan, Hattori and Citizen established component and assembly operations in low cost Hong Kong, Singapore and Malaysia. With hundreds of millions of unserved consumers, the region was also a highly attractive market. From a position of strength in Asia, the Japanese watch companies began in earnest to push into Europe and North America.

The Swiss response to the growing power of U.S. and Japanese competitors was limited. In 1962, the Swiss FH and ASUAG created a research organization, the Centre Electronique Horloger (CEH) to develop a competitive alternative to the tuning fork technology patented by Bulova. These efforts were unsuccessful, in part because of only lukewarm support from member companies. A rising worldwide demand for watches did little to slow the steady decline in the Swiss share of the world market (from 80 per cent in 1946 to 42 per cent in 1970).

Changing Technologies (1970 to 1990)

The advent of light-emitting diodes (LED) and liquid crystal display (LCD) watches constituted a true revolution in the world of watchmaking, as they allowed the digital display of time. In 1970, Hattori Seiko became the first to develop and commercialize a quartz watch named *Astron*, based on LED technology.

Despite their novelty, LED watches had many flaws. A button had to be pushed to activate the display of LED watches, a process that consumed a lot of electrical energy and wore out batteries quickly. Additionally, most people felt that LEDs were distracting and inconvenient to use. In 1973, Seiko introduced the world's first LCD quartz watch with six-digit display and by the late 1970s, LCDs dominated the digital segment. However, digital watches remained largely plagued by quality problems, and consumers never fully embraced the style. Quartz analogue watches, which involved a more delicate manufacturing, and conserved—with their hands and gear train—the traditional appearance of mechanical timepieces, increasingly gained consumers' acceptance. By 1984, over 75 per cent of all watches sold around the world were based on quartz technology, versus only three per cent in 1975. The large majority of quartz watches were analogue.

Quartz watches used an integrated circuit, made up of numerous electronic components grouped together on the basis of a few square millimetres. Extremely accurate, thanks to their high frequency of vibrations (32 kHz), they were accurate to less than one second per day. Generally more sophisticated—in terms of functions—than their mechanical counterparts, they were also far less expensive to manufacture. The average production cost of a standard quartz watch fell from US$200 in 1972 to about US$0.50 in 1984, the cost of components being constantly driven down by the main U.S. chipmakers such as National Semiconductor and Texas Instruments.

Faced with soaring international competition, the Swiss abolished all internal regulations in 1981, and the industry began to consolidate. Many firms merged in an attempt to leverage their marketing and/or manufacturing capabilities. The largest operation resulted in the creation of the Société Suisse pour L'Industrie Horlogère (SSIH), which controlled brands such as Omega and Tissot, among others.

The Japanese Industry

Convinced that technologically sophisticated watches could allow Swiss prices at Timex costs, Hattori Seiko and Citizen made important efforts to promote the new quartz technology. Large investments were made in plant and equipment for fully automated high-volume production of integrated circuits, batteries and LCD panels. Hattori's production lines were designed to produce up to 1,000,000 watches per year per product line. Manufacturing/assembly facilities were set up all around the world (Japan, the

United States, western Europe, Australia, Brazil, Hong Kong, Korea, Mexico). To ease the transition, employees were retrained, relations with distributors were reinforced, and advertising budgets were increased.

By 1979, Hattori produced about 22 million watches annually and became the world's largest watch company in terms of revenues, with sales approaching US$1.2 billion, versus only US$503 million for the Swiss ASUAG. Citizen launched the world's first wristwatch movement with a thickness of less than one millimetre in 1978, and became the global leader in both movement and finished wristwatch production volumes in 1986.

Casio entered the watch market in 1974 with a digital model priced at US$39.95. Its subsequent low-cost, multifunction digital plastic watches were rapidly fitted with gadgetry such as timers and calculators. By 1980, the company had captured 10 per cent of the Japanese digital watch market, and became the world's second most important player in the under US$50 world watch market, behind Timex.

Hattori, Casio and Citizen were largely integrated companies. Most operations, from the production of movements and components to the assembly and distribution of finished watches, were carried out through wholly owned subsidiaries and/or majority joint ventures. In 1980, Japan produced about 67.5 million watches, up from 12.2 million in 1970.

The U.S. Industry

U.S. competitors were relatively slow to get on the electronic bandwagon. Neither Bulova nor Timex's facilities easily allowed the production of quartz crystal or integrated circuits. In fact, they were rapidly becoming obsolete in light of those new technologies sweeping the industry. In addition, Timex was struggling with management problems as Mr. Lehmkuhl—who had run the business for almost 30 years with no clear successor—fell ill and could no longer work. Nevertheless, both companies finally entered the quartz watch market in the mid-1970s, sourcing their quartz components from a variety of suppliers and backing their product lines with full-scale advertising and promotion campaigns. The Timex model was priced at US$125, which was 60 per cent below Seiko's least expensive watch on the market at that time.

About 100 semiconductor firms such as National Semiconductor, Texas Instruments (TI), and Litronix, were also attracted to the promising market for digital watches and circuits for electronic movements in the mid-1970s. Most started as suppliers of quartz movements and components, then invested in high-volume, fully automated watch-manufacturing plants. The belief was that their huge existing distribution channels for consumer electronics products would give them a strong competitive advantage. Watches were introduced at very aggressive prices (TI's retailed at $19.95 in 1976 and $9.99 in 1977). In 1978, TI's digital watch sales reached $100 million, for a pretax profit of US$28 million. However, stagnant demand coupled with continuous price wars and numerous distribution problems led all semiconductor firms to exit the market one by one. In the end, most customers felt uncomfortable buying watches in electronic stores where the semiconductor firms had a distribution advantage.

The price wars following the arrival of these semiconductor firms were also largely detrimental to the main U.S. watchmaking companies. Although it was constantly underpriced by Texas Instruments, Timex turned down a number of propositions to form manufacturing partnerships with several chipmakers. Some observers argued that Timex was probably too proud to accept the idea of co-operation. Timex lost US$10 million in 1980, being surpassed by Seiko as the world's largest watch manufacturer company (both in units and total sales), while its share of the U.S. market fell to under 33 per cent. The two other U.S. players remaining in the industry were not in a much better situation. Bulova experienced three years of significant losses before being purchased by Loews Corporation; Hamilton lost $15 million in 1970 and went bankrupt in 1978: the

Pulsar rights were bought by Seiko and the remaining assets purchased by SSIH.

