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When corporatism leads to corporate governance failure : the case of Swiss watch industry

Schluep Campo, Isabelle ; Aerni, Philipp

Abstract: Corporatism is often seen as the way Swiss stakeholders in business and politics handle industrial challenges in a reasonable and flexible way. The following publication argues, however, that the emergence of corporatist structures in the Swiss watch industry has often encouraged rent-seeking and collusion at the expense of the creation of new markets through innovation. This legacy makes it currently difficult for the industry to effectively respond to new technological challenges and changing societal preferences in the global watch business. The report draws on archival sources, accessible since 2015, that were extensively discussed in the Swiss print media in early 2016. They provide increasing evidence of corporate governance failure in the 1983 merger of SSIH (Société suisse pour l'industrie horlogère) and ASUAG (Allgemeine Schweizerische Uhrenindustrie AG) that led to today's Swatch Group. The merger, induced by the involved Swiss banks, was portrayed as a necessary step to save the two allegedly bankrupt watch companies. Yet, the archival sources show that ASUAG had already been successfully restructured and was ready to conquer global markets with its new product, the Swatch.

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When corporatism leads to corporate governance failure

**The case of the
Swiss watch industry**

**Isabelle Schluemp Campo
&
Philipp Aerni**

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Contents

Summary	6
Acknowledgements	8
Acronyms and abbreviations	9
1 Introduction	11
2. Historical background	15
2.1 The Foundation of ASUAG	16
2.2 The 1951 “Watch Statute”	18
2.3 Post World War II economic expansion and the 1961 Watch Statute	19
3. Corporatism in Switzerland	21
3.1 Corporatism embodied in the “Swiss made” label for watches	23
4. The crisis of the Swiss watch industry in the 1970s	27
4.1 Swiss technology commercialized elsewhere	28
4.2 The role of the Swiss banks	29
4.2.1 <i>SSIH before the merger</i>	29
4.2.2 <i>ASUAG before the merger</i>	31
5. A merger of unequals: SSIH and ASUAG become SMH	37
5.1 How a former state monopoly became a private monopoly	43
5.2 Pretending to be Robin Hood while representing the establishment	48
5.2.1 <i>Nicolas G. Hayek</i>	49
5.2.2 <i>Smart Car</i>	52
5.2.3 <i>Car batteries</i>	53
5.2.4 <i>Innovation rhetoric</i>	54
5.2.5 <i>Regulation and securing ownership</i>	56

The Swiss watch industry

6.	The position of the Swiss watch industry in the global market	59
6.1	The Swiss watch industry at its peak in 2014	61
6.2	Export crisis of the Swiss watch industry in 2015	62
6.3	Challenges facing the watch industry	65
6.3.1	<i>The rise of smartwatches and wearables</i>	65
6.3.2	<i>The Apple Watch</i>	67
6.3.3	<i>Inventory problems and short selling</i>	68
6.3.4	<i>Pending lawsuit</i>	69
6.4	Strengthening “Swissness” rules, the usual corporatist response	70
7.	Market and political power of Swatch Group	72
7.1	Market power of Swatch Group	72
7.1.1	<i>Swatch Group market power in production and distribution</i>	73
7.1.2	<i>Monopoly of Swatch Group in different markets of the watch industry</i>	74
7.1.3	<i>WEKO’s decision regarding Swatch Group’s market power</i>	77
8.	The revision of the “Swiss made” regulation	83
8.1	The revision of the “Swiss made” regulation for watches	83
8.2	The role of the Federation of the Swiss Watch Industry (FH) in the design of new “Swiss made” regulation for watches	86
8.3	Impacts of the new “Swiss made” regulation for watches	87
9.	The Swatch Group: high on reputation, low on corporate governance	90
9.1.	Corporate governance problems	90
9.2.	What Swatch Group and Volkswagen may have in common	92
10.	Conclusions	95

BOXES

1	Economic articles in the Swiss constitution	19
2	1971 requirements for the “Swiss made” label for watches	25
3	Delirium and Swatch	34
4	How the ASUAG-SSIH merger was portrayed officially	45
5	The prestige value of mechanical watches	61
6	WEKO’s decision in light of the Cartel Act	81
7	The complex and costly new “Swiss made” label for watches	85
8	The position of the Swatch Group within FH	87

ANNEX OF FIGURES

106

1	Share of Swiss watch production in global output of watches and movements	106
2	Number of workers and manufacturers in the Swiss watch industry	107
3	Exports of Swiss finished watches and movement blanks, 1944–1982	108
4	Exports of Swiss clocks and watches and parts, 1988–2015	109
5	Imports of clocks and watches and parts by Switzerland, 1988–2015	110
6	Leading companies in the watch market, 2014	111
7	Development of inventories, Swatch Group, 1999–2015	112
8	Organization of ASUAG, 1982	113
9	Swatch Group net sales and profits, 1983–2012	114
10	Companies of the Swatch Group	115
11	ASUAG in numbers, 1973–1982	116
12	SSIH in numbers, 1971–1982	117
13	Unemployment rate in the Swiss watch industry, 2008–2016	118

Summary

Corporatism is often seen as the way Swiss stakeholders in business and politics handle industrial challenges in a reasonable and flexible way. The following publication argues, however, that the emergence of corporatist structures in the Swiss watch industry has often encouraged rent-seeking and collusion at the expense of the creation of new markets through innovation. This legacy makes it currently difficult for the industry to effectively respond to new technological challenges and changing societal preferences in the global watch business.

The report draws on archival sources, accessible since 2015, that were also extensively discussed in the Swiss print media in early 2016. They provide increasing evidence of corporate governance failure in the 1983 merger of SSIH (*Société suisse pour l'industrie horlogère*) and ASUAG (*Allgemeine Schweizerische Uhrenindustrie AG*) that led to today's Swatch Group. The merger, induced by Swiss banks, was portrayed as a necessary step to save the two allegedly bankrupt watch companies. Yet, the archival sources show that ASUAG had already been successfully restructured and was ready to conquer global markets with its new product, the Swatch.

Through a forced merger of unequals, the banks were able to avoid heavy losses that would have resulted from the bankruptcy of the ailing SSIH. The merger essentially enabled the conversion of a former state monopoly, called ASUAG, into an even stronger private monopoly, eventually called the Swatch Group.

The Swatch Group was able to establish itself as the leading watch company in the world by benefiting from prior innovation and corporate restructuring. In addition, the company built up its market power through extensive brand and "Swissness" marketing, political lobbying designed to preserve its monopoly

pricing power in the production of certain watch parts, and the rhetoric of innovation to keep shareholders in good hope.

The new “Swiss made” regulation for watches, to be enforced by 2017, as well as weak anti-trust legislation and a permissive political culture towards popular “Swiss made” monopolies reflect a new type of corporatism that leads to corporate governance failure. Urgent policy reforms are required to revitalize the Swiss watch industry through entrepreneurial outsiders who are able to challenge complacent insiders and respond to the global rise of the smartwatch with bold innovation rather than defensive regulation.

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Her interest in the Swiss watch industry originates from the field work she did for her book titled “Manufacturing Time – Global Competition in the Watch Industry, 1795–2000” which she had published in the year 2000. We are very thankful for all the inspiring conversations we had with Amy and all the insights she shared with us. In addition, we would like to thank the numerous Swiss stakeholders who shared their insights with us on the Swiss watch industry, in particular Elmar Mock, Kenji Izumi, Paul Wyser, Rolf Rothacher, Bruno Bohlhalter and Dirk Schröder.

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Zurich, June 9, 2016,
Isabelle Schluep Campo and Philipp Aerni

Acronyms and abbreviations

ASUAG	Allgemeine Schweizerische Uhrenindustrie Aktiengesellschaft / General Swiss Watch Corporation
BBL	Bundesblatt / Federal Gazette
CEH	Centre Electronique Horloger
CEAHR	Confédération Européenne des Associations d'Horlogers Réparateurs (European Confederation of Watch and Clock Repairer's Associations)
EBITA	Earnings before interest, taxes, and amortization
EFTA	European Free Trade Association
ETA SA	Elegance, Technology, Accuracy, originally called Ébauches SA
FH	Fédération de l'industrie horlogère suisse / Federation of the Swiss Watch Industry
FINMA	Finanzmarktaufsicht / Swiss Federal Banking Commission
GATT	General Agreement on Tariffs and Trade
GWC	General Watch Co. Ltd.
IFRS	International Financial Reporting Standard
IGE	Institut für geistiges Eigentum / Swiss Federal Institute for Intellectual Property Rights
PR	Public Relations
R&D	Research and Development
SBV /	Schweizerischer Bankverein /
SBC	Swiss Banking Corporation
SIEC	Significant Impediment to Effective Competition
SMH	Société de Microélectronique et d'Horlogerie / Swiss Corporation for Microelectronics and Watchmaking Industries
SMI	Swiss Market Index
SR	Systematische Rechtssammlung / Classified compilation of federal laws

The Swiss watch industry

SSIH	Société suisse pour l'industrie horlogère / Swiss Watch Industry Corporation
SWA	Schweizerisches Wirtschaftsarchiv / Swiss Economic Archive
UBAH	Union des branches annexes de l'horlogerie / Union of Associated Watchmaking Activities
SBG /	Schweizerische Bankgesellschaft /
UBS	Union Bank of Switzerland
STEA	Steuerungsausschuss / Interim Steering Committee of ASUAG in 1982
WEKO	Wettbewerbskommission / Swiss Federal Competition Commission
WTO	World Trade Organization

Chapter 1

Introduction

The history of the Swiss watch industry in the 20th century was shaped by the spirit of Swiss corporatism. Whenever the industry faced crises, the Swiss government sat together with the powerful stakeholders of the watch industry to come up with policy measures designed to reconcile industrial interests with the public interest. As a consequence, the watch industry was regulated and supported by the state in a way that protected Swiss production and employment in the short term but caused challenges in the long term that could not be addressed through government intervention alone.

While the government gradually withdrew its stake in the watch industry after World War II, the crisis of the watch industry in the 1970s forced not just the state but also Swiss banks, which ended up being the de-facto owners of the industry in the late 1970s, to take action. They eventually decided to merge the two largest Swiss watch companies, SSIH and ASUAG¹, into one company in 1983. This was then widely celebrated as the necessary measure to restructure the industry in a way that would restore its global competitiveness.

Yet, archival sources at the Swiss Economic Archive at the University of Basel, accessible since 2015, reveal some major irregularities in the transactions that led to the ASUAG-SSIH merger². The archival material documents the period between 1968 and 1984 with a special focus on the history of ASUAG. It reveals that ASUAG may have faced some short-term losses in the early 1980s due to external factors. But, unlike SSIH, ASUAG had been well re-structured and was

1. SSIH stands for Swiss Watch Industry Corporation (Société suisse pour l'industrie horlogère) and ASUAG for General Swiss Watch Corporation (Allgemeine Schweizerische Uhrenindustrie Aktiengesellschaft).

2. The archive reference number is: CH SWA PA 532.

The Swiss watch industry

widely recognized as the innovation leader in watch manufacturing and technology. Yet, admitting that it was a merger of unequals was not in the interest of the Union Bank of Switzerland (UBS), which had previously invested millions in the ineffective restructuring of SSIH and could not afford to let it go bankrupt without losing face. UBS and the Swiss Bank Corporation (SBC) led a consortium of Swiss banks that provided the necessary funds to enable the merger and endow it with new capital. Since the bank consortium never had the intention to run the ASUAG-SSIH merger itself, they accepted the proposal of UBS Banker and former chairman of the governing board of SSIH, Peter Gross, to assist Nicolas Hayek in his efforts to acquire a 51 per cent share and obtain the majority of voting rights of the merged company that by then was called SMH³. Nicolas Hayek was able to realize this option in September 1985 thanks to the support of a pool of investors who agreed to let him have the sole voting right for the pool⁴. SMH was renamed Swatch Group in 1998 with the Hayek family as its de-facto owner.

Documenting the historical background of the watch industry since the end of World War I is important in order to understand how such a merger was able to convert ASUAG, which used to be essentially a state monopoly, into a private monopoly, owned primarily by the Hayek family.

Understanding the history of corporatism in the Swiss watch industry is also important in order to make sense of the responses of the Federation of the Swiss Watch Industry (Fédération de l'industrie horlogère suisse, FH) and the Swiss government to the current global economic and technological challenges. These challenges are mainly linked to the economic slowdown of China and the rise of the smartwatch. Instead of exposing companies to more international competition,

3. ASUAG-SSIH was renamed SMH in 1984 and stands for Swiss Corporation for Microelectronics and Watchmaking Industries (Société de Microélectronique et d'Horlogerie).

4. Graden, Tobias, 2016, Wie Nicolas G. Hayek zur Swatch Group kam. Bieler Tagblatt, 04.03.2016.

FH has successfully lobbied with the government to pass the new “Swiss made” regulation for watches. The regulation raises the local content requirements from 50 per cent to 60 per cent in order to protect the Swiss brand and keep jobs in Switzerland. However, in view of the growing vertical integration of the big Swiss watch companies, the costly and complex regulation is likely to further reduce domestic competition at the expense of global competitiveness⁵.

