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YOUNGME MOON

The Birth of the Swatch

Ten years ago, the people on the original Swatch team asked a crazy question: Why can't we design a striking, low-cost, high-quality watch and build it in Switzerland? The bankers were skeptical. A few suppliers refused to sell us parts. They said we would ruin the industry with this crazy product. But the team overcame the resistance and got the job done.

—Nicolas Hayek[1]

In 1993, Swatch was the best-selling watch in the history of the watch industry. In 1992 alone, it sold 27 million units, while cumulative sales surpassed 100 million units (see **Exhibit 1**). In addition, it was widely acknowledged that the entire Swiss watch industry had been on the brink of disaster when the Swatch had been introduced 10 years ago; the phenomenal success of the Swatch was considered by many to have been a key factor in its resurgence.

At the management level, much of the credit for the turnaround had been directed toward Nicolas Hayek, CEO of the Societe Suisse de Microelectronique et d'Horlogerie (SMH), which controlled nine global Swiss brands including Swatch. Over the past 10 years, Hayek had led the way for the success of the Swatch by committing SMH to a business strategy that in many ways defied industry wisdom about how global watch companies should be run. This strategy was based on a strict commitment to vertical integration (the company assembled all of the watches it sold and built most of the components for the watches it assembled), decentralized marketing (each of SMH's nine brands had total authority over product designs and marketing), and portfolio management (SMH's goal was to have a competitive brand in every price segment in the market).

Industry Background

Prior to the 1950s, watchmaking was a craft that required the skills of a master jewelry maker combined with the expertise of a micromechanical engineer. A watch typically consisted of a meticulously crafted mechanical movement[2] with more than 100 separate components that had been

[1] All quotations in this case are reprinted by permission of *Harvard Business Review* from "Message and Muscle: An Interview with Swatch Titan Nicolas Hayek," by William Taylor, March–April 1993, pp. 99–110. Copyright © 1993 by the Harvard Business School Publishing Corporation; all rights reserved.

[2] A "movement" is the set of components that comprises the "guts" of a watch. Movements can either be mechanical or electronic.

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assembled with great care and precision. The better the watch, the more jewels it contained; these jewels—usually synthetic rubies, sapphires, or other hard stones—enabled the watch to withstand years of mechanical wear.

Watches were often considered to be financial investments; as with fine heirlooms, it was not uncommon for them to be handed down from one generation to the next. They were typically enclosed in beautifully constructed casings made from precious metals and were sold primarily through jewelers and upscale department stores; in fact, watch repair was an ongoing source of revenue for these retailers.

The Swiss dominated the watch industry, in large part because of their centuries-long history of jewelry-making expertise. Watchmaking was a source of national pride, and the "Made in Switzerland" label was a global seal of quality, status, and prestige. Around the world, the general public consensus was that the only "good" watches were Swiss watches.

By 1945, there were close to 2,500 Swiss watchmaking firms, 90% of which employed fewer than 50 people. Some of the most well-respected Swiss watch brands included Beaume & Mercier (established in 1830), Longines (1832), Omega (1848), Piaget (1874), Movado (1881), and Rolex (1908). Altogether, the Swiss accounted for 80% of the world's total watch production and 99% of all U.S. imports.

The Emergence of Low-Cost Competition

In 1951, a company called U.S. Time introduced a line of disposable watches bearing the Timex brand name. During World War II, the company's wartime efforts had resulted in the development of a way to produce low-cost mechanical movements that used hard alloy metals in place of jewels. These new alloy bearings not only lowered the cost of goods, they made automated production easier, further lowering costs.

Timex watches were very simply designed and used cheap exterior materials that gave the devices a strictly functional appearance. The watches could not be opened, so after-sales repairs were impossible; however, because Timex watches were priced so low (between $6.95 and $7.95), the company was able to market them as being disposable. An extensive television advertising campaign was launched in support of the product's introduction. The ads—which used the now-classic tagline, "It takes a lickin' and keeps on tickin'"—used a series of "torture tests" involving often absurd stunts (e.g., a Timex being spun for seven days in a vacuum cleaner, a Timex taped to a giant lobster's claw)[3] to communicate the durability of Timex watches despite their low price point.

Traditional jewelers had no interest in carrying Timex watches. They were priced too low, they lacked the precious metal exteriors of Swiss watches, and because they eliminated the need for repair, they generated no after-sales revenues. Timex was thus forced to look elsewhere for distribution, ultimately selling its watches through a variety of low-priced outlets such as drugstores and discount houses.