Watchmaking Activities in Hong Kong and Korea

By the end of the 1970s, Hong Kong had become the highest volume producer of timepieces in the world. Japanese, American and European watchmakers had all established assembly plants (mechanical, digital and quartz analogue watches) in the city to take advantage of highly skilled, cheap labor and favorable tax conditions. Numerous local semiconductor firms had also engaged in the production of low-cost digital quartz watches that were then distributed through local retail chains and department stores, or exported, mainly towards mainland China.

The timepiece industry in Korea also experienced considerable growth in the 1970s. By 1988, the country's total watch exports amounted to US$39 million, along with a rising reputation in the eyes of the world for quality assembling capabilities.

The Hong Kong and Korean watch industries benefited from their flexible manufacturing systems, capable of handling small quantity orders in different styles. However, downward pressures on prices and low profit margins discouraged local watch producers from investing in technology and branding.

The Swiss Industry Responds Slowly

Although the Swiss pioneered quartz technology, they were particularly reluctant to adopt the new technology. Contrary to the Japanese, their industry structure was very fragmented and, therefore, not adapted to high-volume mass production procedures. Besides, electronic watches were regarded as being unreliable, unsophisticated, and not up to Swiss quality standards. Consequently, digital and analogue quartz watches were regarded as just a passing fad, and in 1974, accounted for only 1.7 per cent of the 84.4 million watches exported from Switzerland. Instead, the Swiss focused on the high-end, mechanical segment of the industry, where traditional craftsmanship remained the deciding factor.

As SSIH and ASUAG regularly increased prices to maintain profitability, foreign competition rapidly established a strong foothold in the low and middle price ranges where the Swiss were forced to abandon their leadership, virtually without a fight. Compounding the problems faced by the Swiss, the U.S. dollar more than halved its value against the Swiss franc during the 1970s. The appreciating Swiss franc effectively raised the export prices of Swiss watches (see Exhibit 2).

The Swiss industry experienced a severe crisis in the late 1970s and early 1980s. Its exports of watches and movements decreased from 94 million in 1974 to 43 million in 1983, while its world market share slid from 43 per cent to less than 15 per cent during that same period. Employment fell from 90,000 (1970) to 47,000 (1980) to 34,000 (1984) and bankruptcies reduced the number of firms from 1,618 to 860 to 630 respectively. These competitive changes resulted mainly from the seeming inability of the Swiss to adapt to the rapid emergence of new watch technologies.

	1950–1970	*1971*	*1972*	*1974*	*1976*	*1978*	*1980*
Swiss Franc	4.37	4.15	4.15	3.58	2.89	2.24	2.18

Exhibit 2 Exchange Rate to the U.S. Dollar (Annual Average)

Source: International Monetary Fund Yearbook of Statistics.

Near Death Experience

In the early 1980s, Swiss watch production hit an all time low. SSIH and ASUAG faced liquidation and a profound restructuring of the Swiss industry became necessary. The Swiss government provided financial assistance and initiated the "electronic watch" program in 1978 to promote new technologies as well as the production of electronic watch components in Switzerland. But this initiative was not sufficient, and in 1981 SSIH reported a loss of SFr142 million, giving the company a negative net worth of SFr27.4 million. The Swiss creditor banks—which had just taken over the country's two largest watchmaking groups—were getting ready to sell prestigious brand names, such as Omega, Tissot or Longines to the Japanese. But Nicolas Hayek, the already well-known founder and CEO of Hayek Engineering, a consulting firm based in Zurich, was convinced he could revive the Swiss industry and regain lost market share, primarily in the lower-end segment. He invested $102 million—mostly his own money—and led a group of 16 investors in buying back the two groups, before orchestrating their merger in 1983.

SMH and Swatch

Hayek teamed with Dr. Ernst Thomke to head the new group, Société Micromécanique et Horlogère (SMH). After the merger, SMH owned many of the country's famous watchmaking names, such as Omega, Tissot, Longines and Rado. Five years later, the group had become the world's largest watchmaking company. Its first product initiative, Swatch, was to become an enormous commercial success, as well as the main instrument behind the revitalization of the entire Swiss industry.

The Swatch mania marked the 1980s for the Swiss industry. The Swatch (contraction of "Swiss" and "watch") was conceived as an inexpensive, SFr50 (US$40), yet good quality watch, with quartz accuracy, water and shock resistance, as well as a one-year guarantee. The concept was challenging. Particular efforts were needed to reduce production costs down to Asian levels. Watch engineers slashed the number of individual parts required in the production of a watch from 91 to 51, and housed them in a standardized plastic case that could be produced on a fully automated assembly line. For the first time ever, it became possible to produce cheap watches in high cost Switzerland. By 1985, production costs were decreased to under SFr10 per unit, and only 130 people were needed to assemble the first eight million Swatch models. By comparison, 350 people were still required to assemble 700,000 Omega watches.

Swatch was an immediate success. Within two years of its 1983 launch, sales were averaging 100,000 units a months, for a cumulative total of 13 million sold. In 1985, Swatch accounted for over 80 per cent of SMH's total unit sales, and by 1989, just six years after its debut, the company had placed 70 million Swatches on customers' wrists.

Marketing was key to the watch's success. Franz Sprecher, an independent consultant, and Max Imgrüth, a graduate of New York's Fashion Institute of Technology, helped SMH position the watch as a lifestyle symbol and fashion accessory, not as a traditional timekeeping instrument. With their trendy and colorful designs, models were created for every occasion.

Initially, the media appeared to be mesmerized by Hayek's charismatic style and unusual approach to marketing. This resulted in lots of free media coverage and publicity. The company also spent liberally on special events and public relation activities. SMH budgeted about SFr5 million per Swatch product line per year in promotional money, and used celebrity endorsements extensively. Swatches were sold through nonconventional channels of distribution such as discount houses and department stores, where variety and low prices constituted the main selling points. Swatch made a few attempts to diversify, but its line of accessories (casual clothing and footwear, umbrellas, sunglasses, and cigarette lighters) experienced mixed success and was discontinued in 1988.