Since the early 1970s, watch companies must comply with strict criteria to obtain the “Swiss made” label. Yet, the “Swiss made” regulation for watches approved by the Federal Council in September 2015 goes far beyond the generally accepted criteria and is likely to be incompatible with certain bilateral trade agreements as well as the principles of the World Trade Organization (WTO)⁶. Despite its costliness and complexity, it does not enhance the effectiveness of the protection of the Swiss brand from counterfeit products abroad. It rather represents a traditional Swiss corporatist response to emerging global challenges through regulation rather than innovation. However, while the protection and support of the Swiss watch industry was previously based on a deal behind closed doors, the new protectionism is publicly announced as a patriotic step to protect the value of “Swiss made” products in agriculture and industry. The belief that Swiss watches, especially in the higher price segments, will always fetch a high premium, independent of the economic and technological changes, highlights the dangers of Swiss complacency. In this publication, we argue that this complacency has a lot to do with a lack of public understanding of the history of the Swiss watch industry and how corporatist responses tended to prevent rather than enable the reinvention of the industry.

5. Schaible, Franz, 2015, “Swissness benachteiligt Konsumenten”. Interview mit Ronnie Bernheim. Schweiz am Sonntag 5. September 2015 (available online: <http://www.aargauerzeitung.ch/wirtschaft/swissness-benachteiligt-konsumenten-129519839>).

6. Aerni, Philipp, 2015, Stellungnahme zur Revision der Verordnung über die Benützung des Schweizer Namens für Uhren. Brief vom 2. Dezember 2015 an das Schweizerische Institut für Geistiges Eigentum, Bern.

The Swiss watch industry

The book is structured as follows: the historical background of the Swiss watch industry since the end of the World War I is discussed in Chapter 2. It illustrates how corporatism shaped the structure of the industry and how government interventions shaped the structure of the watch market over time. Corporatism in Switzerland will then be discussed in the context of the watch industry in Chapter 3. In Chapter 4, we elucidate the corporatist response during the crisis of the watch industry in the 1970s. Chapter 5 examines the official portrayal of the merger of SSIH and ASUAG in 1983 and compares it with the facts found in the sources of the Swiss Economic Archive of the University of Basel. Chapter 6 explores the position of the Swiss watch industry in the global market and the challenges it is currently facing. Chapter 7 documents how the market and political power of the Swatch Group, the world's largest watch company (in terms of sales value), has continuously increased. Chapter 8 discusses the recently approved "Swiss made" regulation for watches. The chapter also discusses how this will impair the ability of the Swiss watch industry to respond to disruptive technology, such as the smartwatch. Chapter 9 discusses corporate governance problems of the Swatch Group and what Swatch Group and the car-maker Volkswagen have in common. The paper ends with conclusions and outlook in Chapter 10.

Chapter 2

Historical background¹

The watch industry has always been very sensitive to global economic trends due to its high dependency on exports. Until World War I, Swiss watch companies dominated world markets thanks to their reputation for quality, innovation and precision, but also their ability to respond to competition challenges from abroad, especially the emerging watch production system in the United States². After the war, the industry entered a deep crisis from which it recovered briefly in the late 1920s only to be hit again by the global economic recession in the 1930s. In that period, the watch industry was fragmented and characterized by small-scale businesses that were competing fiercely, yet lacked the ability to expand in scope and scale. In order to cut costs, avoid the high import tariffs for finished watches in destination countries and remain competitive, Swiss watch companies often exported so-called “chablons”, which were semi-finished movements for final assembly abroad. This trend was called “chablonnage” and led to undesirable know-how transfer to foreign competitors. This was considered to be neither in the interest of the industry nor in the public interest.

In order to suppress the practice of “chablonnage” and to preserve the industry structure, the watch industry moved towards a cartelistic structure in the 1920s and 1930s. The different sectors of the industry got organized into associations: Swiss manufacturers of finished watches came under the umbrella of the Swiss Watch Industry Federation (Fédération Horlogère FH,

1. Information in this chapter is mostly based on: BBL 1983 III 945. Botschaft über die Veräusserung der Beteiligung des Bundes am Aktienkapital der Allgemeinen Schweizerischen Uhrenindustrie AG vom 14. September 1983.

2. Glasmeier, Amy, 1991, Technological discontinuities and flexible production networks: The case of Switzerland and the world watch industry. Research Policy, Volume 20, Issue 5: 469–485.

The Swiss watch industry

later called the Fédération de l'Industrie horlogère suisse) in 1924; Firms producing movement blanks (“ébauches”) became united under Ébauches SA, founded in 1924; and finally the Union of Associated Watchmaking Activities (Union des branches annexes de l’horlogerie, UBAH) grouped the component manufacturers. Through these associations and unions a very large share of producer firms could be organized.

The three entities adopted a set of conventions to stop the ruinous competition and to ban “chablonnage” abroad. Measures comprised, for example, minimum prices and export restrictions. However, these private legal agreements were not successful in discouraging the practice. As a consequence, people affected by the decline of the domestic watch industry called for state intervention. In 1931, a petition of 56 000 signatures was handed over to the Swiss Federal Council with a request to take measures to end “chablonnage” and to remedy the situation in the watch industry.

2.1 The Foundation of ASUAG

The 1931 petition induced the Swiss government to financially contribute to the foundation of the ASUAG holding³. ASUAG united Ébauches SA with most of the remaining independent movement blank producers⁴ and the manufacturers of regulating components (spiral spring, escapement and balance wheel). While the Swiss government provided CHF 6 million to write

3. Bundesbeschluss vom 26. September 1931 über die Unterstützung der Uhrenindustrie (SR 934.13).

4. In the course of the creation of ASUAG, ETA SA – a subsidiary of Eterna watch company in Grenchen – had to be sold by the owner, Theodor Schild, so it could be integrated into ASUAG. In this particular case, the owner was compensated only for half of the company’s value in cash, for the other half he received shares of the Ébauches SA. Even though there was a compensation, it was de-facto an expropriation in the name of the interest of the country. Subsequently, the shareholders of the Ébauches SA were affected by a second expropriation in 1983 when SSIH merged with ASUAG. History on the Eterna company is available online: <http://www.schild-eterna.de/seite2.htm>; personal communication with the daughter in law of Theodor Schild (2016).

down the non-performing assets of ASUAG and an interest-free loan of CHF 7.5 million, the banks and the watch industry each subscribed to share capital of CHF 5 million. The emergency law (*Notrecht*)⁵ that had been in force since World War I provided the legal basis for state interventions that were contrary to the provisions on freedom of trade and industry (*Handels- und Gewerbefreiheit*) as established in Art. 31 of the revised Swiss Federal Constitution from 1874.

In its statutes, ASUAG was obliged to deliver parts, components and movement blanks to all watch manufacturers in Switzerland⁶. Another purpose of ASUAG was to retain control over key technologies by prohibiting exports such as templates, components, watch-manufacturing and assembly technologies and tools to other countries. This aim was certainly different from a profit-oriented shareholder company. However, the concentration process was meant to help achieve economies of scale and to ensure the predictable supply of components to Swiss watchmaking companies.

One year earlier, the merger of the Omega and Tissot brands in 1930 resulted in the creation of SSIH (*Société suisse pour l'industrie horlogère*). While SSIH concentrated on the production of finished watches, ASUAG focused on movements and other watch parts. For the next five decades, SSIH and ASUAG remained the two largest companies in the Swiss watch industry and they continuously grew in size.

The strategy of consolidation was insofar promising as it partly eliminated competition within Switzerland and ensured that smaller companies could

5. During severe crises such as World War I & II or the economic depression of the 1930s extraconstitutional federal emergency law was applied that gave the Federal Council powers that normally only the Parliament was entitled to exercise.

6. From the outset, ASUAG controlled four groups: Ébauches SA, Fabriques d'Assortiments réunies SA, Fabriques de Balanciers réunis SA, Société des fabriques de spiraux réunis SA.

The Swiss watch industry

survive as subsidiaries and suppliers of SSIH and ASUAG. However, the regulation was incomplete. ASUAG did not control all movement blank and regulating component producers since preventing new companies from entering the sector was not possible. It took direct governmental intervention in 1934 designed to demand export permits for movement blanks, watch parts and kits as additional barriers to market entry.

By doing so, the government gave legal backing to the 1928 watch industry conventions and made dissidents comply. In 1936, government control tightened even more by enforcing minimum prices fixed by the 1928 conventions on the dissidents, and by regulating home-based work.

2.2 The 1951 “Watch Statute”

In 1937, the Swiss government integrated the different interventionist measures in the watch industry into a single state decree designed to protect the Swiss watch industry. The decree became untenable after World War II when the new economic articles in the Swiss Federal Constitution (Box 1) were approved in a national referendum in 1947. These articles were designed, among other things, to enhance economic freedom in trade and industry. In view of its cartelistic structure, the public-legal order of the watch industry was not compatible with this objective. Yet, the structure was eventually preserved by the so-called “Watch Statute” (*statut légal de l'horlogerie*), which was approved in a national referendum in 1951. It essentially legalized the state-controlled monopoly on movements and assortments that governed the watch industry from the 1930s to the 1960s. According to Katzenstein (1984) the statute “prolonged government supervision of this cartelized industry” for ten years and “was intended to preserve decentralization in the face of economic change”⁷. The statute further benefited the so-called “watch

7. Katzenstein, Peter J., 1984, *Corporatism and Change, Austria, Switzerland, and the Politics of Industry*. Ithaca, N.Y.: Cornell University Press. p. 218.

Box 1 Economic articles in the Swiss constitution

The Swiss emergency law dating back to World War I restricted economic freedom and led to the formation of cartels and monopolies. Eventually, this led to the national referendum on the economic articles (*Wirtschaftsartikel*) approved in 1947. The economic articles broadly regulated the relationship between the government and the economy (economic policy). The freedom of trade and industry was re-established and anti-trust provisions introduced. Social policy measures had to be compatible with the freedom of trade and industry. However, the economic articles also introduced corporatist elements into the constitution such as the involvement of associations in the preparation of legal projects and their implementation and the possibility for generally binding sectorial employment agreements.

Source: Wirtschaftsartikel, Historisches Lexikon der Schweiz (available online: <http://www.hls-dhs-dss.ch/textes/d/D13805.php>).

barons” because it allowed them to extract rents resulting from fixed sales prices for parts, and to benefit from high barriers to market entry. Yet, the companies producing the finished watches were increasingly exposed to international competition.

2.3 Post World War II economic expansion and the 1961 Watch Statute

After World War II, the Swiss watch industry expanded considerably due to the strong worldwide economic recovery. Industrial expansion in the 1950s and 1960s was also fuelled by efforts to liberalize international trade. Tariff reductions within the GATT (General Agreement on Tariffs and Trade), the elimination of tariffs on watch products among members of EFTA (European Free Trade Association) in 1966, and the end of Swiss export restrictions in 1965 on shipments of components to US producers contributed to the increase

The Swiss watch industry

in export sales of Swiss watches without the need to abandon the cartelistic structure of the industry⁸.

The production volume of time pieces and movement blanks in Switzerland peaked in 1974, but the Swiss share in the total world production volume had already started to decline in the 1950s due to increased production capacities outside Switzerland. By 1982, the Swiss share in global world production eventually shrunk to only 9.3 per cent, compared to 60 per cent in 1949 (see Figure 1 in Annex).

Early steps of trade liberalization also induced the Swiss government to shift its industrial policy focus from preserving jobs in the Swiss watch industry and preventing “chablonnage” towards improving the industry’s international competitiveness.

The “Watch Statute” of 1961 introduced a transitional regime designed to gradually remove measures that prevented competition. The export licensing system was eased considerably (with the exception of the exports of movement parts and blanks) and a quality control system was introduced to foster competition and to avoid the export of qualitatively bad watches that could threaten the reputation of the Swiss watch. Another purpose of the quality control system was to keep barriers to market entry high, once the permit system for the establishment of new companies in the watch industry was abandoned in 1966⁹.

8. Katzenstein, Peter J., 1984, *Corporatism and Change, Austria, Switzerland, and the Politics of Industry*. Ithaca, N.Y.: Cornell University Press. p. 217.

9. BBl 1969 II, 1489. Botschaft des Bundesrates zum Entwurf eines Bundesbeschlusses über die offizielle Qualitätskontrolle in der schweizerischen Uhrenindustrie und die Ergänzung des Markenschutzgesetzes vom 2. September 1970.

Chapter 3

Corporatism in Switzerland

Before discussing the causes of the global economic crisis of the 1970s and its consequences for the Swiss watch industry, we need to understand the model of corporatism that emerged in Switzerland after the end of World War I, and how it evolved in the Swiss watch industry.

Katzenstein defines “democratic corporatism” in Switzerland, Germany and Austria as an “interest-group system that is characterized by a voluntary and informal coordination of conflicting objectives through continuous political bargaining among interest groups, state bureaucracies, and political parties”¹. However, unlike for Germany and Austria, where trade unions play a crucial role in corporatism, he considers Swiss corporatism to be more liberal. Klaus Armingeon believes that this liberal corporatism has nevertheless resulted in favourable social outcomes such as the expansion of the welfare state, low unemployment rates and stable prices during the cold war period in Switzerland. Moreover, since the institutional setting in which political bargaining takes place in Switzerland offers many opportunities to block reforms that might negatively affect a powerful stakeholder, Swiss corporatism has proved to be remarkably stable, despite rather weak trade unions, the pressure for deregulation after the Cold War and the shrinking loyalty of voters and employees to particular political parties and economic organizations². Sciarini challenges this view, however, by arguing that corporatism has become increasingly mediatized, forcing policy makers to increasingly compete over media attention to attract public support for their political

1. Katzenstein, Peter J., 1984, *Corporatism and Change, Austria, Switzerland, and the Politics of Industry*. Ithaca, N.Y.: Cornell University Press. p. 27.

2. Armingeon, Klaus, 1997, Swiss corporatism in comparative perspective. *Western European Politics* 20(2). p. 164–179.

The Swiss watch industry

agenda – often at the expense of the consensus-oriented pre-parliamentary phase of political decision making³.