By the end of the 1950s, one out of every three watches bought in the United States was a Timex, and by 1970, Timex (having changed its name from U.S. Time) was selling more watches (in terms of units) than any other manufacturer in the world. At about the same time, several Japanese

[3] Other examples of these torture tests included a Timex strapped to Mickey Mantle's baseball bat, a Timex frozen in an ice cube tray, a Timex wrapped around a turtle in a tank, a Timex taped to the propeller of an outboard motor, a Timex tumbling over the Grand Coulee Dam, and a Timex being held fist first by a diver leaping 87 feet from the Acapulco cliffs. Many of the ads starred John Cameron Swayze, one of the most popular television news personalities of the 1950s.

companies—including Hattori-Seiko and Citizen—had taken over the Japanese market. After successfully expanding into other parts of Asia, these Japanese watch manufacturers were now pushing into Europe and North America as well. The result was that, even as worldwide demand for watches grew, the Swiss share of the global market declined, from 80% in 1946 to just 42% in 1970.

The Introduction of Quartz Technology

In 1970, the introduction of quartz technology changed the nature of competition in the watch industry once again. Unlike mechanical movements, quartz movements used an integrated circuit made up of numerous electronic components, resulting in a watch that was comparable in accuracy to Swiss-made mechanical watches (accurate to less than one second per day). Quartz watches had a couple of other advantages over mechanical watches. First, because they were based on electronics, they generally allowed for more sophisticated functionality than their mechanical counterparts—for example, in addition to providing the time, they could easily provide the date and day of the week. Second, they were not only significantly cheaper to manufacture, their costs of production were constantly being driven down by chipmakers such as National Semiconductor and Texas Instruments.

Some quartz watches incorporated a digital display; however, the most popular were analog watches that used gold or silver plating to mimic the traditional appearance of their more expensive, Swiss-made mechanical counterparts. Leading the production of quartz watches were Japanese manufacturers, in particular, Hattori-Seiko and Citizen, both of which had made huge investments in building fully automated, high-volume facilities around the world (e.g., in Hong Kong, Korea, Brazil, and Mexico) for the manufacture and assembly of quartz watches. They were soon joined by Casio, which specialized in producing low-priced, multifunctional, plastic digital watches that incorporated features such as timers and calculators. As Hayek recalled:

> Throughout the 1970s, as companies in Hong Kong assembled hundreds of millions of cheap watches, Japan made investments to supply them with movements. They built big factories and slashed prices. A movement used to cost, on average, between $8 and $20. Today it costs between $2 and $5. The Swiss couldn't play that game. . . . We were uncompetitive on cost. We just didn't have the volume.

By 1979, Hattori-Seiko was producing 22 million watches annually and had become the world's largest watch company in terms of revenues. In the under-$50 category, Timex was still the world leader (although it had lost tremendous ground in the above-$50 category to Seiko), followed by Casio. By 1984, more than three-fourths of the watches sold around the world were based on quartz technology (most were manufactured in Hong Kong), and by 1986, Citizen had become the overall global leader in both movement and finished watch production volumes.

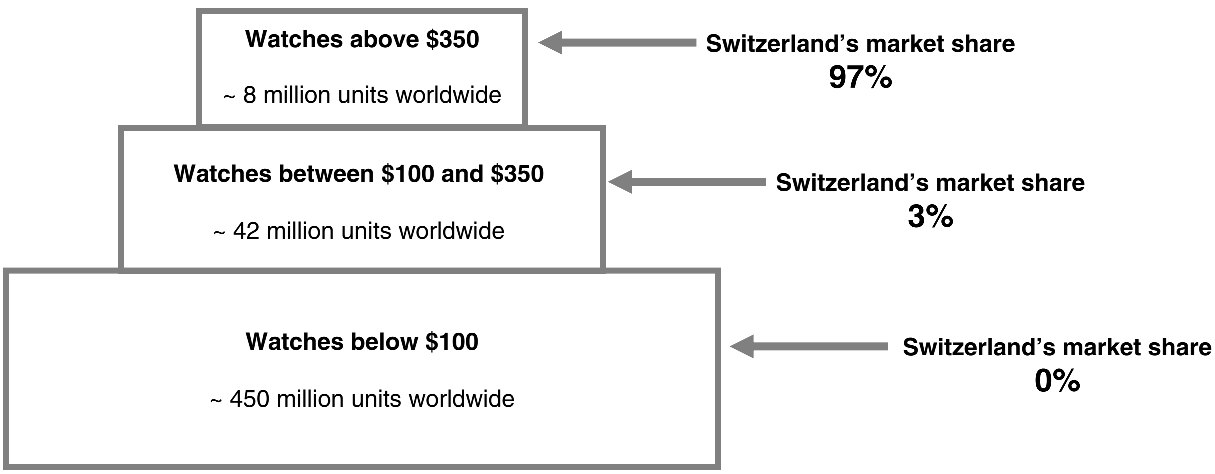
The Swiss Watch Industry in Free Fall

The rise of quartz technology hastened the decline of the Swiss watch industry. Ironically, the Swiss had pioneered quartz technology; however, Swiss watchmakers had refused to embrace quartz based on the belief that electronic watches were unreliable, unsophisticated, and beneath Swiss quality standards. Because the common perception was that quartz watches were a passing fad, the Swiss had remained committed to producing high-end mechanical watches that required traditional craftsmanship. Now, as Japanese watchmakers saturated the global market with quartz watches at rock-bottom prices, Switzerland found itself unable to compete.