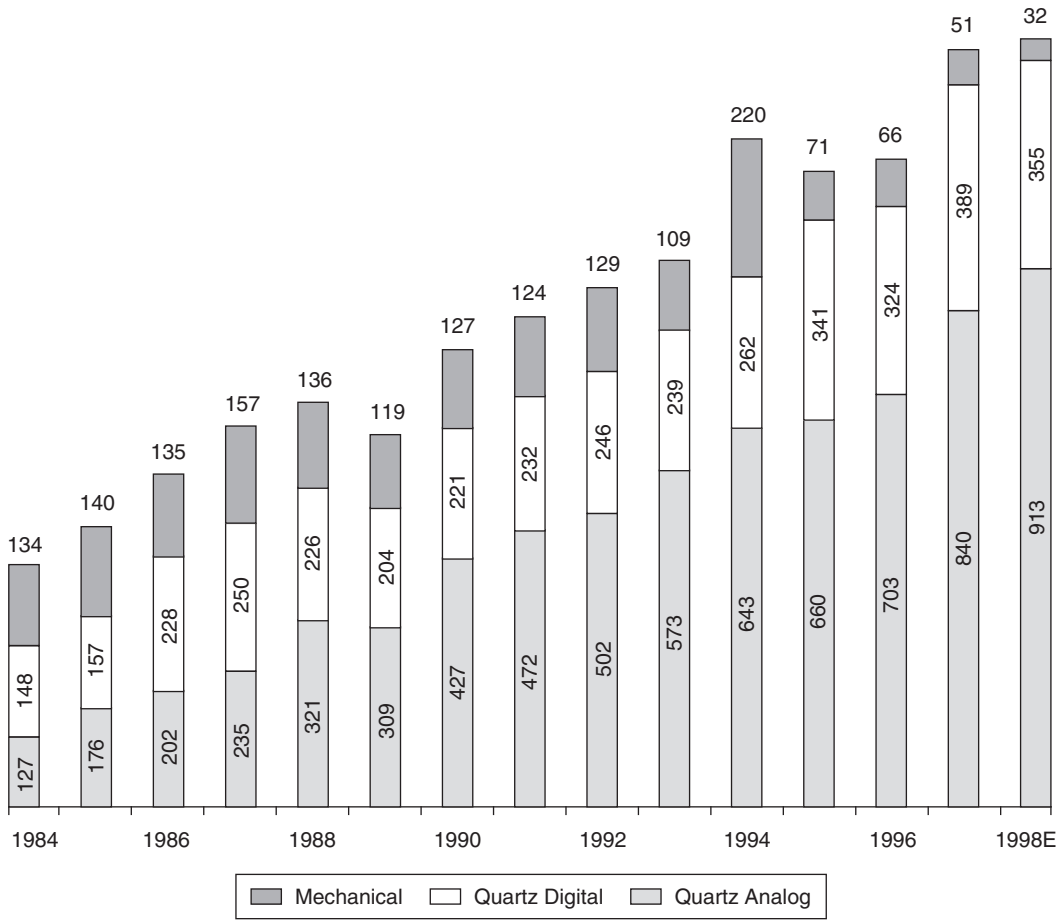

Exhibit 3 Global Watch Production; 1984 to 1998

Source: FH, Federation of the Swiss Watch Industry, and Japan Clock and Watch Association

Competing in Real Time (1990s)

Global watch production grew steadily in the 1990s, at a rate of about four per cent per annum, and reached 1.3 billion watches in 1998, equivalent to 22 per cent of the world's population (see Exhibit 3). The production of mechanical watches (and to a lesser extent, that of digital watches) gradually decreased over the years, while that of analogue quartz watches rose 11 per cent per year on average. In 1998, quartz watches—digital and analogue—accounted for about 97 per cent of the worldwide industry's production in volume. On average, annual watch purchases were about one unit per person in North America, and 0.6 unit per person in Europe and Japan. Together these three regions—which accounted for 14 per cent of the world's population—generated about 56 per cent of global watch demand (see Exhibit 4).

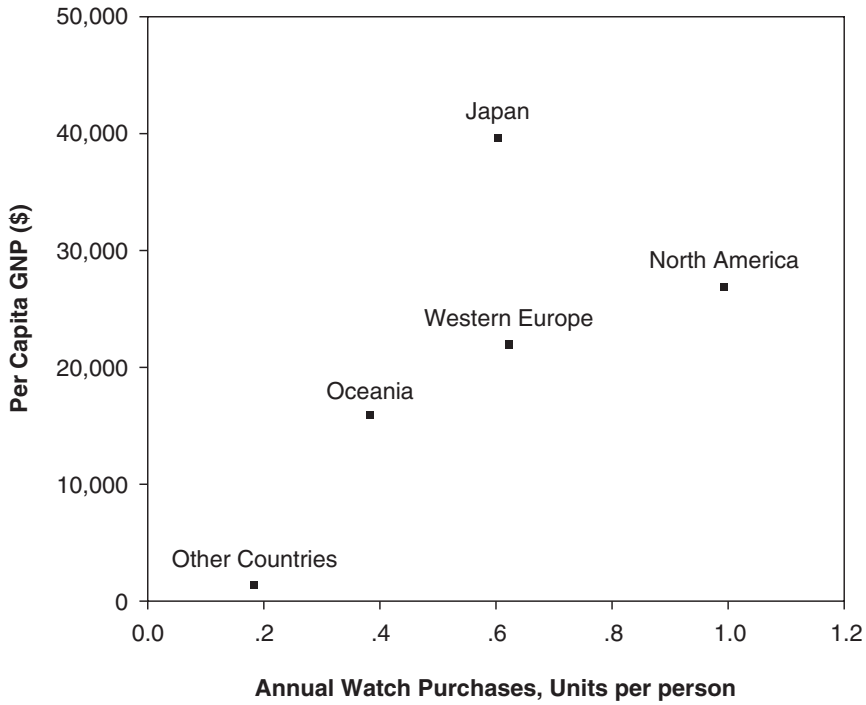

Exhibit 4 Per Capita GNP and Annual Watch Purchases, by Region

Source: Japan Clock and Watch Association, United Nations Demographic Yearbook, The World Bank.