Most prior publications tend to praise Swiss corporatism for its orderly and quite reasonable handling of difficult industrial transitions, joint responses to new needs in vocational training and skill development, and the facilitation of social partnership. Joint collective action in the public interest is indeed praiseworthy. However, corporatist decision making in affluent countries such as Switzerland can also be problematic, especially when it concerns industrial and agricultural policy. In such political arenas the involved stakeholders are often focused on defending their stake in a changing economic and technological environment – framing foreign competition as a threat to national interests. As such, they claim to speak on behalf of the public interest by arguing that they aim to protect Swiss quality standards, keep jobs in Switzerland through domestic cooperation and to shield people from potential risks associated with change through foreign competition. They, however, tend to conceal their private interest to maintain the status quo and secure access to scarce public resources⁴. In other words, fear of change is portrayed as a moral concern, benefiting insiders at the expense of outsiders⁵.

The history of the watch industry illustrates this well. The Swiss watch industry faced increasing competition from abroad and economic decline at home in the 1930s. As a result, interventionist policies were put in place to protect domestic industry from foreign competition. Such measures defied the Swiss

3. Sciarini, Pascal et al., 2015, Political decision making in Switzerland: The consensus model under pressure. Palgrave Macmillan.

4. Aerni, Philipp et al., 2009, Nostalgia Versus Pragmatism? How Attitudes and Interests Shape the Term Sustainable Agriculture in Switzerland and New Zealand, *Food Policy* 34(2): 227–235.

5. Aerni, Philipp, 2011, Die Moralisierung der Politik als Kehrseite der Angst vor dem globalen Wandel. In: Philipp Aerni und Klaus-Jürgen Grün (Hrsg), *Moral und Angst*. Vandenhoeck und Ruprecht Verlag, Göttingen: 13–32.

constitutional rights of freedom of trade and industry and led to the cartelization of the watch industry – enhancing the risk of corporate governance failure.

Even though corporatism back then is different from corporatism today, most types of corporatism in economic policy end in the same unintended long-term consequences: namely, protecting rent-seeking insiders from innovation-seeking outsiders. Corporatism may thus protect the public interest in the short term (e.g. preserving jobs) but undermine industrial competitiveness and the capacity to innovate in the long term.

3.1 Corporatism embodied in the “Swiss made” label for watches

In the post-World War II era, the Swiss watch industry was in a position of market dominance (Figure 1). Trade liberalization, the introduction of automation and rationalization processes, especially by American and Japanese watchmakers, and the quartz revolution led to fundamental changes on the supply side of the Swiss watchmaking industry. Especially the quartz revolution initiated the transition from the mechanical to the electronic age in watchmaking. It unleashed disruptive forces that could only be mastered by reorganizing the entire industry and investing in a new labour force with new skills.

In view of the looming challenges, the “Watch Statute” was abandoned in 1971 and all remaining interventionist measures were removed. Instead, the “Swiss made” label for watches (Box 2), based on Swiss trademark law, was introduced to strengthen the existing quality control system of Swiss watch manufacturing. The government justified this measure not only with the economic importance of the watch sector but also the national interest. Even though the value of watch exports amounted to only half the value generated by export sales in machinery or the chemical industry, Swiss watches, and what they stood for abroad, were deemed to be of particular national public interest. As cherished consumer goods, watches were sold worldwide and reached millions of people. Since they were well-suited to promote the quality and reliability of Swiss products abroad,

The Swiss watch industry

international sales and marketing of Swiss watches were expected to have positive spillovers for the reputation of other Swiss export products. The Swiss bar association argued for example that the good reputation of the Swiss watch must be considered as a common property and that its preservation therefore was of national interest⁶. The geographical indication for Swiss watches as well as the quality control system were found to be compatible with the freedom of trade and industry provisions in the Swiss constitution. The legal measures stemming from the trademark law were complemented by the quality control system designed to prevent the misuse of the “Swiss made” label⁷.

The consensus on the importance of the “Swiss made” label laid the ground for a new type of corporatism that had the objective to promote the reputation of Swiss products abroad – in the public interest. For that purpose, industry bodies (in analogy to former organizations of craftsmen, such as guild systems) first set the rules that apply to their members (and that restrict membership), and second, claim to act in the public interest⁸, for example by claiming to preserve jobs in Switzerland.

The local content requirements of the “Swiss made” regulation plus strict quality control helped to ensure that ASUAG kept its monopoly⁹ in the area of movement blanks and watch parts. The same applied to SSIH for finished watches. This addition to the Swiss trademark law was criticized at that time

6. BBl 1970 II 697. Botschaft des Bundesrates an die Bundesversammlung über die offizielle Qualitätskontrolle in der schweizerischen Uhrenindustrie und die Ergänzung des Markenschutzgesetzes. p. 698.

7. BBl 1969 II, 1489. Botschaft des Bundesrates zum Entwurf eines Bundesbeschlusses über die offizielle Qualitätskontrolle in der schweizerischen Uhrenindustrie und die Ergänzung des Markenschutzgesetzes vom 2. September 1970.

8. Sauter, Wolf, 2015, Containing corporatism: EU competition law and private interest government, TILEC Discussion Paper, DP 2015-001. p. 2.

9. Schweizerische Studiengruppe für Konsumentenfragen, 1971, Neuartiger Interventionismus, Unter dem Banner der Qualitätsförderung – Für Uhren ersetzt der Bundesrat den Marktmechanismus, Der Bund, Bern, 3. Februar.

Box 2 1971 requirements for the “Swiss made” label for watches

A watch that carries the “Swiss made” label has to fulfill the following requirements: the movement of the watch has to be Swiss; the movement of the watch is encased in Switzerland and the final inspection by the manufacturer is carried out on Swiss grounds. A watch movement is considered to be Swiss if it is assembled in Switzerland, inspected by the manufacturer in Switzerland, and at least 50 per cent of the total value of the components is manufactured in Switzerland, without taking into account the cost of assembly. There is no provision on the total value of the watch that has to be of Swiss origin. No other sector of the Swiss economy enjoyed such legislation at that time.

Source: SR 232.119. Verordnung über die Benützung des Schweizer Namens für Uhren (available online: <https://www.admin.ch/opc/de/classified-compilation/19710361/199505010000/232.119.pdf>).

in the press because it gives the Federal Council general powers to prescribe quality standards for any industry or any product on behalf of protecting the general interest of the Swiss economy. It was further argued that “not the indication of the country of origin but the creation, promotion and care of watch brands is decisive for the success of the industry as demonstrated by the competitors from the USA and Japan”. Further, increased competition from abroad was not seen as a threat for the quality of watches. In fact, the quality of watches from Japanese and US companies was often seen as superior because of more advanced production technologies¹⁰.

According to Katzenstein¹¹, the new regulation therefore “[...] worked to the disadvantage of a sizeable low-cost segment of the Swiss watch industry,

10. Ibid.

11. Katzenstein, Peter J., 1984, *Corporatism and Change, Austria, Switzerland, and the Politics of Industry*. Ithaca, N.Y.: Cornell University Press. p. 218.

The Swiss watch industry

which produced just under one-half of the total volume (about 15 per cent of the value) of watch exports in 1969. These producers were attracted to foreign sourcing of components and foreign production; they were intent on meeting Japanese and American competition in this cost-efficient segment of world markets”¹².

12. Katzenstein, Peter J., 1984, *Corporatism and Change, Austria, Switzerland, and the Politics of Industry*. Ithaca, N.Y.: Cornell University Press. p. 220–221.

Chapter 4

The crisis of the Swiss watch industry in the 1970s

In the 1970s, the post-war global economic boom came to an end. The collapse of the Bretton Woods System¹ in 1971 led to a strong appreciation of the Swiss franc while productivity in the Swiss watch industry was comparatively low. Finally, the energy crisis and Switzerland's strong dependence on fuel imports led to higher variable production costs. As a result, the average price of a Swiss watch in the dollar zone was about 180 per cent² higher in 1978 than in 1971. All these trends were not conducive to facing the growing competition from newly industrialized countries in Asia as well as the United States.

The Japanese developed modern assembly line systems that enabled them to automate large parts of the production of mechanical watches. As a consequence, they were able to produce at much lower cost, with a smaller workforce and in a quality and precision that challenged the Swiss quality label. Moreover, their watches were much lighter than similarly priced Swiss watches with their pin-pallet escapement invented by Georges Frédéric Roskopf in the 19th century. Roskopf's technology had dominated the low-end price segment of watches for decades. Customers increasingly turned their back on these low-end mechanical Swiss watches, and the Swiss watch industry dramatically lost market share (Figure 1), while the per unit export price for such Swiss

1. In 1971, the United States unilaterally terminated convertibility of the US dollar to gold. This marked the end of the Bretton Woods Agreement established in 1944 which provided for a system of fixed exchange rates after World War II.

2. Documentation of the history of SSIH 1930–1980, p. 49. Found in the Swiss Economic Archive Basel.

The Swiss watch industry

watches increased from CHF 47 in 1974 to CHF 148 in 1982. The resulting losses revealed the structural problems in the Swiss watch industry. The business of homeworkers in the Swiss watch industry was basically eliminated and even established companies had to dismiss thousands of skilled workers (Figure 2).

4.1 Swiss technology commercialized elsewhere

Switzerland recognized the potential of electronic watches for the automatization of work processes in watch manufacturing but failed to anticipate the extent to which it would change the entire industry. In 1950, while working for the American company Bulova in Biel, Switzerland, the Swiss Max Hetzel developed Accutron, the first “electronic watch” and a forerunner of modern quartz watches. In the late 1960s, a subsidiary of ASUAG secured access to Bulova’s know-how in chip production by signing a cross-licence agreement³.

Yet, the leaders in the Swiss watch industry did not just react to the electronic watch by imitating foreign innovations, but proactively decided to establish their own national watch research centre called the Centre for Electronic Watches (Centre Electronique Horloger – CEH) in N uchatel in 1962. The CEH’s main purpose was to develop a “Swiss made” quartz wristwatch. In 1967, the CEH presented the world’s first prototype analogue quartz wristwatch: the  bauches SA Beta 21. Yet, the Japanese company Seiko came up with the world’s first commercial quartz wristwatch, the Astron. This watch was released just prior to the introduction of the commercial version of  bauches SA Beta 21.

Despite being a technological leader at the beginning of the electronic age of the global watch industry, the core competence of the Swiss watch industry was with the production of mechanical watches. In fact, Swiss excellence in the

3. Katzenstein, Peter J., 1984, *Corporatism and Change, Austria, Switzerland, and the Politics of Industry*. Ithaca, N.Y.: Cornell University Press. p. 218.

production of mechanical watches constituted part of Swiss national identity and was embodied firmly in the “Swiss made” label. There was therefore great reluctance in Switzerland to invest in the commercialization of cheaper quartz watches. While the Swiss were worried about possible cannibalization effects, competitors abroad understood the potential of the technology and further improved it.

4.2 The role of the Swiss banks

The global economic and technological transformation of the watch industry in the 1970s caught the two largest Swiss watch companies, SSIH and ASUAG, on the wrong foot. By the 1970s, SSIH was the largest producer of wrist watches in Switzerland and globally the third largest company for finished watches with a turnover of more than CHF 700 million. The second most important player in the business of finished watches in Switzerland was the General Watch Co. Ltd. (GWC). The holding contained 14 different Swiss watch brands (see Figure 8). It was acquired by ASUAG in 1971. In both companies, SSIH and ASUAG, the role of the banks became decisive. The Union Bank of Switzerland (Schweizerische Bankgesellschaft) became by far the largest shareholder of SSIH and ASUAG was dominated by a consortium of Swiss banks under the leadership of the Swiss Bank Corporation (Schweizerischer Bankverein).

4.2.1 SSIH before the merger

The financial troubles of SSIH had already become apparent in the first half of the 1970s. The company amassed huge inventories and its sales volume declined from 14 million time pieces in 1973 to 6.3 million in 1978. The company reduced its personnel in the same period by 20 per cent and its turnover declined from CHF 733 million in 1974 to CHF 662 million in 1978⁴.

4. Documentation of the history of SSIH 1930–1980, p. 58. Found in the Swiss Economic Archive Basel.

The Swiss watch industry

SSIH did undertake efforts to adapt its production and organizational structure to the new market realities, reinforced research and development, and strengthened its marketing. But all this did nothing to improve its market position. Reserves melted away, and assets declined to an extent that new capital from the Swiss banks had to be injected constantly. At a later stage this new capital was converted into shares making the Union Bank of Switzerland (UBS) the principal shareholder. Additional Swiss banks with minor stakes in SSIH were the Swiss Bank Corporation (SBC), Credit Union (Volksbank), and the Bernese Cantonal Bank.

As SSIH became insolvent, its creditor banks assumed control in 1981. The UBS Banker Peter Gross became president of the governing board of SSIH. In search for someone who could manage the turnaround of the company, he asked Hayek Engineering AG to screen especially the two most valuable brands of SSIH, Omega and Tissot. They had incurred heavy losses and restructuring was unavoidable. However, restructuring efforts of SSIH in 1981, based on the analysis of Hayek Engineering AG and under the auspices of Mr Gross, completely failed to save the company⁵. Based on the consolidated profit and loss statement of ASUAG-SSIH, the *Neue Zürcher Zeitung* (NZZ) journalist Hansjörg Abt concluded later that SSIH, and within SSIH, Omega in particular, was actually the sick patient in this merger of unequals⁶. The *Weltwoche* journalist Oliver Fahrni went even further in an article published in 1985. He argued that Peter Gross had failed to restructure Omega already back in 1981 and that only the merger with ASUAG made it possible to save this valuable SSIH luxury brand from the collapse⁷. The consolidated financial statements of

5. Hadorn, Werner., 2016, Swatch Geschichte: So war es wirklich. Interview mit Pierre Renggli. Biel/Bienne Wochenzeitung (8/13) 24/25 Februar 2016: 3 (available online: http://www.bielbienne.com/tl_files/BB.16/bb_aktuell.pdf).