For its part, the Swiss watch industry was dominated by two companies. The first was ASUAG, a holding company formed in 1931 consisting of some 100 separate companies, including Rado, Tissot, and Longines. The second was SSIH, a private watch company formed in the 1980s that controlled brands such as Omega and Tissot. By 1983, both of these companies were losing millions of dollars, and Switzerland's unit share of the world watch market had fallen to less than 15%.

In order to maintain profitability, SSIH and ASUAG had regularly increased prices, which had only furthered Switzerland's isolation at the upper segment of the market (see **Figure A** below). Hayek said, "The Swiss spent much of the 1970s reacting to quartz by retreating: 'Why should we compete with Japan and Hong Kong? They make junk, then they give it away. We have no margin there.' Of course, as we retreated, the Japanese moved up to the next layer of the cake. Then the retreat would start again."

Figure A The Three Major Price Segments in the Worldwide Watch Industry in the Early 1980s



Source: *Harvard Business Review*, March–April 1993, pp. 99–110.

SMH: Hayek Takes Over

In 1983, both SSIH and ASUAG faced insolvency, and their Swiss creditor banks were considering selling some of their most prestigious watch brands to the Japanese. However, Nicolas Hayek, the founder and CEO of a Zurich-based consulting firm called Hayek Engineering and the banks' chief advisor on the nation's watch industry, recommended that the bankers merge the two companies instead. Hayek became CEO of the merged entity and eventually assembled a group of investors to buy a controlling stake in the company, Societe Suisse de Microelectronique et d'Horlogerie (SMH). The new company now controlled many of the world's best-known watch brands, including Omega, Tissot, Longines, and Rado. Hayek described the situation when he took over:

> [It was a] chaotic jungle. An absolute mess. Most people who analyze the destruction of the Swiss watch industry in the 1970s emphasize price and technology. They point to the arrival of hundreds of millions of cheap quartz watches from Japan and Hong Kong and our decision to ignore quartz, a technology we invented. But we had huge problems beyond technology. There were problems of strategy, structure, management. . . . SSIH had no discipline and no strategy.

> . . . ASUAG owned more than 100 separate companies—some big, some small, some modern, some backward. Most of these companies did their own marketing, their own R&D, their own assembly. It was crazy.

Hayek right began executing a shift in the company's strategy: "I decided we could retreat no longer. We had to have a broad market presence. We needed at least one profitable, growing, global brand in every segment—including the low end." He continued:

> This is not a commodity competition. Let's say you have three similar watches. One says "Made in Japan" and sells for $100. Another says "Made in Switzerland" and sells for $110. A third says "Made in Hong Kong" and sells for $90. Which watch will consumers prefer? In Europe, between 75% and 95% of all consumers will prefer the Swiss watch in spite of the 10% premium. In the United States, depending on which region you are talking about, between 51% and 75% of all consumers will prefer the Swiss watch.

The Swatch Concept

Hayek's low-end product initiative was a quartz watch called Swatch ("Swiss" + "watch"). From the start, the Swatch initiative was controversial for several reasons. First, Hayek was fully committed to vertical integration; that is, he was determined to build and assemble the low-priced quartz watch entirely in Switzerland. This meant that SMH had to bring its production costs down to Asian levels, a huge undertaking given the high cost of production in Switzerland. "It's not just possible to build mass-market products in countries like Switzerland. It's mandatory," Hayek argued. "We must build where we live. . . . That means focusing on labor. If we can design a manufacturing process in which direct labor accounts for less than 10% of total costs, there is nothing to stop us from building a product in Switzerland, the most expensive country in the world. Nothing."

Ultimately, this requirement involved designing proprietary production techniques that enabled SMH factories to churn out Swatches on a fully automated production line; in the process, the company managed to slash the number of individual parts required to build a Swatch from 91 to 51, resulting in a production cost of under 10 Swiss francs (SFr) per unit.[4]

Second, the Swatch team decided that the watch would be encased in cheap plastic. This decision caused great consternation within the Swiss watch industry, which had always been known for using the highest-quality metals and jewels in its watches. "The banks studied our report and got nervous," said Hayek. "[They said], 'This is not what consumers think of when they think of Switzerland. What the hell are you going to do with this piece of plastic against Japan and Hong Kong?' But we were adamant: if we did not have mass production, if we did not have a strong position in the low end, we could not control quality and costs in the other segments."

Third, the Swatch team decided that the Swatch would have a unique message, one unlike that of any other watch brand in the market. Hayek elaborated:

> I understood that we were not just selling a consumer product, or even a branded product. We were selling an emotional product. You wear a watch on your wrist, right against your skin. You have it there for 12 hours a day, maybe 24 hours a day. It can be an important part of your self-image. It doesn't have to be a commodity. It shouldn't be a commodity. I knew that if

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[4] One indication of this operational efficiency was that only 130 workers were needed to assemble the first 8 million Swatches; by comparison, 350 workers were required to assemble 700,000 Omegas.