Industry Restructuring

The global watch industry experienced downward profit pressures in the 1990s, as many watchmakers incessantly cut prices—driven in part by a push for economies of scale. Overcapacity and tough head-to-head competition led prices of basic watch movements to be slashed by over 30 per cent in 1998 alone. By the end of the decade, consolidation had reduced the number of watch movement manufacturers from 30 to just three (the Swatch Group—having changed its name from SMH—as well as Seiko and Citizen). The achievement of a critical mass was becoming a necessity to compete globally in all segments of the industry.

Several types of internal reorganizations allowed companies to realize economies of scale and/or maintain profitability. These included:

Restructuring Initiatives

Many watchmaking companies reacted to declining prices in their core business by increasing productivity and shifting manufacturing overseas. With the exception of the Swatch Group, most watch companies manufactured in Southeast Asia exclusively.

Pursuing Acquisitions

In tune with its strategy to reinforce its position in the luxury or prestige brands, the Swatch Group acquired Blancpain in 1992, thereby also taking control of Frederic Piguet, a company admired for its complex, high-quality mechanical movements. In January 1999, the Swatch Group purchased the total shares of Favre and Perret, the highly reputed producer of quality

Swiss watchcases. As another example, Gucci, the luxury Italian company, acquired Severin Montres, its 23-year Swiss watch manufacturer, for $150 million in November 1997. The following year, Gucci's watch sales increased by 160 per cent to $60.1 million. "There is no question that Gucci is destined to become more than a shoe and bag business," said De Boisgelin, an equity analyst with Merrill Lynch in London.[2]

Accessing New Distribution Channels

Watchmakers traditionally used independent agents to sell products around the world. However, increasing difficulties controlling the merchandising and pricing policies used by local retailers led many of them to alter their strategies. In 1997, the Swatch Group opened 61 new free-standing Swatch stores (mostly operated as franchisees), bringing the total to 120 (including five megastores) in more than 20 countries. Despite the risks involved, the strategy was promising: sales at New York's Swatch Time Shop boutiques approached 100,000 units in 1998, up 32 per cent over 1997. By taking over 85 per cent of its distribution network, Tag Heuer increased its gross margins from 45 per cent to 65 per cent, which more than offset the cost of running local subsidiaries. According to CEO Christian Viros, the move allowed "greater control of our destiny, better control of the implementation of our marketing programs, better understanding of local issues, and greater reactiveness to new developments."[3]

Creating New Niche Products

Despite ongoing consolidation, there was a viable place for niche companies with clearly defined brands and images. By the late 1990s, Switzerland had about 600 watchmaking companies, employing 34,000 employees, in addition to the big four (The Swatch Group, The Vendôme Luxury Group, Rolex and Tag Heuer), which together accounted for 75 per cent to 80 per cent of Swiss industry turnover. As examples of niche players, St. John Timepieces entered the industry in 1997 with a collection of Swiss watches specifically designed for sophisticated women, retailing from $450 to $18,000. Breitling scarcely deviated from the aerial image it established in 1884. In 1999, it equipped Breitling Orbiter 3's pilots, Bertrand Piccard and Brian Jones, with wristwatches for their successful, first nonstop 26,602 miles balloon flight around the world.

Increasing Advertising

The overabundance of supply in the industry implied that watchmakers had to find ways to distinguish their offerings from those of their competitors. Advertising expenditures reached unprecedented levels. In the 1990s, 40 per cent of the value of all Swiss advertisements in international media promoted wristwatches, not banking institutions. Seiko's 1998 *Electricity* campaign was backed with a 60 per cent increase in media spending, while Timex allocated about US$8 million in 1999 to market its *Turn 'n' Pull* Alarm watches.

Huge advertising budgets were not, per se, a guarantee of success. The campaigns also needed to be creative in order to get consumers' attention. Companies turned down conservative ads in favor of eye-popping, humorous, and thought-provoking messages that obtained an emotional reaction from viewers. For example, Bulgari formed a one-year partnership with Alitalia, Italy's national airline, to have a personalized Boeing 747 fly around the world with a three-dimensional image of its latest cutting-edge aluminum timepiece painted on the fuselage. Audemars Piguet's ad crusade, "Who is behind an Audemars Piguet Watch*?*" featured mysterious men and women showing off their watch faces while their own faces remain obscured. Other watchmakers tried to get exposure in action-packed movies such as *Men in Black* and *Lethal Weapon 4* (Hamilton), James Bond (Omega), or *Armageddon* (Tag Heuer). Strong marketing muscle was also put behind sports partnerships. For example, Tag Heuer and Hugo Boss had long been associated with Formula One auto racing, and Spanish-based Festina with cycling events such as the Tour de France.

Emphasizing Quality

Faced with strong competition from independent, low cost Asian producers, many European and U.S. watchmakers chose to gradually reposition their brands in the upper market, and proposed increasingly expensive and sophisticated watches. According to the Federation of the Swiss Watch Industry, the average price of a Swiss wristwatch, taking account of all materials, rose from US$132 in 1996 to US$157 in 1997. A growing number of customers were becoming aware of quality and increasingly wanted a watch with lasting value.

Emphasizing Technology

The end of the 1990s looked promising in terms of technological breakthroughs. Bulova's *Vibra Alarm* watch featured dual sound and vibrating alarms. In Seiko's *Kinetic*, an oscillating weight was set in motion by the slightest movements of the wearer's arm ("If you're going to create electricity, use it!"). Timex's *DataLink* pioneered the utilization of wristwatches as wearable information devices. Following Timex's lead, various watch manufacturers introduced multifunctional watches that could be interfaced with personal computers. Other manufacturers designed watches with built-in global positioning systems (Casio, Timex), or offered fast, customized and reliable access to Internet services.

Accentuating Fashion

Another noticeable trend was the entry of fashion house designers. By 1999, and partly thanks to the Swatch revolution, people increasingly believed that they were judged by what they wore on their wrists. Fashion designers strove to create new watch brands to meet every one of their possible fashion needs. Some decided to put their signatures on stylized watches produced in co-operation with major specialist manufacturers. Examples included Emporio Armani (Fossil), Calvin Klein (The Swatch Group), Guess (Timex) and Yves St Laurent (Citizen). Others, such as Bulgari, Hermes, and Dior set up their own in-house manufacturing operations. "We have very high expectations for this side of the business," said Guillaume de Seynes, director of Hermes Montres. "Watches are already our fourth biggest product in sales terms after leather, silk, and ready-to-wear. We've made a significant investment in the new factory because we expect even faster growth in the future."[4]

Developments in the Hong Kong and Japanese Industries

In the late 1990s, Hong Kong was the world's dominant centre for watch assembly. In 1998, about 80 per cent of all watches produced worldwide were assembled in the city (see Exhibit 5).