6. Abt, Hansjörg, 1984, Die Omega als Sorgenkind der Asuag-SSIH, Mageres Ergebnis dreijähriger Restrukturierungsmaßnahmen, NZZ, 20.06.1984.

7. Fahrni, Oliver, 1985, Das tickende Paket ist vortrefflich geschnürt, Die Weltwoche, 31. Januar 1985.

SSIH, published on 31. December 1980, 1981 and 1982, respectively, confirm these allegations: the losses were CHF 161.6 million in 1980, CHF 38.4 million in 1981 and CHF 17.1 million in 1982⁸.

Figure 12 shows that consolidated equity of SSIH had started to sharply deteriorate back in 1976. This also had to do with consolidated sales that were mostly downward trending after 1974. This is in sharp contrast to ASUAG, which showed a very solid equity situation throughout the 1970s and had upward trending sales before the watch crisis hit the company (Figure 11).

4.2.2 ASUAG before the merger

In the 1970s, ASUAG was the world's largest producer of movement blanks and movement parts. At that time, ASUAG was seeking vertical integration in response to the end of the "Watch Statute". With the acquisition of the General Watch Co. Ltd. (GWC) ASUAG's turnover grew from CHF 760 million in the 1970s to CHF 1.4 billion in 1974 with watches and finished movements assuming a share of 43.9 per cent (before it was merely 5 per cent)⁹. While ASUAG grew in size, the Swiss federal government reduced its stake in the company from 38 per cent in 1971 to 8 per cent of the shares in 1978¹⁰. ASUAG nevertheless stuck to its original state-mandated mission to supply watch components to all Swiss watch companies on equal terms. The gradual withdrawal of the government eventually made a fundamental

8. SSIH Schweizerische Gesellschaft für Uhrenindustrie AG, Geschäftsbericht 1980 – 1981, Geschäftsbericht 1981/1982, Geschäftsbericht 1982/1983. Zentrale für Wirtschaftsdokumentation, Universität Zürich. Sales of Omega declined from CHF 269.4 million in 1979 to CHF 217.6 million in 1980.

9. Donzé. P.-Y., 2014, A Business History of the Swatch Group: The Rebirth of Swiss Watchmaking and the Globalization of the Luxury Industry. Palgrave Macmillan.

10. Katzenstein, p. 218; BBL 1983 III 945. Botschaft über die Veräusserung der Beteiligung des Bundes am Aktienkapital der Allgemeinen Schweizerischen Uhrenindustrie AG vom 14. September 1983. p. 952.

The Swiss watch industry

restructuring of the company possible but also resulted in an increase in debt compared to equity.

According to Donzé¹¹, the watch crisis that started in 1975 was not a result of the quartz revolution (product innovation) but due to the structural unsuitability of the Swiss watch industry to acquire new technologies and to integrate them into the production system (process innovation). Unlike the Swiss, the Japanese were capable of mass producing high-quality mechanical watches. As a result, their mechanical watches became cheaper while the Swiss ones became ever more expensive (partly also because of the appreciation of the Swiss franc). This caused the global market share of Swiss mechanical watches to fall steadily. Strengthened and supported by the watch statue (1934–1971), the dispersion of the industry between numerous independent companies precluded a rationalization of the production of parts and movements for high-quality mechanical watches. In 1978, when Ernst Thomke was appointed as head of Ébauches SA (subsequently renamed ETA SA), the movement manufacturer that belonged to ASUAG, he initiated a profound restructuring process by merging and streamlining the various subsidiaries of the holding company Ébauches SA. This made it possible to invest first of all in process innovation, introducing automation technology in piece and part manufacturing. As a result of this restructuring, ASUAG would eventually be able again to compete with the Japanese in the segment of high-quality mechanical watches¹². In addition, it started with the manufacturing of quartz watches. The share of quartz watches and movements in the production of ASUAG stood at 9.3 per cent in 1975 and climbed up to 77.2 per cent (number of units) in 1982. Designing, prototyping and the production of new products and processes were reconfigured in a short period of time and lead to a fundamental transformation of the company. In addition, ASUAG competed

11. Donzé. P.-Y., 2014, *A Business History of the Swatch Group: The Rebirth of Swiss Watchmaking and the Globalization of the Luxury Industry*. Palgrave Macmillan.

12. Ibid.

with the Japanese in the field of product innovation. In 1978, Ébauches SA already won the contest for the thinnest watch by presenting the slimmest watch called Delirium (Box 3).

Aside from Delirium, ETA SA developed the novel Swatch concept with a completely separate team. Dr Thomke supported the idea developed by two brilliant engineers who came up with the concept of a cheap quartz watch made out of plastic. He freed them from all other responsibilities in the company, made them directly accountable to him and protected them from internal broadside. After 18 months they were able to come up with a working prototype. This prototype was cheap but not very attractive. A marketing concept was subsequently developed to make the Swatch “chic”, to make it “fashion that ticks”. Fashion designers were subsequently asked to design a colourful “rolex for ordinary people”¹³ (Box 3). This revolutionary product innovation eventually helped ASUAG to overcome the quartz crisis that threatened the Swiss watch industry in the early 1980s.

In retrospect, the product and process innovation would not have been possible without a CEO like Ernst Thomke. He combined entrepreneurial spirit, science and engineering skills with the instinct of recruiting the right people and had the courage of the outsider to take on the conservative corporatist culture that prevailed within this large watch company¹⁴.

In contrast to SSIH that had been in financial troubles for many years, ASUAG’s financial situation only started to deteriorate considerably by 1981 at the onset of the worldwide watch crisis due to the oversupply of quartz watches from Japan. Moreover, its market share for mechanical watches and mechanical parts was still eroding. Since prices for Swiss mechanical watches did not decline at

13. Garel, Gilles and Elmar Mock, 2016, *The Innovation Factory: Taking the Plunge*. Auerback Publications.

14. *Ibid.*

Box 3 Delirium and Swatch

In the 1970s, Gedalio “Gerry” Grinberg, the founder and chairman of the Movado Group and the main distributor of Swiss watches in the United States became increasingly impatient with thick Swiss mechanical watches. He threatened Swiss watch exporters to buy thin Seiko watches available in Japan, unless they come up with something similar on their own. As a consequence, Ernst Thomke, the CEO of ETA and board member of ASUAG, asked Urs Giger, head of R&D at ETA to organize a joint team with the technical directors of CEH in Neuchâtel and Renata, a coin battery manufacturer in Itingen near Basel, to develop a watch that would outcompete any other available watch in terms of thinness. The design engineer Maurice Grimm made use of a well-known idea to directly mount the watch components onto the case back (*Platine*) to economize space. As a result, the so-called Delirium watch was developed. Its thinness was 1.97 mm and thus outcompeted the Seiko model (2.5 mm). With its metal frame it was, however, quite delicate and expensive. Its commercial success was thus limited to the Concord Delirium, for which Gerry Grinberg obtained the marketing rights.

continued on page 35

that time, the demand shrunk and the sales of ASUAG temporarily fell to an unprecedented low level.

Figure 3 shows that ASUAG remained the worldwide leader in exports of movement blanks. But, the production declined considerably from roughly 20 million in 1981 to only 13 million pieces in 1982. The value of these exports declined from CHF 382 million in 1981 to CHF 256 million in 1982. Yet, as of December 31 of 1981, ASUAG still had consolidated equity of CHF 321 million combined with consolidated debt of CHF 799 million. Its annual consolidated turnover was CHF 1 413 million¹⁵. For many years, equity was between 40–50

Box 3, continued from page 34

The president of the governing board of ASUAG, Pierre Renggli, suggested to Ernst Thomke to create a cheap watch for the mass market under the brand of Certina. Dr Thomke subsequently wrote the specification sheet for the development of an inexpensive, reliable, waterproof watch that could be manufactured in a fully automated way in Switzerland. He then embraced the idea of Elmar Mock and Jacques Müller to develop an affordable plastic quartz watch. It was called the Vulgaris Project. The watch itself was eventually called the “Swatch”. Its architecture and conceptual idea was very different from the one of Delirium. Swatch was produced in a fully automated way, which made it possible to reduce the labour costs to a tenth of the total production cost. It consisted of only 51 components and its production costs were far below those of mechanical watches. The idea of a cheap and mass-produced plastic watch broke with all traditions in the watch industry, while the Delirium was merely based on shifting “traditional parts of a watch around towards the edge in order to flatten them”.

Source: Carrera, Roland, 1992, Swatchissimo 1891–1991. Antiquorum.

per cent of current assets (*Umlaufvermögen*) and only dipped below this mark in the difficult year of 1982. Equity as a share of borrowed funds was always above 50 per cent until 1980, then dropped to 40 per cent in 1981 and then apparently vanished in 1982. The worsened financial situation was also related to the fact that the sales of Ébauches S.A., which always had been the financial pillar of ASUAG, declined by 32.4 per cent in 1982¹⁶. Figure 11 in the Annex shows how consolidated sales and employees evolved from 1973 to

15. ASUAG, 1983, Geschäftsbericht 1982. Swiss Economic Archive Basel. p. 6.

16. *Ibid.* p. 10.

The Swiss watch industry

1982. While consolidated sales increased between 1976 to 1981, the number of employees steadily declined, which meant that per capita consolidated sales increased from CHF 64 100 to CHF 99 440¹⁷. This resulted in a huge improvement of the productivity. The company's management took additional immediate measures in 1982 such as the introduction of short time work and the reduction of inventories that stood at very high levels, resulting in massive depreciations.

Figure 11 depicts how current assets and consolidated equity were very stable until 1981. While current assets dropped by 19 per cent in 1982, consolidated equity totally vanished, and ended in a negative amount of minus CHF 22.5 million in 1982 – hinting at some irregularities prior to the planned ASUAG-SSIH merger.

17. Ibid. p.6.

Chapter 5

A merger of unequals: SSIH and ASUAG become SMH

In response to the problematic financial situation of ASUAG since 1981, a steering committee, a so-called *Steuerungsausschuss* (STEA), constituted as a supervisory and decision-making body, assumed responsibility for the company on June 30, 1982. The members of this steering committee mainly represented the creditors of the company. At that time, the involved Swiss banks decided already in favour of a standstill agreement ensuring that ASUAG and SSIH would keep their credit lines until June 30, 1983. Peter Gross from UBS then suggested to commission a study from Hayek Engineering AG to screen ASUAG since he would be familiar with the watch industry based on his prior involvement in the restructuring efforts of SSIH¹. The study did not find any sign of negligence in the area of business management. It even concluded that ASUAG had real chances to survive and that it could be reorganized in a way to be again profitable². However, the study was considered to contain too many inconsistencies and all copies were subsequently returned and eliminated³.

At the same time, a comprehensive reorganization took place in ASUAG: restructuring measures were initiated and the sale or closing of several operations within the group were ordered⁴. Despite all these efforts, ASUAG

1. The restructuring of SSIH in 1981 is explained in detail in the SSIH Geschäftsbericht 1981/1982. p. 6.

2. Annual report ASUAG 1983.

3. Graden, Tobias, 2016, Wie Nicolas G. Hayek zur Swatch Group kam. Bieler Tagblatt, 04.03. 2016.

4. BBI 1983 III 945. Botschaft über die Veräusserung der Beteiligung des Bundes am Aktienkapital der Allgemeinen Schweizerischen Uhrenindustrie AG vom 14. September 1983. p. 951.

The Swiss watch industry

had to disclose a loss of CHF 42 million in the first half of the year 1982, for the first time. This induced the Swiss banks, which were heavily implicated in SSIH and ASUAG, to consider the idea of merging the near bankrupt SSIH with ASUAG. Such a step would save UBS the embarrassment and the costs of letting SSIH go bankrupt while portraying the bank and its consortium as patriotic actors determined to save the watch industry.

However, the president of ASUAG, Pierre Renggli, did not see the industrial, organizational, and financial advantages in absorbing a near bankrupt SSIH because despite the difficult short-term challenges related to the watch crisis, his company was in good shape, as the contentious Hayek study commissioned by the banks also confirmed. ASUAG was well organized, had a great portfolio of intellectual property rights and was ready to conquer global markets with the Swatch, which was already launched at that time, independent of whether the company was merged with SSIH or not.

Based on the financial facts, ASUAG was not bankrupt and could not be restructured on the grounds of Swiss insolvency law. This made it indeed difficult for SBC and UBS to justify the merger. SBC, which had the largest stake of the banks in ASUAG, therefore instructed the chief controller of ASUAG, to implement the suggested financial engineering (mainly through massive write-offs) to convert CHF 590 million⁵ in equity into a negative equity of CHF 22.5 million⁶. The Swiss Trust Company (Schweizerische Treuhand

5. The equity capital of CHF 590 million as mentioned by the former Chief Financial Controller of ASUAG, Dirk Schröder, is contested by Bruno Bohlhalter, a former banker of Volksbank (and later Credit Suisse) who recently published his PhD on the history of the watch industry. In a recent article in the Bieler Tagblatt ("Kampf um die Deutung der Geschichte". Bieler Tagblatt, 02.03.2016, p. 2–3) by Tobias Graden, Bohlhalter argues that the equity capital of ASUAG was CHF 321 million. Schröder, however, argues that the number of Bohlhalter refers to the equity capital one year before the merger (as reported in the ASUAG annual report), the one he prepared for the tax declaration in 1982 was however CHF 590 million but has never been published since it was depreciated later in the year to minus CHF 22.5 million.