> we could add genuine emotion to the product, and attack the low end with a strong message, we could succeed.

Prior to the Swatch's launch, the company tested several prototypes in U.S. department stores. The tests were conducted without fanfare—no advertising or promotional support—in markets such as Dallas, Salt Lake City, and San Diego. The results were not very encouraging. Additional tests were conducted in New York and Dallas; these tests only confirmed consumers' lack of enthusiasm for the Swatch concept. Still, SMH decided to proceed with the launch. Hayek noted:

> You can build mass-market products in countries like Switzerland or the United States only if you embrace the fantasy and imagination of your childhood and youth. . . . People may laugh—the CEO of a huge Swiss company talking about fantasy. But that's the real secret behind what we have done. It's an unusual attitude for Switzerland—and for Europe. Too many of Europe's large institutions—companies, governments, unions—are as rigid as prisons. They are all steel and cement and rules. We kill too many good ideas by rejecting them without thinking about them, by laughing at them.

The Swatch Introduction

The Swatch was launched in March 1983 in Switzerland, Great Britain, and the United States. A few months later, the Swatch was introduced in Germany and then in other European countries. Within a few years, it was available in almost every country and continent in the world.

In most of these countries, the Swatch was an immediate success. For example, in the United Kingdom, the company had hoped for first-year sales of 50,000 units; instead, it sold 200,000 units. In fact, within two years of its initial introduction, sales were averaging 100,000 units a month, and the company had already put 13 million Swatches on customers' wrists. (See **Exhibit 1** for detailed sales data.) Many of these customers were young people who had never before shown much interest in the watch category.

Designs and Collections

From the start, it was clear that Swatches were unlike any other traditional timekeeping instrument on the market. Although they were made out of plastic, they featured witty, sometimes outlandish designs that used brash, intense colors; no watch brand had ever used such bold designs and colors to such effect before.

There were dozens and dozens of models to choose from, models for every occasion, for every whim. All of the models were designed by the Swatch Design Lab, which operated in Milan under the guidance of Franco Bosisio. The Swatch Design Lab cranked out two collections a year; each collection consisted of 70 different styles. "We always prepare four times the number of models we need," Bosisio explained. "A group in Milan selects half of those proposed designs and presents them to the management committee in Switzerland. In Switzerland, we make the final choice and decide on the collection." He continued, "We don't get carried away. This is only semi-serious. We want arresting images, but we also wink at the consumer. We don't want people to think too much. We are looking for an immediate emotional reaction—spontaneity."

Because the collections were replaced so rapidly (there were no repeated production runs) and were so wildly different from one another, new models hit the market on an ongoing basis. As a result, consumers who bought one Swatch from one collection often found themselves buying another Swatch from a different collection several months later. In fact, it was not unusual for Swatch aficionados to own dozens of Swatches; the average Italian customer, for example, possessed six. "It's incredible!" remarked Bosisio, who also ran SMH Italy. "And I can't really explain it. We didn't launch Swatch here until 1986. Italy was the last European country to get it. That's strange, in a way, because Italians are crazy for fashion in general and watches in particular. . . . When we finally made the launch, the market exploded. And it has kept growing."

The designs were created by an assortment of artists, architects, and industrial designers. "They come from many backgrounds and from all over the world," said Bosisio. "We have had designers from Italy, Japan, Germany, France, America, Australia, many other places." He continued:

> We rotate people through the lab. Everyone must agree to stay for at least six months. Very few people stay for more than two years. They get tired. We get tired. This is challenging work. Lots of brilliant artists fail when they try to design for us. It's hard to squeeze wonderful ideas into the face and band of a Swatch. In fact, we have more than 3,000 proposed designs that we have never executed.

Many of the designers who lent their work to Swatch were prominent in their own right: Keith Haring, Alessandro Mendini, and Kiki Picasso, to name a few. In some cases, SMH would produce limited editions of their designs; examples included the 120 Swatches designed by Italian artist Mimmo Paladino and the "Veggie Line" designed by Austrian artist Alfred Hofkunst—the latter consisted of Swatches shaped like red chili peppers, cucumbers, and bacon-and-egg combos.[5] Although these limited editions always carried the same sticker prices as the regular collections, they generated significant publicity in the media, not to mention excitement among Swatch lovers.

Swatch also had a reputation for whimsical innovation. In 1985, it became the first watch brand to introduce a see-through watch; it was also the first to introduce a scented watch. For Bosisio, the constant pressure to produce designs that were youthful, provocative, stylish, and yet unpredictable was relentless: "We have no set routines to come up with ideas. We travel constantly, all over the world. We go to the big fashion shows—Premiere Vision in Paris, for example. We go to the opera, to art exhibitions. You can't imagine how many books and magazines we read, how many painters we study. We steep ourselves in the culture of life. And then things happen."