Japanese watch manufacturers saw their combined domestic and overseas watch production rise about 14 per cent per year in the 1990s. Particularly strong in the sports watch segment, the Japanese offered an impressive range of multifunction chronographs for virtually any type of outdoor activity, including diving, mountain climbing and flying. However, sales and profitability deteriorated between 1993 and 1996 due to a rapid appreciation of the yen. In addition, the average unit price of analogue quartz movements fell by nearly 50 per cent to ¥234 in the first half of the decade, and by over 30 per cent in 1998, as major companies boosted production. This collapse severely shook the industry, and many manufacturers, such as Orient Watch, had to exit the market. Throughout the last half of the 1990s, Seiko and Citizen began cutting production in order to hold prices firm.

Citizen maintained its world's volume leadership with 2,500 new models released every year and 311 million timepieces produced in 1997 (about 25 per cent of the world's total and 36 per cent of the global market for analogue quartz watches). Sales were mainly dependent upon Japan (38 per cent), Asia (32 per cent), America (15 per cent) and Europe (14 per cent). Two new collections—the light-powered *Eco-Drive* watches and the affordable luxury *Elegance Signature* dress watches—marked the company's desire to

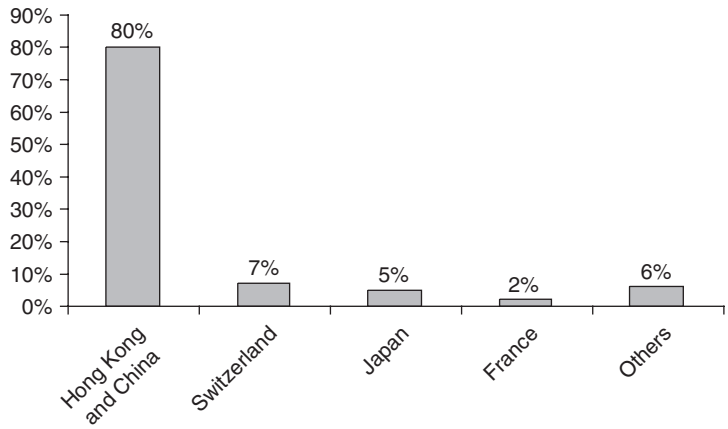

Exhibit 5 World Production of Finished Watches: 500 Million Pieces (1997)
Source: Federation of the Swiss Watch Industry

move from traditional sports watches towards more sophisticated or expensive timepieces.

Seiko introduced a few technological marvels in the early 1990s, such as the *Perpetual Calendar* watch, with the first built-in millennium plus (1,100 years) calendar, *the Scubamaster*, with the first integrated computerized dive table, and the *Receptor MessageWatch*, with paging functions and built-in antenna that allowed access to specialized information services and incoming alphanumeric messages. In 1995, Seiko introduced the *Kinetic* series, backed with a $20 million advertising campaign. The futuristic line became the driving force behind the company's growth in the late 1990s, accounting for 25 per cent of Seiko's $3 billion global sales. Great hopes were also placed on *Kinetic*'s lower-cost cousin, the $200 *Pulsar* solar-powered quartz watch, which was launched at the end of 1996.

Casio enjoyed a significant expansion of its wristwatch division, thanks to the successful launches of the *G-shock* and *Baby-G* product lines. The company was particularly strong in the U.S. (second largest market share after Timex), but also heavily dependent on domestic Japanese sales, which made up two-thirds of total *G-shock* and *Baby-G* sales. A depressed Japanese economy in the late 1990s had a profound negative effect on the company's profits, which were estimated to drop from ¥38 billion in 1998 to ¥19 billion in 1999.[5]

THE U.S. INDUSTRY

The biggest single watch market in the world was also the one with the largest trade deficit. In 1991, exports amounted to $73.4 million compared to an import total of $1.84 billion. Thanks to a factory in Little Rock, Arkansas, Timex was the only U.S. watch company with any domestic production in the late 1990s.

Timex

From sports watches and classic styles to watches featuring *Star Trek* and Walt Disney characters, Timex offerings strove to address a variety of consumer trends in the 1990s. The production of watches for Guess, Timberland, Nautica, and Reebok further emphasized Timex's willingness to reach a mass audience. Two innovations distinguished the company. The first was the durable, multi-function *Ironman Triathlon* watch, named after the gruelling annual Hawaiian sports event. Initially positioned as an instrument for serious athletes, the watch rapidly appealed to a wider audience of pedestrian

Timex	30.6%	Gitano	2.0%
Casio	7.8%	Gucci	1.9%
Seiko	7.4%	Swatch	1.6%
Guess (Timex)	5.0%	Rolex	1.1%
Armitron (Gluck)	4.5%	Movado	1.0%
Citizen	4.0%	Tag Heuer	0.8%
Fossil	3.5%	Hamilton (Swatch)	0.7%
Pulsar (Seiko)	3.1%	Tissot (Swatch)	0.7%
Lorus (Seiko)	2.5%	Omega (Swatch)	0.5%
Bulova	2.2%	Rado (Swatch)	0.2%

Exhibit 6 Share of Purchasers by Brand in the U.S. Market—1999

Source: Euromonitor.

customers. By late 1990s, it was the word's best selling sports watch with more than 25 million units sold since its 1986 introduction. The second was *Indiglo*, a patented luminescent dial technology launched in 1992, and credited with more than doubling the company's sales by 1994. *Indiglo* received considerable attention in 1993 after a group of people trapped in the World Trade Center bombing had been led to safety by an *Indiglo* owner, who guided them down 34 flights of pitch-black stairs through the glow of his Timex watch. Other technological innovations rapidly followed, with Timex *DataLink*, a $139 wristwatch allowing wireless transfer to and from a desktop PC, and *Beepwear*, a $160 alphanumeric pager wristwatch developed and commercialized in partnership with Motorola.