6. Personal Communication with Dirk Schröder, former Chief Controller of ASUAG, January 2016.

AG), which was 100 per cent owned by SBC, did then the audit of ASUAG in 1982 and approved the balance of accounts⁷. This meant that the company was regarded as technically bankrupt like the SSIH, but with the difference that this result had been generated artificially and did not reflect the reality of the company. The negative result, confirmed by the audit, increased pressure on the management and the minority shareholders of ASUAG to agree to the forced merger with SSIH. By today's standards, such a "self-evaluation" would probably be illegal and absolutely incompatible with principles of good corporate governance.

Based on the Hayek study and the audit, the steering committee (STEA) convened a secret conference in Interlaken in mid-January 1983 where the banks finally decided to merge ASUAG and SSIH. The UBS banker and chairman of the governing board of SSIH Peter Gross later explained in an op-ed in *NZZ* in May 1983 that the banks decided to carry out a capital cut that might affect some of the existing shareholders of ASUAG⁸. At the same time, the banks were committed to provide new capital for the newly merged company. The decision in favour of the merger was also framed as a patriotic commitment of the banks to ensure that the production of Swiss mechanical and quartz movements remains in Switzerland. It was, however, also pointed out in the press that it was an open secret in Biel that the merger primarily served the purpose of helping Peter Gross to save his ailing company (SSIH-Omega) by making its troubled legacy disappear through the merger⁹. Yet, Bruno

7. In the annual report 1983 the balance sheet of ASUAG was presented as follows: Per December 31, 1982 ASUAG had a negative balance of CHF 156.5 million. This loss exceeded the company's own assets which stood at CHF 134 million and consisted in CHF 75 million shareholder capital and CHF 59 million in reserves. The result was an over-indebtedness of 22.5 million CHF.

8. Gross, Peter, 1983, Die Schweizer Uhr hat reelle Zukunftschancen. *NZZ*, 13. Mai, 1983, p. 17.

9. Fahrni, Oliver, 1985, Das tickende Paket ist vortrefflich geschnürt, *Die Weltwoche*, 31. Januar 1985. In the same article it is reckoned that the balance sheet of Omega had been tampered with by moving inventories to stores.

The Swiss watch industry

Bohlhalter, who represented the interests of the Volksbank (which was later bought by Credit Suisse) back then concludes in his PhD thesis in 2015¹⁰ that this step proved that the Swiss banks were acting responsibly – allegedly having the public rather than their private interest in mind. He conceals, however, the private interest of Peter Gross to avoid the embarrassment he would have faced as a director general of UBS and former chairman of the governing board of SSIH, if SSIH would have gone bankrupt. Moreover, the demise of SSIH would have affected numerous other companies in the industry that were suppliers to SSIH and highly indebted with the Swiss banks, especially UBS. It was therefore quite convenient to avert bankruptcy of SSIH by merging it with ASUAG, a company that may have been in financial distress since the quartz crisis in 1981 but was well restructured under Pierre Renggli and his team. The commercial potential of ETA's newly developed Swatch became clear when a first batch of 20 000 pieces was practically sold within 14 days at the beginning of 1983. Neither Nicolas Hayek nor Peter Gross did initially acknowledge the potential of Swatch, discarding any claim that this new plastic watch could become a huge commercial success for ASUAG as a whole that would also lift the rest of the Swiss watch industry out of crisis¹¹. The failure to acknowledge the potential of the Swatch is not surprising because admitting that ASUAG may have great future prospects would have been equal to admitting that it was a merger of unequals.

Ultimately, it turned out that the Swiss watch industry was neither saved by the Swiss banks nor by Nicolas Hayek but by the great efforts of the skilled managers, designers and marketing experts of the watchmaking region of northwestern Switzerland to restore the competitiveness of ASUAG prior to the merger. The

10. Bohlhalter Bruno, 2015, Die Uhrenkrisen der 1930er- und 1970/80er-Jahre in der Schweiz: Entstehung und Bewältigung. Dissertation in Contemporary History at University of Fribourg, Switzerland.

11. Graden, Tobias, 2016, Wie Nicolas G. Hayek zur Swatch Group kam. Bieler Tagblatt, 04.03. 2016.

company may have faced temporary financial problems in 1982 but that was mainly because so much had been invested in the renewal of the company. These investments paid out and helped to bail out SSIH in the long run.

The merger of unequals had particular consequences for the minority shareholders of ASUAG (representing smaller players in the watch industry and private persons) who were affected by the decision of the steering committee to carry out a capital cut designed to facilitate the merger. The minority shareholders held 55.5 per cent of the shares¹² and for every old ASUAG share they were offered a new share of the merged SSIH-ASUAG that was worth a tenth of the prior value. The devaluation reduced the share of ownership of the minority shareholders¹³ to 2.5 per cent whereas the banks massively increased their capital stake through debt conversion of bank loans into new shareholder capital making the banks the de-facto owners after the

12. Banks held 36.5 per cent and the Swiss Confederation 8 per cent of the shares. This was the structure of the shareholder capital after the increase of capital in 1978. Source: Asuag, 1981, Asuag 1931–1981, Von der Verwaltungsholding zur operationellen Industriegruppe. p. 14.

13. Annual report ASUAG 1983. Report of the steering committee. "The share capital of par CHF 75 million is reduced to CHF 7.5 million, which corresponds to a reduction of 90 per cent or CHF 67.5 million. p. 4 [...].

Point 5.2: Reduction of the shareholder capital to CHF 7.5 million: the governing board proposes to the general assembly to reduce the shareholder capital from CHF 75 million, composed of 375 000 bearer shares of par CHF 200 each, to CHF 7.5 million, which is CHF 67.5 million, by a reduction of the nominal value of the shares of 90 per cent to CHF 20. Increase of the shareholder capital to CHF 200 million: the governing board proposes to the general assembly to increase the shareholder capital from CHF 7.5 million to CHF 200 million by an emission of 1 925 000 shares of par CHF 100 each. The right of the shareholders to subscribe to these shares has to be excluded, given that the payment in full is entirely done by converting existing debts by the banks into shareholder capital."

The aforementioned article in the Bieler Tagblatt ("Kampf um die Deutung der Geschichte. Bieler Tagblatt", 02.03.2016, p. 2–3) by Tobias Graden refers to the new facts found in the economic archive at the University of Basel, and also mentions a former shareholder of ASUAG who protested against the planned expropriation of former shareholders by the Swiss banks. She was finally compensated for the loss by the SBV general director Walter Fehner, but had to sign an agreement to remain silent about the case. These irregularities were also addressed in Bettina Hahnloser's book "Der Uhrenpatron und das Ende einer

The Swiss watch industry

merger. At SSIH, on the other hand, shares were exchanged one to one¹⁴. As SSIH was almost entirely in the hands of banks (before the merger: 96.3 per cent; afterwards 92.6 per cent) and only few other shareholders existed, their loss was minimal¹⁵.

The motivation of the involved banks for the massive financial engagement was not only to prevent a disaster in the economy and to keep its face but also to recuperate at some point the money that had been pumped into the watch industry¹⁶. Hansjörg Abt pointed out that the banks were in a double role as creditors and owners (98 per cent of Asuag-SSIH shareholder capital) and therefore had to bear the full risk and with it the leadership responsibility. As banks usually do not want to end up as long-term owners of a company, it was clear¹⁷ that, at some point, they would pull out of the sector.

Ära" (NZZ Libro 2015) and discussed in a book review in the Swiss newspaper 'der Bund' (Wie Grenchen dank der Familie Schild zur Uhrenmetropole wurde, 10.11.2015).

The same shareholder wrote in a letter dated from August 30 1983 (found in the economic archive at the University of Basel) to the president of the governing board of Asuag (F. Millet), the president of the governing board of Ébauches SA (W. Frehner), and to the director of the Swiss trust company (Bysäth). In that letter she laments that the information provided at the general assembly of Ébauches SA from June 30 1983 was unsatisfactory.

She finds that the situation of the company's assets was much better than officially portrayed. She also questioned the conversion of Ébauches shares to Asuag shares as the assets still amounted to CHF 222 million. Further she criticizes the information policy of the responsible persons and the inadequate information received from the auditing agency, even more so as the governing board would not accept a representative of the minority shareholders. She asks for several changes of the information policy at general assemblies.

14. ASUAG-SSIH, 1984, Bericht des Verwaltungsrates gemäss Art. 650/630 des Obligationenrechts."^{4.3} The merger takes place by exchanging shares of SSIH into shares of Asuag-SSIH according to the following share exchange ratio:

a) The shareholders of SSIH receive for eight registered shares of par CHF 2.50 one Asuag-SSIH registered share of par CHF 20. [...]

b) The shareholders of SSIH receive for four bearer shares of par CHF 5.00 one Asuag-SSIH bearer share of par CHF 20.

15. Personal Communication with Dirk Schröder, former Chief Controller of ASUAG, January 2016.

16. Abt, Hansjörg, 1985, Entlassung der Asuag-SSIH aus der Obhut und Verantwortung der Banken?, NZZ, 17. Januar, 1985.

17. Ibid.

The Swiss government agreed to completely pull its remaining shareholding capital out of ASUAG and leave the company to market forces¹⁸. Yet, it did not raise any antitrust concerns related to the merger (Box 4). This eventually paved the way for a huge conglomerate that once was a government sanctioned monopoly to be converted into a private monopoly. Hardly an act that proved to be in the public interest.

5.1 How a former state monopoly became a private monopoly

At the end of 1983, the ASUAG-SSIH merger was completed and the new company was named ASUAG-SSIH holding. The new structure resulted in a concentration of industrial activities such as research and development (R&D) and production under the umbrella of the ETA company in Grenchen, formerly owned by ASUAG. By the end of 1983, ETA already had sold 1.1 million Swatches. Even though the good start of the Swatch ensured that marketing costs were covered and machines could be written off, there was no profit yet resulting from the Swatch business. As a consequence, the ASUAG-SSIH still incurred losses in 1983. Yet, in 1984, 3.7 million Swatch watches were sold and the Swatch AG was founded with the purpose to market the ETA-manufactured Swatch. The marketing concept and philosophy of Swatch was developed by Franz Sprecher who was an ETA employee since 1981. After making Swatch a profitable business, Ernst Thomke was also asked to restructure the loss-making brands of SSIH. He reorganized first Tissot company in 1984 and in 1985 Omega by refocusing the brand on a limited number of models with a strong identity and to accentuate the connotation of high-end luxury attached to this brand. This paved the way for the economic recovery of Omega¹⁹.

18. BBl 1983 III 945. Botschaft über die Veräusserung der Beteiligung des Bundes am Aktienkapital der Allgemeinen Schweizerischen Uhrenindustrie AG vom 14. September 1983. p. 952.

19. Donzé. P.-Y., 2014, A Business History of the Swatch Group: The Rebirth of Swiss Watchmaking and the Globalization of the Luxury Industry. Palgrave Macmillan.

The Swiss watch industry

By then, Nicolas Hayek was the president of the governing board of SMH. He approved of the successful reorganization of the Tissot and Omega brands but was not directly involved in the actions²⁰. Yet, Ernst Thomke seemed to have disliked the way Peter Gross and Nicolas Hayek tended to appropriate the story of the successful restructuring of the Swiss watch industry as their achievement. In a letter also found in the economic archive of the University of Basel and cited in a recent article in *Tages-Anzeiger*, he points at the fact that Peter Gross and Nicolas Hayek were largely accountable for the prior failure to restructure Tissot and Omega and would therefore have no right to portray the successful restructuring of the watch industry as their achievement²¹.

The stunning success of Swatch in 1984 was also related to the recovery of the global economy. Floating exchange rates were then well established, the transition to the electronic era was accomplished and watch technology had stabilized. In 1985, the 10 millionth Swatch was sold²², and its sales contributed considerably to the excellent performance of ETA company. The global success of Swatch allowed the company to enhance the worldwide awareness also for other famous mechanical Swiss watch brands such as Rado and Longines (formerly owned by ASUAG) and Tissot and Omega (formerly owned by SSIH).

In 1985, the SSIH-ASUAG merger was re-named SMH. This new watch conglomerate under the operational leadership of Ernst Thomke became a global leader in watch production and technology. It had reduced its workforce by half, operated with the most up to date facilities, had new very successful products such as the Swatch and excellent engineers and managers. Yet, the banks never had the intention to remain the de-facto owners of SMH and were

20. Garell, Gilles and Elmar Mock, 2016, *The Innovation Factory: Taking the Plunge*. Auerback Publications.

21. Mettler, Jon, 2016, *Zweifel und Hayeks Erfolgsgeschichte*. *Tages-Anzeiger*, 5.3. 2016.

22. <https://de.wikipedia.org/wiki/Swatch>

Box 4 How the ASUAG-SSIH merger was portrayed officially

The banks and governing boards of SSIH and ASUAG argued that a merger was necessary in view of the dire financial situation of both companies. They also argued that the two companies suffered from several interface problems that affect the whole Swiss watch industry. By merging the two companies, synergies in the areas of finished watches, movements and cases as well as an appropriate clustering of activities could be achieved; this would then lay the grounds for an improvement of capacity utilization which in turn would contribute to securing jobs. At the ordinary general assembly from June 29 of 1983 the following financial restructuring measures were endorsed: The banks forwent outstanding debts of CHF 30 million. With this, ASUAG's alleged over-indebtedness of CHF 22.5 million was eliminated, and CHF 7.5 million in share capital was created. This share capital represented a tenth of the previous nominal share capital of CHF 75 million. The banks then injected another CHF 392.5 million by netting against liabilities in order to regain a sufficient asset basis of about a third of the balance sheet total. This sum together with the CHF 7.5 million of share capital provided the new capital basis of CHF 400 million. After the merger with SSIH, the share capital of ASUAG-SSIH was CHF 300 million (share capital ASUAG 200 million, share capital SSIH CHF 100 million). In order to fulfill the minimal equity requirements for the merger, the implicated banks had to ask for an exception from the Swiss Federal Banking Commission (now FINMA). It was granted because the restructuring was seen in the interest of the whole economy. After the merger, ASUAG-SSIH consisted of three groups: finished watches, movements & parts, and industry products, which were then integrated into a financial holding. The three groups were organized and managed independently.