Swatch customers were unlike the buyers of any other watch brand. Intensely loyal, they were always on the lookout for intriguing new designs. Of course, one of the elements that made the Swatch so popular among these consumers was its price, just $40 in the United States, SFr50 in Switzerland. This low price tag made it easy for consumers to purchase Swatches on impulse. Bosisio explained:

> Few people appreciate how and why price has been so important. Everywhere in the world, Swatch is sold at an affordable price. But it's also a simple price, a clean price. In the United States, $40. In Switzerland, SFr50. In Germany, DM60. In Japan, Y7,000. It has also been, in the first ten years, an unchanging price. Despite our incredible success in the market, despite the huge unmet demand in countries like Italy, we have never raised the price of Swatch to our dealers. And we forbid our dealers from marking up the price to their customers. Can you name another fashion product whose price has stayed exactly the same for ten years?
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> Price becomes a mirror for the other attributes we try to communicate. It helps set us apart from the rest of the world. A Swatch is not just affordable, it's approachable. Buying a Swatch

[5] Bill Workman, "Veggie Swatch Watch Sets Off Feeding Frenzy," *San Francisco Chronicle*, September 12, 1991, p. B5.

> is an easy decision to make, an easy decision to live with. It's provocative. But it doesn't make you think too much.

Controlling the Swatch Message

SMH's general approach to promotion was to spend roughly 30% of the Swatch's retail price on advertising. (At the time, this was more than double the industry average.) In Europe, Swatch's ad spend was roughly $15 million in 1989–1990 and close to $28 million by 1992. This ranked Swatch among the top 100 advertisers on European television (it was ranked 56); no other watch brand ranked on this list.[6] The high-profile advertising approach was especially uncommon for a Swiss manufacturer—most Swiss brands preferred a more discreet promotional approach involving classy, full-page advertisements in magazines targeting a narrow, upscale demographic.

Swatch's marketing plan was also unique in the watch industry in its emphasis on below-the-line activities. The company had become notorious for unorthodox promotional stunts—everything from break-dancing sponsorships to celebrity endorsements. The company also used special events and product placements to promote the Swatch brand. Hayek offered this example:

> How did we launch Swatch in Germany? Did we saturate the airwaves with paid advertisements? No. Anyone can do that. We built a giant Swatch. It was 500 feet high, weighed 13 tons, and actually worked. We suspended that giant Swatch outside the tallest skyscraper in Frankfurt, the headquarters of Commerzbank. It was really something to see! I remember asking the chairman of the bank for permission. He thought we were crazy. We were crazy. . . . [But] we persuaded him that this giant Swatch would show his customers that his bank had heart and emotion. So there it hung. And all it said was: Swatch. Swiss. DM60.
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> That outrageous display communicated the essence of the Swatch message. It was high quality—Swiss. It was low cost—what could be more affordable than DM60? It was a big provocation to hang a watch from a huge, grim skyscraper. And it was funny, fanciful, a joke—joy of life. Believe me, when we took it down, everyone we had wanted to reach had received our message.

In 1990, the company created a Swatch Collectors Club for its most ardent fans. For an annual fee of about $90, members received an exclusive collectors' Swatch each year instead of a traditional membership card. In addition, they received a subscription to the *Swatch Street Journal*, a magazine produced by SMH that featured the latest news and information about Swatch in particular and pop culture trends in general. Within a year, the Swatch Collectors Club had more than 50,000 members.[7]

As Hayek put it, "Everything we do and the way we do everything sends a message." This included Swatch's distribution strategy, which eschewed the jewelry stores and specialty watch shops favored by most watch manufacturers. Instead, the company adopted an unconventional retail approach that created many nontraditional points of purchase.[8] The Veggie Swatch line, for example, was sold in fruit and vegetable markets. In department stores, SMH preferred to keep Swatch out of the jewelry displays where other watches were sold and instead pushed for shop-in-shop systems or miniboutiques that focused exclusively on the Swatch brand.

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[6] "Euromarketing's Top 100 Pan-European TV Brands in 1992," *Euromarketing*, May 1993.

[7] "Ein Jahr im Swatch Club," *Direct Marketing*, April 1992.

[8] Eileen B. Brill, "Swatch Timepieces Become a Fashion Hit," *Women's Wear Daily*, October 5, 1984, 148, p. 16.

Swatch also opened a number of freestanding monobrand Swatch stores, most of which were franchised and located in exclusive, high-fashion districts. These stores—each of which cost roughly $1.5 million to get up and running—were supplied on a quota basis, which meant that they were often crowded with people eager to get their hands on a limited supply of the latest designs.[9] By 1992, Swatch had 27 stores in operation worldwide.