Timex's annual sales exceeded $600 million in the late 1990s, one-quarter of which came from the U.S. market where the company remained the top selling watch company, far ahead of its main competitors. By 1999, with a 30 per cent market share in its hands, Timex had sold more watches in the U.S. than the next five competitors combined (see Exhibit 6). However, the huge majority of these watches were manufactured in Asia.

New Entrants in the 1990s

By the early 1990s, mainland China and India had emerged among the fastest growing watch markets in the world. With a combined population of 2.1 billion people, these markets could not be ignored, especially after a series of government decisions to liberalize trade and investment in those countries. A number of reputable watchmaking companies had established a presence in India and mainland China, despite the threat of counterfeiting (about 50 per cent of wristwatches sold in those markets were either counterfeited or smuggled in). Most came in via the trading route, appointing local distributors such as Dream Time Watches in India. This strategy was ideal for the Swiss, who could capitalize on the well-appreciated label "Swiss made." Others such as Timex, Seiko and Citizen established their own production facilities, often in co-operation with key local partners.

Titan Industries was probably one of the most remarkable industry success stories of the 1990s. The group was established in 1987, with a greenfield investment of $130 million from giant Indian conglomerate Tata Group and the government of Tamil Nadu state, where Titan built one of the world's biggest integrated watch factories, near India's technological centre Bangalore. Constantly scanning the world for best practices, Titan sourced designs and technology from France, Switzerland and Germany, watchstraps from Austria, and cases from Japan. This world-class strategy created a remarkably successful company. During its first year of operation, 750,000 high-quality finished timepieces were produced and, in 1997, the company enjoyed a

dominant 60 per cent share of the organized Indian watch market, with pretax profits amounting to US$7.5 million on turnover of US$96 million. Titan's management believed the company had little choice but to internationalize, partly to defend its own domestic position. Mr. Desai, Titan's vice-chairman and managing director commented on the need to globalize: "India is being globalized and the whole world is now turning up in India. So the kind of protection we've enjoyed will go. It's going to get very crowded."[6] By 1997, the company exported over 600,000 watches annually and had established offices in Dubai, London, New York and Singapore. However, by the end of the 1990s and despite the company's recent $20 million advertising campaign, it was difficult to predict international success. Seducing consumers into buying $120 to $700 Indian-made wristwatches was challenging given the country's poor reputation for the quality of its exports.

THE SWISS INDUSTRY IN THE LATE 1990S

In the late 1990s, watch production in Switzerland was the country's third most important industry behind the chemical-pharmaceutical and electronic industries. In 1998, 34 million timepieces were produced in Switzerland for a total value of SFr8.2 billion.[7] Of those, 90 per cent were exported, positioning the country as the world's leading exporter—in value—of finished watches (see Exhibit 7).

The Swiss industry had the ability to provide consumers with a comprehensive choice of products in all market segments. Whatever their needs and preferences (mechanical versus quartz technologies; diamond set watch of precious metals versus stainless steel, plastic or ceramic; classic appearance versus trendy design), consumers could always find a "Swiss made" solution when shopping for their wristwatches. Of course, the Swiss industry stood apart in the upper market range where its watches had gained an unequalled reputation for quality, styling, reliability and accuracy. In 1998, the average price of watches exported by Switzerland was SFr235, four times higher than the average of the world industry (see Exhibits 8 and 9). The "Swiss made" label remained one the oldest examples of a registered and fiercely protected national branding name, which could be used only on watches and clocks containing at least 50 per cent Swiss-manufactured components by value.

The Vendôme Luxury Group accounted for about 20 per cent of Swiss industry turnover, privately-held Rolex for 15 per cent, and Tag Heuer—which sold over 673,000 units in 1997, for seven per cent. The Swatch Group was the main player with a third of industry turnover. Thanks to its 14 brands (Blancpain, Omega, Rado, Longines, Tissot, Calvin Klein, Certina, Mido, Hamilton, Pierre Balmain, Swatch, Flick Flack, Lanco, and Endura), the group had gained a presence in all price and market categories.

Swiss watches were sold all around the world. Exports to the United States increased by more than 10 per cent in 1998 for the third consecutive year. Sales in Europe were also on the rise, especially in Spain (+41.3 per cent), Italy (+18 per cent) and France (+16 per cent). In Asia, the ongoing economic crisis depressed demand and put downward pressures on prices (the demand in Hong Kong, Singapore, Thailand and Taiwan dropped by 23 per cent or SFr500 million in 1998). In 1997, Tag Heuer saw Asian sales drop by 21.4 per cent from SFr130 million to SFr102.9 million, accounting for the brand's overall 5.4 per cent decrease.

The Swatch Group

In value terms, the Swatch Group was the world's leading manufacturer of watches (14 per cent share of the world market). In 1998, the Swatch Group increased its gross sales and net profits by 7.1 per cent and 7.5 per cent respectively. With a growth averaging 15 per cent to 25 per cent per year, Omega had been a major profit driver for the group (see Exhibit 12), thanks to a successful repositioning strategy initiated in the early 1990s. To rejuvenate the brand, cheaper, silver-plated gold was used to replace more

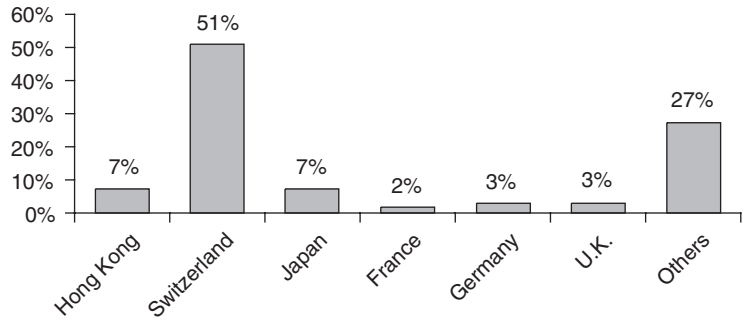

Exhibit 7 World Production of Finished Watches in Value Terms: 16 Billion Swiss Francs (1997)

Source: Federation of the Swiss Watch Industry.