Source: BBl 1983 III 945. Botschaft über die Veräusserung der Beteiligung des Bundes am Aktienkapital der Allgemeinen Schweizerischen Uhrenindustrie AG vom 14. September 1983. p. 951; Eidgenössische Bankenkommission, 1983, Jahresbericht. p. 31–33.

The Swiss watch industry

in search of a buyer. Peter Gross encouraged Nicolas Hayek to buy a stake in the merger as early as 1984. He was then able to convince the bank consortium that Nicolas Hayek should be given the opportunity to acquire a majority stake in SMH provided that he was able to raise the necessary financial means. Stephan Schmidheiny helped him do so. Together they acquired an initial stake of 7 per cent in January 1985. He then was able to put together a pool of investors which managed to exercise the option to acquire a 51 per cent stake (estimated value CHF 153 million) in SMH by September 1985. Even though CHF 153 million corresponded to the nominal value of the shares, it can be considered as a very favourable bargain in view of the fact that SMH employed 12 000 people in 90 factories and research centres and owned well-known brands such as Omega and Longines, and last but not least the Swatch itself. The brand value of Omega alone was estimated to be CHF 300 million during the years of crisis when foreign companies showed some interest in the purchase of the brand²³. Moreover, the assets of ASUAG-SSIH not only comprised the shareholder capital of CHF 300 million but also free reserves of CHF 120 million and CHF 169 million in provisions. Reserves that, most probably, had asset character. The commercial value of ASUAG-SSIH was estimated in 1983 to be around CHF 0.5 billion, once *agio* on the occasion of the reorganisation was also taken into account²⁴.

Hayek's pool of investors included additional investors such as Esther Grether, Peter E. Baumberger, and Franz Wassmer. Most of them were heirs of large and well-known family businesses²⁵. They all signed a shareholder's agreement designed to give Nicolas Hayek the sole voting right for the pool.

23. Graden, Tobias, 2016, *Wie Nicolas G. Hayek zur Swatch Group kam*. Bieler Tagblatt, 04.03. 2016.

24. Abt, Hansjörg, 1985, *Entlassung der Asuag-SSIH aus der Obhut und Verantwortung der Banken? Fortgeschrittene Verhandlungen mit potentiellen Investoren*, NZ, 17.01.1985.

25. Donzé, P.-Y., 2011, *La circulation des richesses. Le retour de l'industrie horlogère suisse sur le marché mondial: une Business History du Swatch Group (1983–2010)* (No. 4). Université de Neuchâtel.

At the core of the “Hayek pool” was the so-called WAT-Holding, controlled by Nicolas G. Hayek (until 2010) and Stephan Schmidheiny (involved until 1993). The WAT-Holding was eventually controlling 33.3 per cent of SMH shareholder capital.

Since UBS Banker Peter Gross appears to have played a crucial role in facilitating this favourable deal as former president of SSIH and promoter of Nicolas Hayek, his favour was returned: from 1985 onwards he was on the board of SMH, and from 1998–2011 he was vice-president of the governing board of the Swatch Group. Equally, Walter Frehner who was director general of SBC and member of the governing board of ASUAG was also rewarded with a post as vice-president of the governing board of SMH which he held until 1997.

In July 1993, the equity capital of SMH was financially restructured. According to Dirk Schröder²⁶, the official purpose of the restructuring was to split and standardize the SMH share capital (CHF 331 263 000) and to issue new nominal shares of a value of CHF 10 per share (CHF 15 030 000) and bearer shares of a value of CHF 50 per share (CHF 3 619 260). By cutting the value of a new nominal share from originally CHF 100 to CHF 10, a “people’s share” representing one vote for one share was apparently created. Ultimately, the nominal capital value of the company remained the same. However, the effect of this financial engineering was that the 51 per cent majority ownership of the Hayek pool of investors was no more based on the value (CHF 153 million) but the number of shares (18 641 260), independent of whether these were nominal or bearer shares. The reduction of the nominal value in the Hayek pool of investors took place by selling the original shares at market prices which peaked in July 1993. The adjustment from share value to numbers of shares in the 51 per cent majority ownership as well as the selling

26. Dirk Schröder, 1994, Bieler Wirtschaftsbrief, Nr. 77, 27.01.

of the liquidated nominal value of the Hayek Pool of investors brought substantial monetary gains without losing influence. This may also explain the willingness of Stephan Schmidheiny to cede control of operating decisions and responsibility to Hayek by choosing bearer shares for practical reasons. This allowed Hayek to *de-facto* control SMH with effectively only 13 per cent of its shares [...]”²⁷. The financial engineering also resulted in a liquidation profit for the Hayek-pool members of CHF 1 895.6 million in cash, according to the analysis of Schröder²⁸. Taking this into consideration, the withdrawal of Schmidheiny in 1993 from the WAT Holding makes sense from a profit-maximizing point of view: the market value of his SMH-share package increased by CHF 1 295 million. SMH shares outside the Hayek-pool in the hands of small investors as well as pension and investment funds in 1993 may have reached a market value of up to CHF 5 958.9 million. Yet, they would only have had 44.9 per cent of the votes. The question then was how recoverable in value these shares were taking into account that the total SMH market capitalization of CHF 8 715 million stood against assets of only CHF 1 575 million. Schröder considered the huge difference to be just “air” based on words only.

5.2 Pretending to be Robin Hood while representing the establishment

The NZZ journalist Hansjörg Abt noticed a lack of transparency in the financial statement of SMH already in 1991²⁹. He complains that the annual report of this public company does not contain any quantifiable information about the profitability of the different brands and the numerous markets in which Swatch Group was active. This makes it hard for him to understand how the unfavourable global market environment in the second half of 1990 (mainly

27. Breiding, R. James, 2012, *Swiss Made: The Untold Story Behind Switzerland's Success*. Profile Books Ltd.

28. Dirk Schröder, 1994, *Bieler Wirtschaftsbrief*, Nr. 77, 27.01.

29. Abt, Hansjörg, 1991, *SMH nach Golf-Turbulenzen wieder im Steigflug*. NZZ, 13.06.1991: 35.

attributed to currency appreciation) would still lead to a higher net profit, more liquidity and a higher degree of equity financing of the company, as presented in the annual meeting. He attributed this success primarily to the liquidation of reserves of more than CHF 30 million. As such, the profitability of the company had less to do with real success in the operative business but with financial engineering. In fact, the shoring up of the share price and the generous dividends for shareholders under Nicolas Hayek make sense in the context of the planned restructuring of the SMH equity capital in 1993. In view of this clever financial engineering one must acknowledge the ability of Nicolas Hayek to mobilize his business network and personal resources in a way that maximize financial returns not just for himself but also his partners. Ultimately these skills made him a billionaire. Yet, his often mentioned claim to be an outsider that challenged the Swiss establishment in finance and watch-making contradicts the fact that he actually owes his career to the finance establishment and that he was not a pioneer in the watch industry but rather inherited what others had accomplished.

5.2.1 Nicolas G. Hayek

Nicolas Hayek used to portray himself as an outsider who saved an ailing watch business through groundbreaking and permanent innovation. In an interview with Harvard Business Review in 1993³⁰, he argues that SSIH and ASUAG were a mess before he arrived. Allegedly he had to convince the banks that the Swatch might become a commercial success. Almost everything he said in this interview appears to be a sort of confabulation in retrospect: Whenever he begins a sentence in the interview with “we had to [...]” he was actually referring to decisions in which he had not been involved since they had taken place prior to his employment as a consultant of the Swiss banks “to save the watch industry”. All the major technological

30. Taylor, William, 1993, Message and Muscle: An Interview with Swatch Titan Nicolas Hayek. Harvard Business Review, March–April 1993 (available online).

The Swiss watch industry

breakthroughs, the automation of assembly lines in watch manufacturing, the vertical integration strategy and the marketing idea behind the Swatch as an emotional product that would help revive the image of the entire watch industry, took place in the period from 1978 to 1982. Moreover, he proudly explains how he saved the Omega brand, even though his personal attempt to do so for SSIH failed in 1981 (Section 4.2.1) and when the turnaround had been achieved later on, it did not happen under his leadership but first under Ernst Thomke and his team, until his departure in 1992 and later under Jean-Claude Biver, who joined SMH in 1993 after he sold the successfully restored luxury watch brand Blancpain to Hayek's conglomerate. The story of Blancpain is remarkable because it originally belonged to SSIH. Peter Gross and Nicolas Hayek did not seem to see any value in this brand when they sold it to Jean-Claude Biver and Jacques Piguet for CHF 18 000 in 1983. Biver and his team proved their marketing skills by increasing the turnover of Blancpain from CHF 8.9 million in 1985 to CHF 56 million in 1991. SMH eventually acquired Blancpain and Frédéric Piguet in 1992 for CHF 60 million and made Jean-Claude Biver the boss of Omega and member of the executive board of Swatch. Biver's new team succeeded in repositioning the Omega brand. The new marketing strategy was designed to strengthen Omega brand's position as an "affordable luxury" product. The brand became a vehicle for images and emotions which tell a story, a process which creates added value and makes it possible to turn a watch into a luxury good. Media events and clever product placement were the cornerstone of the luxury brand marketing. Biver also used his success with Blancpain and before Audemars Piguet as a template to eventually help make the high-end brands of Swatch Group a global success. When he left Swatch Group in 2003 to take on the new challenge of restructuring the ailing watch company Hublot, the grandson of Nicolas Hayek, Marc Hayek, partially occupied his vacancy in the Swatch Group³¹.

31. Donzé. P.-Y., 2014, A Business History of the Swatch Group: The Rebirth of Swiss Watchmaking and the Globalization of the Luxury Industry. Palgrave Macmillan.

Nicolas Hayek essentially appropriated the achievements of the teams led by Thomke and later Biver³² as his own. He was able to convince himself to be a genius and maverick who is not afraid to be blunt and honest with the Swiss economic and political establishment that would promote monetary and economic policies that run counter to the interests of independent-minded entrepreneurs such as him that are primarily concerned with creating jobs in Switzerland. He was also not shy of attacking the Swiss government for being too soft in Libya in 2009. But when he was subsequently criticized by the media for being a hypocrite in view of his eagerness to sell watches to dubious Arab leaders, he punished the media group concerned, called Edipresse, by immediately ceasing to place any advertisements in the respective newspaper causing a decrease in annual revenues of CHF 40 million to the publisher³³.

In his attacks against “the establishment”, Nicolas Hayek tended to forget how this very establishment in finance helped him to become the de-facto owner of the Swatch Group. Moreover, the investors who made it possible for him to gain a significant stake in SMH were all part of the Swiss industrial establishment (Section 5.1.1). Important investors such as Esther Grether (personal care business), Stephan Schmidheiny (cement) and Paul Wassmer (construction and building materials) were all heirs of large industrial companies.

Finally, Nicolas Hayek was also notorious for his media announcements of groundbreaking, far-sighted and sustainable innovation to be realized by Swatch Group in the near future.

32. Jean-Claude Biver often points out how much Nicolas Hayek did for the Swiss watch industry. This is not surprising in view of the fact that Hayek also enabled Biver to unfold his potential in the watch industry and offered him very generous terms of employment.

33. Hässig, Lukas, 2009, Uhrenkönig Hayek stoppt Werbung bei Edipresse. Handelszeitung, 29.09.2009 (available online: <http://www.handelszeitung.ch/unternehmen/uhrenkoenig-hayek-stoppt-werbung-bei-edipresse>).

The Swiss watch industry

5.2.2 Smart Car

A first example was the Smart Car. The idea of a small and stylish city car with a hybrid drivetrain was great, but SMH needed to have a partner in the car industry. When an agreement with Volkswagen was reached in 1991, this raised great expectations, which were, however, disappointed when the new leader of Volkswagen Ferdinand Piëch decided to call off the deal in late 1993. Volkswagen was developing its own “three-litre car”, the eventual Volkswagen Lupo 3L³⁴. This concept was believed to be a better business proposition. It was nevertheless a great opportunity for Nicolas Hayek to present himself as the Robin Hood that challenges the mighty car industry.

He did it again a couple of years later when he started a new alliance with Daimler Benz AG. They ultimately designed and produced the Smart, but with little technological input from Swatch. It also ended up as a diesel-fuelled car. Swatch Group eventually sold its shares in 1998. Again, the story was portrayed as innovative David (Swatch Group) versus conservative Goliath (Daimler Benz AG).

But was Nicolas Hayek really the visionary who was too much ahead of his time to revolutionize the car industry with an electro mobile? Was he in fact interested in commercializing the Smart mobile? The documentary movie, made by his son Nick Hayek who became the CEO of Swatch Group in 2003, suggests so. Nick and his sister Nayla, who became chair of the governing board of the Swatch Group after Nicolas Hayek died in 2010, basically replicated the marketing strategy of their late father by portraying the Swatch Group as an innovative company ahead of its time.