The Swatch Success Story

The success of the Swatch brand exceeded all of the company's expectations. In 1992 alone, the company sold 26 million Swatches; the same year, cumulative sales hit the 100 million mark, making Swatch the best-selling watch in history. Swatches designed by the late New York artist Keith Haring commanded prices in excess of $2,000 (one Keith Haring Swatch reportedly sold for $10,000), and a 1989 watch designed by Italian artist Mimmo Paladino garnered $24,432 at a Christie's auction in Zurich.[10]

"It's almost embarrassing," Bosisio remarked. "I go out to dinner, and all I see are Swatches." For his part, Hayek offered this explanation for the success of the Swatch:

> Fashion is important. The people at our Swatch Lab in Milan and our many other designers do beautiful work. The artists who make our Swatch special collections design wonderful watches. . . . [But we] are not just offering people a style. We are offering them a message. This is an absolutely critical point. Fashion is about image. Emotional products are about message—a strong, exciting, distinct, authentic message that tells people who you are and why you do what you do. There are many elements that make up the Swatch message. High quality. Low cost. Provocative. Joy of life. But the most important element of the Swatch message is the hardest for others to copy. Ultimately, we are not just offering watches. We are offering our personal culture.

Swatch had reversed SMH's fortunes as well. In its first year (1983), SMH had lost SFr173 million ($124 million) on revenues of SFr1.5 billion ($1.1 billion), but by 1992, the company was posting profits of SFr413 million ($289 million) on revenues of SFr2.8 billion ($2 billion). (See **Exhibits 2** through **4** for detailed financial information.)

That same year, SMH's production of watches grew by 12% to 87 million units, giving SMH aworld market share of 9%, trailing Citizen (22%) and Seiko (19%). In terms of value, SMH ranked second with a 16% share, behind only Seiko. Meanwhile, the entire Swiss watch industry had benefited from SMH's resurgence: While Swiss watchmakers now controlled 18% of total world volume, they commanded 55% of total value. (See **Exhibits 5** and **6** for details.) "Swatch has helped the entire Swiss industry," Hayek commented. "It has restored our credibility with the public. It has restored our credibility with the trade. The perception of Swiss watches today is so different from ten years ago."

Still, the world watch market remained highly fragmented, and aside from the three leading manufacturers—Citizen, Seiko, and SMH—there were hundreds of small players in Switzerland, Asia, and the United States. Aside from SMH's Swatch, the Swiss companies tended to focus on the high-priced watch segment, while the Asian companies (most of which were based in Hong Kong)

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[9] "Swatch: Opened a New Store in Milan," *Women's Wear Daily*, May 22, 1992, p. 7.

[10] Madonna Behen, "New Ideas Have Swatch Ticking Again," *Women's Wear Daily*, August 30, 1991, 162 (43), p. 1; "Swatch on Show: Exhibit at the Aaron Faber Gallery in New York," *Women's Wear Daily*, 161 (126), p. 8; Laurena Cahill, "The Art of Time Gets Top Dollar," *Asian Business*, November 1991, 28 (11), p. 68.

tended to focus on producing cheap watches for the low-priced segment. (For the most part, U.S. manufacturers relied on imports of finished watches produced under their own label in Hong Kong and China.)

The SMH Portfolio

The Swatch brand was responsible for more than a third of the company's volume output. The company's other eight global brands—Blancpain, Omega, Longines, Rado, Tissot, Certina, Hamilton, and Swatch brand extension Flik Flak—accounted for the remainder. Blancpain anchored the super high end of the market; the company sold a few thousand of these watches a year at prices of $200,000 or higher. Flik Flak, a children's brand that was priced below Swatch, anchored the other end of the market. "Each brand is different, so each message is different," Hayek explained. "But each brand has a message. My job is to sit in the bunker with a machine gun defending the distinct messages of all my brands. I am the custodian of our messages. I review every new communications campaign for every single brand."

The watch industry still consisted of three primary sectors. (See **Exhibit 3** for SMH's 1993 unit sales by price segment.) At 26 million units a year, Swatch was the undisputed market share leader in the highly fragmented low-price sector, but its market share was still very low, in the single digits. In addition, having pioneered the fashion subcategory in this segment, Swatch now found itself competing against a growing number of licensed fashion brands that were flooding into this sector; these included brands such as Benetton, Fossil, Guess, Relic, and other own-label watches. Most of these watches were manufactured in Asia.

The midprice sector ($100 to $350) remained more traditional, that is, less fashion oriented. Most customers in this price range preferred watches that looked more expensive than they really were; quartz watches made with plated or nonprecious metals were most popular. Because consumer price sensitivity was highest in this segment, margins tended to be lower than in the other two segments. And while Citizen and Seiko remained the dominant players, they now competed against a number of Hong Kong manufacturers producing own-label brands. This was SMH's weakest segment; the company offered its Tissot, Certina, and Hamilton brands in this price range.