	Turnover in SFr. Million	*Market Share*
Rolex	2,200	28%
Vendôme*	1,540	20%
Swatch Group**	1,000–1,100	14%
Gucci	620	8%
TAG Heuer	470	6%
Patek Philippe	250	3%
Bulgari	215	3%
Chopard	195	3%
Jaeger LeCoultre	180	2%
Audemars Piguet	120	2%
Other (Ebel, IWC, Breguet,. . .)	910	12%
Total	**7,750**	**100%**

Exhibit 8 Luxury, Prestige and Top Range: Global Market Players (1998)

Source: Bank Leu estimates, Vendôme Group Data.

*(Cartier, Piaget, Vacheron and Constantin, Beaume & Mercier)
**(Blancpain, Omega, Rado, Longines)

expensive metals (platinum, titanium, solid gold and special steel alloys). The company also streamlined its models from 2,500 to 130 representing four distinct product lines. Other major initiatives consisted of integrating distribution and launching a new advertising campaign (with Cindy Crawford, Michael Schumacher, Martina Hingins and Pierce Brosman as high-profile "ambassadors"). The strategy was quite successful and with an average price point 50 per cent lower than its main competitor, Rolex, Omega seemed to have plenty of room to grow.

Despite the success of the Omega brand, the Swatch Group was facing several issues. Management problems were plaguing the organization. Key figures such as Klaus Schwab, a

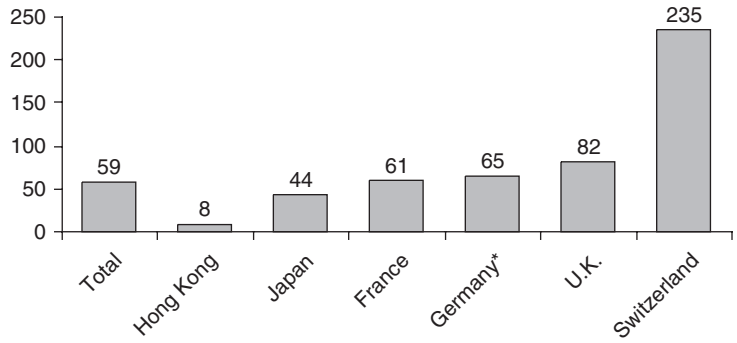

Exhibit 9 Average Price of Watches in 1998 (In Swiss Francs)

Source: Federation of the Swiss Watch Industry.

	Units	*%*	*Value*	*%*	*Swatch market share*
Mass (under $50)	124,653	78%	2,056	34%	9%
Middle market ($50–299)	31,840	20%	2,219	37%	4%
Upper/Luxury ($300)	2,705	2%	1,771	29%	21%
Total	**159,198**	**100%**	**6,046**	**100%**	**11%**

Exhibit 10 U.S. Market and Swatch group's Market Share—1999

Source: Dresdner Kleinwort Benson estimates.

professor at the University of Geneva and founder of the World Economic Forum in Davos, Drs. Stephan Schmidheiny, Pierre Arnold and Walter Frehner all stepped down from the board of directors in the mid-1990s. Several managing directors also left the group in the last two years. Hayek's management style was resulting in growing criticism in the company. Dr. Ernst Thomke, a former partner, had less-than-flattering comments about Hayek: "He has to be the big boss alone, and can never share opinions. He was a consultant all his life and he wanted to become a marketer and product developer. But he never learned that job."[8]

The Swatch Group was also experiencing persistent difficulties in establishing a strong foothold in the U.S. market, where it faced stiff competition from Timex, Casio, Seiko and Citizen. Even the Swatch Group's role as the official timekeeper of the 1996 Summer Olympic Games in Atlanta failed to significantly boost interest in the company's offerings. Although, the group generated about 19 per cent of its sales in the U.S. its market share in the basic and middle-priced segments was particularly weak (see Exhibits 6 and 10). Finally, its highly successful and emblematic Swatch brand appeared to be at a crucial crossroads.

The brand had sold a total of 200 million watches since its introduction in 1983. A Collectors' Club (100,000 members worldwide) was founded in 1990 to create an international link between fans around the world. Limited edition watches, special events, and the quarterly *Swatch World* journal also contributed to reinforce the value of the brand. Demand rapidly

exceeded supply for a number of special launches and collectors started to compare the rarity of their collections, to trade and to speculate around Swatches during auction sales. In the early 1990s, it looked as if Swatch's expansion had no limit. So great was management's confidence that the group even decided to actively contribute to the development and market introduction of the small ecological smart car.

Despite the growing interest of many, Swatch sales had plateaued at 18 million to 20 million units a year. In 1998, sales and profit margins were well below the levels achieved in the early 1990s as Swatch was facing increased competition from the likes of Fossil and Guess. One concern was whether there were too many Swatch products on the market. Another concern centred on the product mix. Many young Swatch fans of the past wanted more expensive and sophisticated watches as their incomes increased. A proliferation of products also led to a growing problem with Swatch distributors. Many retailers were dropping Swatch from their shelves. The number of stores selling the trendy watch decreased from 3,000 in the early 1990s to 1,200 in 1998. For Steven Rosdal, co-owner of Hyde Park Jewelers, expressed the views of some retailers: "Swatch came out with more products than the market could bear, and the consumers seemed to back off. I guess if you use the word 'fad' for anything, it could be used for Swatch."[9]

The group was undertaking several steps to revamp and differentiate the brand. First, Swatch was trying to reposition itself from a low-margin, high-volume business involved in day-to-day fashion watches to a high-margin, high-volume enterprise focusing on watches fitted with state-of-the-art electronic gadgetry. As an example of its repositioning efforts, it launched the *Access* watch in 1995, which could be programmed to function as a pass to access ski lifts, hotel chains, public transport and numerous other applications. Although the watch had yet to achieve its commercial potential, there were promising signals: Swatch equipped the Lisbon universal exhibition with one million units and about 200 ski resorts in some 17 countries. Also, with assistance from German Electronics giant Siemens, Swatch developed *Swatch Talk*, a Dick Tracy type wristwatch with an integrated mobile telephone. Finally, Swatch created the *Swatch Beat,* as a completely new global concept of time, as well as a whole new area of market potential. With *Swatch Beat*, time was the same all over the world "No Time Zones, No Geographical Borders." People using the same clock could agree to a phone call at "500," without time zone arithmetic required. The day was divided into 1,000 units (each one being the equivalent of one minute and 26.4 seconds) with a new BMT meridian created in Bienne, home of the Swatch Group.