34. Sulc, Adrian, 2015, Hayeks Idee des Öko-Autos lebt weiter. Der Bund, 30.4.2015 (available online: <http://www.derbund.ch/wirtschaft/unternehmen-und-konjunktur/Hayeks-Idee-des-OekoAutos-lebt-weiter-----/story/19635450>).

Nick Hayek's documentary movie "The Swatch Car Project" was publicly shown for the first time in spring 2015 with the purpose of reminding the Swiss that Swatch Group was always committed to developing a business in the field of environmentally friendly mobility in Switzerland.

5.2.3 Car batteries

Nick Hayek also reminded the audience that his father founded the company Belenos Clean Power AG in 2008 with the purpose of designing car batteries with 50–100 per cent higher capacity compared to those available on the market. The new super battery shall be produced in Switzerland³⁵. In January 2016, Nick Hayek announced in the *NZZ am Sonntag*³⁶ that Belenos is beginning to build a manufacturing plant in Switzerland to produce the first prototypes of the new batteries that were developed by a research team at ETH Zurich under Prof. em. Reinhard Nesper and Dr Semih Afyon. They used the material Vanadium-Borat-Glas as Electrode which may double the capacity and energy density of lithium-ion batteries, while keeping the volume and weight of existing batteries. This is a great scientific achievement for the research team, but does this guarantee commercial success? It may work in coin cells in which the technology has been tested so far and where the expertise of Swatch-owned Renata lies, but do they have the competence, the means and the patience to develop and mass produce large batteries, an expensive and risky investment that is likely to bear fruit in five to six years? And what about the competition in Asia, Germany and the United States? Belenos is certainly not the only company that wants to bring a super battery to the market.

Nick Hayek does not address these questions but expresses confidence to produce the first batch of batteries by the end of 2016 and then generate a

35. Ibid

36. Hug, Daniel, 2016, Superbatterie soll Milliarden einbringen. *NZZ am Sonntag*, 31.01.2016 (available online: <http://www.nzz.ch/nzzas/nzz-am-sonntag/schweizer-innovation-superbatterie-soll-milliarden-einbringen-ld.4718>).

The Swiss watch industry

turnover of CHF 10–15 billion with all the products related to the production of the battery by 2020.

The article in *NZZ am Sonntag* triggered 41 online comments, many from scientists and engineers. They wondered why the article in *NZZ am Sonntag* did not contain any review of the progress in research done elsewhere. German companies such as BASF, Bosch and BMW are longer in the business of environmentally friendly and efficient car batteries and have made huge advances. Other comments point at the progress outside Europe; for example companies such as LG Chem or Samsung SDI in the Far East and Sakit3 in the United States are considered far ahead. Paul Wyser, who had developed the battery for the Swatch and later set up his own company called “Wyon”, a worldwide leader in small-sized customer-specific lithium-ion batteries, regards such announcements by Nick Hayek as public relations (PR) events which have little to do with the tough and risky business of battery development and production³⁷. A further confirmation of the focus on PR is the governing board of Belenos, which does not just include Nick and Nayla Hayek but also celebrities such as the actor George Clooney and the astronaut Claude Nicollier.

5.2.4 Innovation rhetoric

Even though Nick Hayek claims that the battery will be “Swiss made” and create thousands of new jobs, he intends to list Belenos at the Hong Kong stock exchange and produce a factory there due to the expected demand in Asia. While he regularly condemns the Swiss stock exchange for being dominated by irresponsible and incompetent speculators – this rhetoric started once the share value of Swatch Group started to decline – he seems to trust in the Hong Kong stock exchange for doing a better job.

37. Personal Communication with Paul Wyser, 01.02.2016.

It is not just the innovation rhetoric and “speculator” bashing, that Nick Hayek inherited from his father, but also the belief that he is the outsider entrepreneur that does not owe anything to the support of the establishment. In a recent op-ed to *Schweiz am Sonntag*, Nick Hayek criticizes the “banker” mentality in Switzerland that disrespects the fruits of an energetic and innovative Swiss manufacturing sector, the foundation of Swiss wealth and prosperity³⁸. He is right about the importance of the manufacturing sector, but the Swatch Group is hardly an example of an innovative company, considering that its profits largely derive from its price-setting power and that its expenses for in-house R&D have decreased roughly by half since he became an executive in the business of his father in 2003³⁹.

A lot of previously trumped up innovations such as the flik-flak (watch for children), System51 (a Swatch with a mechanical movement), and, more recently, the Bellamy watch (near-field technology for cash free payments with a watch) and Swatch Touch Zero One (a smartwatch for beach volleyball players) were also announced in similar staged media events⁴⁰. It is certain that the Swatch Group continues to obtain many patents. The 2015 annual report points out that Swatch Group achieved a record of 200 patents in 2015 alone. However, their quality and potential commercial value is not discussed⁴¹.

38. Hayek, Nick, 2015, Wird die Schweiz zum Land ohne Industrie? *Schweiz am Sonntag*, 27. 12. 2015 (available online: http://www.schweizamsonntag.ch/ressort/wirtschaft/wird_die_schweiz_zum_land_ohne_industrie/).

39. Pilet, François, 2015, La part des revenus que Swatch consacre à la recherche et développement a baissé de moitié depuis 2003. *SOJH*, 1.12. 2015 (available online: <http://www.sojh.ch/legacy/?page=a7dd12b1dab17d2&type=create&id=42572>).

40. Tissot may have been a pioneer in smartwatch technology with the first T-Touch watch in 1999, featuring a tactile sapphire crystal to access the functions of the movement. Its latest product, the Tissot T-Touch Expert Solar is however merely a tool watch, made for a very specific buyer. As paying features become incorporated in ever more capable smartwatches it is very possible that smartphones could quickly cannibalize simple watches with this feature.

41. Swatch Group, Annual Report, released March 10, 2016.

The Swiss watch industry

Even though it is too early to judge the commercial fate of the most recent innovations, the Swatch Group has so far been unable to translate any of the prior innovations into a commercial success comparable to the Swatch, which had not been developed by Hayek.

Donzé therefore points out in his book on the history of the watch industry⁴² that Swatch Group managed to establish itself as the leading watch company in the world without introducing a single fundamental innovation in the technical field.

The lack of ability of the Swatch Group to develop and commercialize groundbreaking innovation appears to be unrelated to external factors, such as monetary policies or the “bad” car industry. It may, however, have a lot to do with the corporate culture of the Swatch Group (in the case of the Smart Car), which is more about brand marketing than innovation. The Swatch Group is taking advantage of its price-setting power as a private monopoly for numerous watch components, and its ability to extract large premia from the sale of “Swiss made” watches. These two main sources of revenues account for the revival of the Swiss watch industry after the Swatch revolution in the early 1980s under Ernst Thomke and his team. Swatch Group under the Hayek family may have built an image of being an innovative company, but this was rather part of its marketing strategy as will be illustrated in further detail in Chapter 6.3.

Company expenses for research and development (R&D) in fact decreased by more than half over the past decade (in per centage of the total revenues) as will be illustrated in further detail in Chapter 6.3.

5.2.5 Regulation and securing ownership

Nick Hayek’s tendency to portray himself as a patriotic industry patron in public

42. Donzé. P.-Y., 2014, A Business History of the Swatch Group: The Rebirth of Swiss Watchmaking and the Globalization of the Luxury Industry. Palgrave Macmillan.

may eventually backfire. He successfully lobbied mainly through the FH to push up the local contents requirements for watches from 50 per cent to 60 per cent to obtain the “Swiss made” label. Since this measure negatively affects the competitiveness of the Swiss manufacturing sector as a whole, the new “Swiss made” requirements are more likely to kill rather than create Swiss-based jobs. Many long-established Swiss companies have decided to dispense with the “Swiss made” label entirely in order to maintain the flexibility in production that allows them to remain innovative and cost-competitive. This also applies to the Swiss watch industry.

In May 2016, Daniela Aeschlimann-Schneider, daughter of the president of the Swiss Federal Council, Johann Schneider-Ammann, has been elected to the governing board of the Swatch Group. She is relatively inexperienced and has very few mandates beyond the industrial group of her family, the Ammann Group⁴³. Swatch Group claims that Ms Aeschlimann-Schneider has been chosen for her wide experience as an independent entrepreneur who knows about the value of “Swiss made”. When asked whether the fact that she is the daughter of Johann Schneider Ammann, current president of the Swiss Federal Council and part of the Swatch Group governing board until 2010, Swatch Group media desk responded that political links were definitely not part of the selection criteria⁴⁴.

Again and again, Nick Hayek, like his father Nicolas Hayek, manages to portray himself as a political and economic outsider in Switzerland while ensuring that the most influential political and economic insiders implicitly

43. Ammann Group Holding AG is a member of the Hayek Pool. With this, descendants of U. Ammann-Schellenberg senior (father of the wife of the current Swiss Federal Councillor Johann Schneider-Ammann) are also involved as beneficial owners. Further, ‘Families Ammann’ (pension funds, foundations and individuals, Madisa AG) are close to the Hayek Pool but are not part of it (see Swatch Group annual report 2015, p. 146). They are listed as significant shareholders.

44. Flubacher, Rita, 2016, Familiäre Verhältnisse. Tages-Anzeiger, 8.4.2016.

The Swiss watch industry

endorse the private monopoly of Swatch Group and expensive “Swissness” regulation that others find hard to comply with. All this political lobbying is increasingly eroding Swiss competitiveness in the global watch business since the early 1990s, when Ernst Thomke decided to leave SMH. The loss of competitiveness may definitely not be in the public interest but does not seem to be an issue of concern for the Hayek family, this also includes the youngest family member in the executive board, Marc Hayek. As the son of the Chairwoman of the governing board, Nayla Hayek, and grandson of Nicolas Hayek, he is currently CEO of three Swatch Group luxury brands: Blancpain, Breguet and Jaquet-Droz. He is also on the governing board of Swatch Group and widely assumed to become the next Hayek in charge of Swatch Group⁴⁵. In a recent interview he reaffirmed his intention to basically follow the strategy of Nick Hayek. He attributes the current difficulties of the company to external factors that cannot be influenced by the company⁴⁶. His remark in an interview in the *Sonntagsblick* that Swatch Group would not dismiss anybody for economic reasons indicates that the Hayek family feels rather immune to the forces of technological and economic change⁴⁷.

45. Sulc, Adrian, 2016, Interview mit Marc Hayek, der Bund, 19.3.2016.

46. Ibid.

47. 20 Minuten, 2016, Gesagt: ‚Aus wirtschaftlichen Gründen wird bei uns niemand entlassen‘. Marc Hayek im Gespräch mit dem „Sonntagsblick“. *Wirtschaft*, 21. März, 2016: p. 18.

Chapter 6

The position of the Swiss watch industry in the global market

In the 1990s, the returns and the number of employees of the SMH/Swatch Group continuously increased, not least because Nicolas Hayek was able to keep most of the skilled designers, managers and marketing experts that Ernst Thomke had recruited earlier. The exploitation of economies of scale in the production and marketing of the Swatch greatly contributed to the overall commercial success. Sales increased thanks also to the exploitation of economies of scope – producing the same product over and over again in different variations. Economies of scope are “efficiencies wrought by variety, not volume”¹. They make product diversification efficient if they are based on the common and recurrent use of proprietary know-how or on an indivisible physical asset².

Nicolas Hayek’s push for vertical integration included also the creation of Swatch retail shops, which helped to reduce counterfeiting and added to the effectiveness of the brand campaigns. It made Swatch a cult object with great emotional value³.

The huge commercial success of the Swatch in the high-volume/low-price segment was instrumental for the recovery of the Swiss watch industry after the

1. Goldhar, Joel D. and Mariann Jelinek, 1983, Plan for Economies of Scope, Harvard Business Review.

2. Teece, David J., 1980. Economies of Scope and the Scope of the Enterprise, Journal of Economic Behavior & Organization 1 (3).

3. Wegelin, J. and B. Leighton, 2010, Mr. Swatch: Nicolas Hayek and the secret of his success. Free Association 2010.

The Swiss watch industry

crisis in the early 1980s. Thanks to global advertising campaigns, Swatch gained great visibility and, with it, paving the way for the revival of many higher-priced mechanical Swiss watch brands⁴.

The renewed popularity of expensive mechanical Swiss watches led to a shift in focus from high volumes in the lower price segment of electronic watches to low volumes in the high-priced segment of luxury mechanical watches that do not have a battery but run on a spring⁵.

As a consequence, the share of the export volume of mechanical watches increased from less than 10 per cent⁶ at the start of the 1990s to 28 per cent in 2014⁷. While at the start of the 1990s, mechanical watches accounted for little over 40 per cent⁸ of Swiss watch export sales, they generated a record of 79 per cent in 2014⁹, based on the value. Even though the Swiss watch industry is diversified and present in all of the different price segments, the repositioning in the high-price segment and the sizeable profits generated with luxury watches is striking. However, the assumption that rich people will always want expensive Swiss watches can easily lead to complacency bearing the risk to fall behind technological developments elsewhere.

4. Credit Suisse Global Research, 2013, Swiss Watch Industry, Prospects and Challenges. Swiss Issues Industries, October (available online: <https://www.credit-suisse.com/media/production/pb/docs/unternehmen/kmugrossunternehmen/uhrenstudie-en.pdf>).

5. Mechanical movements use energy from a wound spring to power the watch. This spring stores energy and transfers it through a series of gears and springs, regulating the release of energy to power the watch. To create power in a quartz watch movement, a battery sends an electrical current through a small quartz crystal, electrifying the crystal to create vibrations. These vibrations keep the movement oscillating and drive the motor to move the watch hands (available online: <http://www.wixonjewelers.com/education/swiss-watches/watch-movements/>).