In the upper-price segment ($350 and above), SMH competed primarily against other Swiss manufacturers.[11] With the exception of a few brands such as Cartier, most of the competitors in this sector were small, privately owned firms that produced a very small volume of watches per year. SMH offered its Longines and Rado brands in this segment, but its flagship high-end brand was Omega, whose 130 models sold for anywhere between $700 and $20,000.

Indeed, even as the success of Swatch had garnered most of the world's attention, Omega had experienced its own turnaround in the 1980s. As Hayek put it, "We built Swatch from the ground up. We had to rescue Omega from near oblivion. Omega is a crucial brand for SMH. We make as much money with Omega as we do with Swatch. Yet no one ever discusses it." He explained:

> The problems started in the early 1970s. . . . Omega became greedy. Rolex sells 600,000 watches per year. That's about as many as you can sell before a luxury brand begins to lose its prestige. That's about how many Omega was selling in the late 1970s. But Omega wanted to grow more rapidly. So they took the easy route. They figured, "If we can sell 600,000, why not

[11] The luxury subsegment represented the highest end of this category; it consisted of highly complex mechanical watches, chronographs, and jeweled timepieces priced at $800 and above. Blancpain was SMH's luxury brand.

> a million? Or 2 million? Or 3 million?" Which meant, of course, they had to lower the price radically. . . . That was the kiss of death. Omega was everywhere: high price, medium price, precious metals, cheap gold plating. . . . No one knew what Omega stood for. By the end of 1980, the company was again in a deep crisis, its deepest ever.

In 1985, Hayek began implementing a strategy to "give Omega back its message. Not an image, a message. We had to be clear, consistent, and credible." He described the message as follows:

> Omega is an elite watch for people who achieve—in sports, the arts, business, the professions—and help shape the world. It is a watch for people who are somebody because they made themselves somebody, not because their grandfather left them a trust fund or because they made money from insider trading. . . . We stopped building lavish or showy watches—people who achieve don't care about those things. We stopped making Omegas with gold plating. We made smart watches out of real metal: platinum, titanium, gold, special steel alloys. Omega started making sense again. This is what an Omega looks like. This is what Omega stands for. We gave Omega back its message.

All nine of SMH's global brands had their own organizations and their own management teams; these teams had total authority over product designs, marketing, and communications for their brands. In contrast, manufacturing and assembly had to be negotiated through SMH's technology and manufacturing arms. "Brands no longer build their own watches," Hayek explained. "Our production divisions have full responsibility for manufacturing and assembly."

SMH's manufacturing organization was ETA; it was responsible for all electronic movement research, for building all of the company's quartz movements, and for assembly of all of its quartz watches. In this regard, Hayek's commitment to vertical integration was unwavering:

> Here is the strategic reality we face. There are three centers of watchmaking in the world: Switzerland, Japan, and Hong Kong. But only the Swiss and the Japanese build movements. . . . To build electronic movements, you have to master semiconductor technology, quartz, batteries, miniaturization. For mechanical movements, you have to master intricate micromechanics and the old art of watchmaking in the luxury segment. You either commit fully to the business or get out. We have some advantages here in Switzerland. We have hundreds of years of experience in the technologies and techniques of watchmaking. Families have spent generations in our factories. They have a feel for this business, a special touch. They are masters at working with parts so small you need a microscope to see them.

"Our cost structure today is completely different from when we created SMH," Hayek continued. "It is not merely because we are more productive. It is because we have totally changed the logic of our business system. We have radically decentralized marketing and thoroughly centralized manufacturing." Moreover, despite their decentralized marketing structures, Hayek believed that there was synergy between all of SMH's brands:

> Jewelers and department stores beg us to carry Swatch. If customers come for Swatch, and the shop doesn't have it, they won't accept anything else. They leave disappointed. This has a big psychological spillover to all of our brands—including Omega. . . . I really believe the phenomenal success of these $40 watches helps the climate for selling $500 watches—or $5,000 watches, for that matter.

Looking Forward

In 1993, the Swatch brand was still growing strong, although many wondered whether the success of the brand had reached its apex, particularly in the United States, where growth appeared to be tapering off in recent years. Of course, the end of the Swatch boom had been predicted several times before, and in each case, the brand had continued to exceed expectations.

Meanwhile, the Swatch brand had grown to include two new extensions, both introduced in 1990. The Scuba line featured diving watches that were water resistant up to 200 meters; they were priced at SFr60. The Chrono line offered technical watches with features such as four stopwatch hands in addition to the normal hour and minute hands; these were priced at SFr100. SMH, which now had 15,000 employees, was also in the process of extending the Swatch brand to new arenas such as telecommunications devices (Swatch pagers and telephones had recently been launched) and automobiles (an environmentally friendly Swatch concept car—the Swatchmobil—was in the works). In response to critics who believed he was overextending the brand by diversifying into these areas, Hayek had this to say:

> Look at the wristwatch pagers out there today. They have digital displays. They are ugly. They are heavy. It's not accident that we will market the world's first successful analog wristwatch pager. We have the technology. We know how to design manufacturing systems that make us competitive. We also know how to design attractive product—and how to market them.