As a second initiative, Swatch launched a new advertising campaign ("Time is what you make of it") designed to reinforce the brand's primary message ("Innovation, provocation, fun. Forever.") Sponsorship was primarily focused on new and youth-oriented sports or events with an offbeat lifestyle, such as snowboarding, mountain biking, bungee jumping, and rock climbing.

However, in October 1998, Swatch sold its minority 19 per cent shareholding of Micro Compact Car, the vehicle producer, to manufacturing partner Daimler-Benz. Although the group was still looking for key partners to develop the hybrid electric *Swatchmobile,* management made it clear that its core business remained the watch industry and microelectronics.

Strategic Decisions

In early June 1999, Hayek was under growing pressure to clarify the company's strategy. Many observers and shareholders were wondering whether the original management philosophy that shaped the company's success remained viable.

Conventional wisdom suggested that all watch companies should locate manufacturing activities in countries that offered low-cost production solutions. The Swatch Group had always remained committed to its Swiss home base, leaving the bulk of its technology, people and manufacturing in the isolated villages

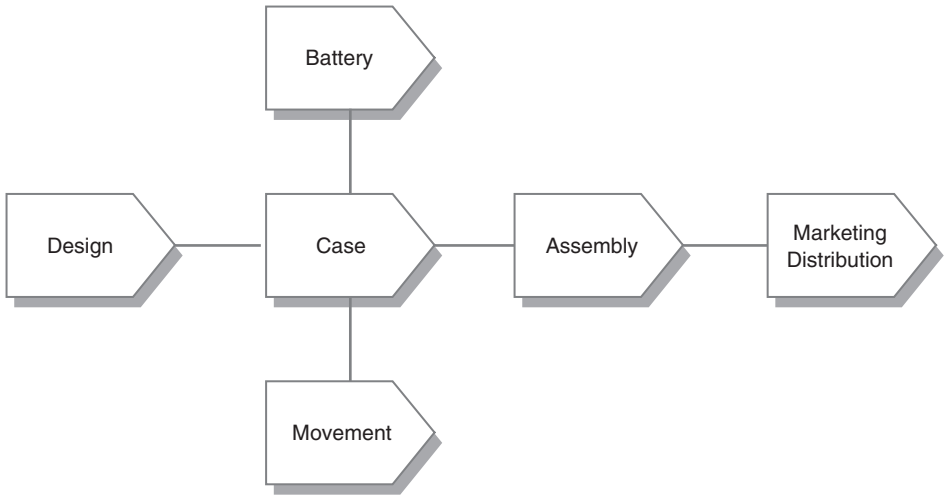

Exhibit 11 Watch Production and Value Added Chain

	Units in thou.	*Average price in SFr**	*Turnover in SFr. million*	*% of total*	*EBIT in SFr. million*	*% total*	*Margin in %*
Omega	550	1,200	670	28%	147	47%	22%
Swatch	26,000	36	925	38%	79	25%	9%
Tissot	1,600	100–150	210	9%	20	6%	10%
Rado	300	570	170	7%	31	10%	18%
Longines	550	270	150	6%	23	7%	15%
Calvin Klein	600	130	75	3%	4	1%	5%
Blancpain	10	6,500	65	3%	6	2%	9%
Other	1,500	80	145	6%	3	1%	2%
Total	**31,110**	**80**	**2,410**	**100%**	**312**	**100%**	**13.0%**

Exhibit 12 The Swatch Group's Turnover and Margin Estimates for 1998

Source: Bank Leu estimates.

*Factory gate price

surrounding the Jura Mountains. Those places possessed hundred years of experience in the art of watchmaking. Employees had spent generations in the factories controlled by the Swatch Group, where they developed a special feel and touch for this business along with a true sense of organizational commitment. However, the company's junior secretaries in Switzerland earned more than senior engineers at competitors in Thailand, Malaysia, China or India. Maybe it was time to move on and stop building watches in one of the most expensive countries in the world. But which, if any, of the value-added chain activities should be moved (see Exhibit 11)?

With its huge domestic demand and low-cost labor, India offered interesting sourcing opportunities. Many industry analysts believed that Titan Industries was looking for key foreign partners,

after the demise of an early alliance with Timex. Would a partnership with a company like Titan make sense, or if and when the company were to move, should it go it alone?

Another trend management had to address was the movement of many watch companies into ever-more narrow or differentiated market niches. The Swatch Group was present in all market segments and price categories, but its performance depended mainly on four brands names, Omega, Swatch, Tissot and Rado, which together accounted for 82 per cent of total sales and 88 per cent of operating profit in 1998 (see Exhibit 12). Perhaps it was time to reorganize the company's portfolio. Advertising budgets had already been reallocated towards the luxury and high-tech markets, where the company was also constantly looking for key partners and acquisition targets. However, for many industry observers, this product market strategy (luxury-high tech and/or globalization) was becoming too complex for the company's internal capabilities, as indicated in the failure of the smart car project.

NOTES

1. This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of the Swatch Group or any of its employees.
2. Women's Wear Daily, March 20, 1998.
3. Chief Executive, 1998.
4. Financial Times, April 24/25 1999
5. In June 1999 US$1 = ¥119
6. Financial Times London Edition. Financial Times. September 10, 1997; 43.
7. In June 1999, SF 1 = US$0.66.
8. Time, March 28, 1994.
9. Jewellers' Circular-Keystone, December 1998

THUNDERBIRD
THE GARVIN SCHOOL OF INTERNATIONAL MANAGEMENT

WHIRLPOOL CORPORATION'S GLOBAL STRATEGY

Prepared by Meredith Martin, Simon Algar, and Vipon Kumar
under the supervision of Professor Andrew C. Inkpen

We want to be able to take the best capabilities we have and leverage them in all our companies worldwide.

—David Whitman,
Whirlpool CEO, 1994, Quoted in
the *Harvard Business Review*

In 1989, Whirlpool Corporation (Whirlpool) embarked on an ambitious global expansion with the objective of becoming the world market leader in home appliances. Beginning with the purchase of a majority stake in an appliance company owned by Philips, the Dutch electronics firm, Whirlpool purchased a majority stake in