He concluded:

> The Swatch is based on radical innovations in design, automation, and assembly, as well as in marketing and communications. One of our plants in Grenchen makes up to 35,000 Swatches and millions of components a day. From midnight until 8 a.m., it runs practically without human intervention. Swatch is a triumph of engineering. But it is really a triumph of imagination. If you combine powerful technology with fantasy, you create something very distinct.

Exhibit 1 Swatch Unit Sales Over Time (in millions)

	Units/Year	Growth Rate	Units Cumulative
1983	3.0	33%	3
1984	4.0	33%	7
1985	8.0	100%	15
1986	12.0	50%	27
1987	12.5	4%	40
1988	12.5	0%	53
1989	12.5	0%	65
1990	14.0	12%	79
1991	17.5	25%	97
1992	26.0	49%	123
1993	31.5	21%	154

Source: Company annual reports.

Exhibit 2 SMH Financials; Year to December 31 (in SFr millions)

	1988	1989	1990	1991	1992	1993
Gross Sales	**1,847**	**2,146**	**2,139**	**2,373**	**2,846**	**2,855**
Sales Deductions	-80	-90	-81	-69	-84	-85
Net Sales	**1,767**	**2,056**	**2,058**	**2,304**	**2,762**	**2,770**
Other Operating Income	24	29	15	17	18	22
Internally Manufactured Equipment	14	16	16	-22	74	105
Total Revenues	**1,805**	**2,101**	**2,089**	**2,299**	**2,854**	**2,897**
Cost of Materials	681	793	755	554	683	732
Personnel Costs	580	646	665	715	788	798
Cost of Services	331	346	361	120	175	159
Depreciation	71	80	90	113	124	120
Other Operating Costs	0	0	0	501	592	592
Operating Profit	**142**	**236**	**218**	**296**	**492**	**496**
Interest & Div Income	0	0	0	46	55	70
Interest Expenditure	25	17	15	51	38	42
Net Extraordinaries	9	-10	20	8	1	4
Pre-Tax Profit	**126**	**209**	**223**	**299**	**510**	**528**
Net Profit	**105**	**175**	**191**	**251**	**413**	**441**
Sales by Product Type (as a % of gross sales)						
Low-Priced Watches	14%	13%	15%	19%	26%	28%
Mid-Priced Watches	14%	13%	13%	12%	11%	10%
High-Priced Watches	33%	36%	35%	34%	33%	31%
Movements & Components	31%	31%	31%	28%	24%	23%
Other	8%	7%	7%	7%	7%	9%

Source: Company annual reports.

Exhibit 3 SMH 1993 Unit Sales by Price Segment

	Units (millions)
Low-Priced Watches	34.9
Mid-Priced Watches	6.4
High-Priced Watches	4.2
Cheap Movements	35.5
Mechanical Movements	6.0
Total Units Sold	**87.0**

Source: Company annual reports.

Exhibit 4 SMH 1993 Unit Sales by Region

	Units (millions)
Europe	37.4
Asia	42.6
America	6.1
Other	0.9
Total Units	**87.0**

Source: Company annual reports.

Exhibit 5 1993 World Production of Watches and Movements, in Volume (millions of units)

	Digital Quartz	Analog Quartz	Mechanical	Country Total	% of World Total
Switzerland	0	163	7	170	18%
SMH	0	78	9	87	9%
Japan	29	343	17	389	41%
Hong Kong	190	n/a	n/a	190	20%
Others	35	52	103	190	20%
World Total	**254**	**558**	**127**	**939**	**100%**

Source: Compiled and adapted from Federation of the Swiss Watch & Clock Industry.

Exhibit 6 1993 World Production of Watches and Movements, in Value (millions of SFr)

	Digital Quartz	Analog Quartz	Mechanical	Country Total	% of World Total
Switzerland	23	4,082	4,144	8,249	55%
SMH	0	1,580	850	2,430	16%
Japan	303	2,771	207	3,281	22%
Hong Kong	1,330	n/a	n/a	1,330	9%
Others	500	750	1,006	2,256	15%
World Total	**2,156**	**7,603**	**5,357**	**15,116**	**100%**

Source: Compiled and adapted from Federation of the Swiss Watch & Clock Industry.

Exhibit 7 Global Watch Production, in Units (millions)

	1984	1985	1986	1987	1988	1989	1990	1991	1992
Mechanical	134	140	135	157	135	119	127	124	129
Quartz Digital	148	157	228	250	226	204	221	232	246
Quartz Analog	127	176	202	235	321	309	427	472	502

Source: Compiled and adapted from Cyril Bouquet, "Swatch and the Global Watch Industry," Ivey Case no. 9A99M023, 1999, Exhibit 3, p. 21.