6. Credit Suisse Global Research, 2013, Swiss Watch Industry, Prospects and Challenges. p. 11.

7. FH, export statistics (available online: <http://www.fhs.ch/eng/statistics.html>).

8. Credit Suisse Global Research, 2013, Swiss Watch Industry, Prospects and Challenges. p. 11.

9. FH, export statistics (available online: <http://www.fhs.ch/eng/statistics.html>).

Box 5 The prestige value of mechanical watches

Even though quartz watches are more accurate than mechanical ones and require minimal maintenance, aside from battery replacements, mechanical watches tend to be more expensive. One reason is that the production of mechanical movements is more complex and costlier. Another is that mechanical timepieces can be sold at higher price premia because they are considered prestige objects and status symbols. For most watch fans, quartz watches are not as desirable because they lack the technical craftsmanship and engineering that mechanical timepieces have.

Source: <http://www.wixonjewelers.com/education/swiss-watches/watch-movements/>

6.1 The Swiss watch industry at its peak in 2014

In 2014, the value generated with Swiss watch exports reached an all-time high of CHF 22.2 billion (Figure 4). Vontobel Bank estimates that worldwide Swiss watch sales generate 57 per cent of the total global market value of CHF 40 billion for watches. Figure 6 in the Annex shows that three Swiss watch companies dominate the international watch industry: Swatch Group, Richemont and Rolex.

The most important export destination for Swiss watches in value terms is Asia (mainly Hong Kong, China, and Japan) with 53 per cent, followed by Europe with 31 per cent and the Americas with 14 per cent (mainly United States)¹⁰.

In terms of units of wrist watches exported, however, Switzerland lags far behind China and Hong Kong. Of an estimated 1.2 billion units of wrist watches produced worldwide in 2014, only 31.2 million units (2.6 per cent of total global

10. Vontobel Bank, 2015, Vontobel Luxury Goods Shop 2015, Zurich. (found in: Uhren von A bis Z - Montres Le Guide, Herausgeber: Ithaka Time SA, Beilage zu NZZ).

The Swiss watch industry

production) were manufactured in Switzerland¹¹. China exported 669 million and Hong Kong 315.1 million time pieces¹². While the unit export price of a Swiss watch amounted to US\$ 803 in 2014, a watch of Chinese origin did cost only US\$ 4¹³. Twenty years ago the average export price for a Swiss watch amounted only to CHF 160 (1992)¹⁴. This clearly proves the increased importance of the low-volume/high price segment for the Swiss watch industry. It may also be an indication for the price-setting power of Swatch Group. This largely accounts for the high EBITA¹⁵ margins despite the relatively low productivity in the Swatch Group.

6.2 Export crisis of the Swiss watch industry in 2015

In 2015, Swiss watch exports started to decline. In October 2015, the export value decreased nominally by 12.3 per cent (CHF 2 billion). This was the biggest monthly drop in export earnings since 2009¹⁶. Over the past year, the value of total watch exports declined by 3.3 per cent to CHF 21.5 billion (Figure 4).

Most relevant was the decline in Hong Kong, which is the most important export market, with a minus of 38.5 per cent. Exports to the United States contracted by 12.2 per cent. Exports to China were down by 5.1 per cent¹⁷. Wrist watches in all price segments saw downturns in the number of units as well as in value terms. For Swatch Group, Hong Kong and China (termed as “Greater China”) constitute the largest market; 33.9 per cent of its net sales revenues originate from this region, followed by other Asian countries with 22.3 per cent, Europe

11. FH and Vontobel Bank, 2015, Vontobel Luxury Goods Shop 2015, Zurich (found in: Uhren von A bis Z - Montres Le Guide, Herausgeber: Ithaka Time SA, Beilage zu NZZ).

12. Ibid.

13. Ibid.

14. Credit Suisse Global Research, 2013, Swiss Watch Industry, Prospects and Challenges, p. 11.

15. EBITDA margin is a measurement of a company's operating profitability as a per centage of its total revenue.

16. FH export statistics (available online: <http://www.fhs.ch/eng/statistics.html>).

17. Ibid.

accounts for 21.8 per cent, Switzerland for 11.7 per cent, and the Americas for 8.6 per cent. In total, net sales in Asia with 56.2 per cent contribute the most¹⁸. Developments in these markets are therefore crucial for the company.

Swatch Group tends to blame the strong Swiss franc, the economic slowdown in East Asia, the low oil revenues in Russia and the Middle East, the terror attacks in Paris and political turmoil in Hong Kong for the decline in exports. But, not all of these external factors have a significant impact on revenues. The appreciation of the Swiss franc against the euro or the Russian ruble is very pronounced, but this is not true for all other currencies. The US and the Hong Kong dollar, or the Chinese renminbi (yuan) for example, appreciated again compared to the Swiss franc. In view of the large price premia that Swiss watches generate as luxury goods on the global market, the price elasticity tends to be low and consequently the effect of an appreciating Swiss franc on sales is rather moderate compared to other industries in which cost-effectiveness is crucial to remain competitive.

Yet, Nick Hayek claims that due the strong Swiss franc, Swatch Group would have lost CHF 4 billion in net sales over the past six years¹⁹. This would be equivalent to a loss in annual sales of CHF 666 million or about eight per cent of total net sales in 2015. However, in Europe net sales have been increasing since 2010, which seems to contradict his reasoning.

Apart from the external factors, there is also endogenous technological change in the global watch industry and being caught unprepared cannot be attributed to events that take place outside the industry.

18 Swatch Group, Annual Report 2015, p. 183.

19. Martel, Andrea, 2016, Optimistischer Swatch-Group-Chef Nick Hayek, "Nicht China ist das Problem, sondern der Franken", NZZ, 10.03.2016 (available online: <http://www.nzz.ch/wirtschaft/unternehmen/optimistischer-swatch-group-chef-nick-hayek-nicht-china-ist-das-problem-sondern-der-franken-ld.6898>).

The Swiss watch industry

The Swiss watch industry seems rather ill-prepared to the current challenges and opportunities related to disruptive new technologies in the market. The rise of smartwatches, especially the Apple Watch in 2015, may reflect the beginning of shifting consumer preferences. While sales of Apple Watch soar, sales of Swiss watches have declined. Yet, Nick Hayek repeatedly told the media in 2015 that smartwatches would not represent a challenge for the Swiss watch industry and that he sees no need to seek collaboration with a company in the Silicon Valley²⁰. And when asked about the decline of the Swatch share price and the high amount of short selling, he blames speculators, and sees no internal causes.

In 2016, Swatch Group paid the same high dividend as in 2015 and will start a share buyback programme of CHF 1.5 billion over three years, designed to shore up the share price. The company justified this measure by pointing at its annual cash flow of CHF 1.5–3 billion compared to annual investments of CHF 500 million²¹. Share buybacks are per se neither good nor bad. However, if the main goal of this financial engineering is to reduce equity and thus improve its profitability – then alarm bells should ring²². The last time when companies had bought back such large volumes of shares as it is the case nowadays was in 2007 before the financial crisis. This indicates that the market is heading towards the end of cycle and that some companies overstretch the instrument and soon will face financial problems²³.

20. Gibbs, Samuel (2015) Swatch CEO: Apple Watch is “interesting toy” that can't last more than 24 hours. The Guardian, 24.08.2015 (available online: <http://www.theguardian.com/technology/2015/aug/24/swatch-ceo-apple-watch-interesting-toy>).

21. Martel, Andrea, 2015, Nick Hayek im Gespräch “Eine Kooperation mit Google oder Intel kommt nicht infrage”. NZZ am Sonntag, 27.03.2015 (available online: <http://www.nzz.ch/wirtschaft/eine-kooperation-mit-google-oder-intel-kommt-nicht-infrage-1.18510907>).

22. Grundlehner, Werner, 2016, Aktienrückkauf als Warnsignal. NZZ 10. Mai 2016 (available online: <http://www.nzz.ch/meinung/kommentare/aktienrueckkauf-die-letzte-idee-der-manager-ld.18870>).

23. Ibid.

6.3 Challenges facing the watch industry

6.3.1 *The rise of smartwatches and wearables*

In the fourth quarter of 2015, 8.1 million smartwatches have been shipped worldwide, compared to 7.9 million watch units shipped out of Switzerland²⁴. It amounts to an increase in sales of smartwatches of 316 per cent compared to the year-ago quarter, and to a decline in sales of Swiss watches of -4.1 per cent in the same period. Even though Apple (5.1 million Apple Watches sold) and Samsung (1.3 million smartwatches sold) are the dominant sellers of smartwatches, many companies outside Switzerland are bent on selling smartwatches in 2016. Especially the fashion company Fossil which sells watches in the price segment of Swatch has acquired numerous smartwatch companies at the end of 2015. Even though many Swiss watch companies are also tinkering with smartwatches, their share in global smartwatch sales is small²⁵. TAG Heuer from LVMH may however prosper with its first high-end smartwatch (price category CHF 1 500), the TAG Heuer Connected. This smartwatch, made by a Swiss company but without the “Swiss made” label, was presented at the Baselworld watch fair in March 2016. Jean-Claude Biver, the former marketing boss of Omega who became CEO of the LVMH’s watch business, was proud of his collaboration with Android and Intel to develop a comprehensive smartwatch that can also be used as a mechanical watch. It seems to become a big commercial success. Within the first four months since its launch at the end of November 2015 he already sold out the first batch of 20 000 smartwatches. He plans now to scale up production and expects to reach annual sales in 2017 of more than 200 000. He was unable to meet the new local content requirements to obtain the “Swiss made” label, but thinks

24. Vanian, Jonathan, 2016 More Smartwatches Were Shipped Worldwide Than Swiss Watches. Fortune Magazine, February 19, 2016 (available online: <http://fortune.com/2016/02/19/more-smartwatches-shipped-worldwide-swiss-watches/>).

25. Strategic Analytics Press Release, February 17, 2016 (available online: <https://www.strategyanalytics.com/strategy-analytics/news/strategy-analytics-press-releases/strategy-analytics-press-release/2016/02/18/global-smartwatch-shipments-overtake-swiss-watch-shipments-in-q4-2015#.VzMjyHUUp3h>).

The Swiss watch industry

that “Swiss made” does not matter that much anyway in order to receive a price premium. After all, TAG Heuer is generally known as a Swiss brand²⁶.

The rapid increase in sales of smartwatches leads to the question whether the established Swiss players in the watch industry are innovating enough to keep up with disruptive technologies combining information technology with watchmaking. The share of revenues invested in R&D decreased from 4 per cent in 2003 to 2.1 per cent in 2014 (compared to Apple with 3.3 per cent and Samsung with 6.4 per cent)²⁷. In turn, the marketing expenses of the Swatch Group stand at a record high of 14 per cent in 2015²⁸.

The low spending on R&D also impacts the Swatch Group’s capacity to innovate on its own. Since the commercial success of the Swatch starting in 1983, no genuinely new scalable market through innovation has been created. The Sistem51 watch, the mechanical version of the quartz-based Swatch, developed by Swatch Group in 2013 could be an innovation with a great potential for commercial success. Sistem51 consists of a 51-part mechanical movement not requiring any maintenance. It is the only mechanical watch manufactured, assembled and finished by automated machines, and sold at a price of only CHF 150. Despite mentioning high growth in sales (“bestselling”) in the last Swatch half-year report in 2015²⁹ the sales volumes of Sistem51 have so far not been disclosed, also not in the latest annual report. It seems that these sales are far below the sales volume of the Apple Watch when considering the numbers above.

26. Meisser, P. and Dittli, Mark (2016) Jean-Claude Biver im Gespräch. Finanz und Wirtschaft, 16.03.2016: 8–9.

27. Pilet, François, 2015, La part des revenus que Swatch consacre à la recherche et développement a baissé de moitié depuis 2003. SOJH, 1.12. 2015 (available online: <http://www.sojh.ch/legacy/?page=a7dd12b1dab17d2&type=create&id=42572>).

28. Martel, Andrea, 2016, Nach einem enttäuschenden Jahresergebnis: die Swatch Group glaubt sich unterschätzt. NZZ, 3. Februar, 2016 (available online: <http://www.nzz.ch/wirtschaft/unternehmen/swatch-mit-weniger-gewinn-1.18688702>:).

29. Swatch Group, 2015, Half-Year Report 2015 (available online: http://www.swatchgroup.com/en/services/archive/2015/half_year_report_2015).

6.3.2 *The Apple Watch*

The big advantage of the Apple Watch is that it is part of Apple company's product ecosystem. In this ecosystem the Apple Watch is essentially a complementary good to the iPad or the iPhone. It is estimated that 1 billion people use Apple devices worldwide.

If Apple as well as the Samsung Watches should once be considered essential extensions of their respective smartphones, then Swatch Group may be caught as unprepared as Kodak company was in the early 2000s. At that time, Kodak noticed that digital cameras were becoming an integral part of the mobile phone, destroying its market for cheap digital snap-shot cameras. The company lacked the internal competences and distribution channels to make the transition from a camera producer to a mobile phone producer³⁰.

The Apple Watch could become a game changer and annihilate the hopes in Sistem51 and other new product developments to revive sales in the lower price segment.

Swatch Group is trying to counter this risk by developing its own smartwatches designed for particular purposes. One is the Swatch Touch Zero One, launched in 2015, a beach volleyball-based fitness tracker that counts steps, distance and calories. Another is Swatch Bellamy, which recently was launched in China and will be available in Switzerland, Brazil, and the United States in the course of 2016. Bellamy includes a chip in an existing Swatch that enables payment functions through near field communication (NFC) technology. Priced at 600 yuan (about US\$ 95), it does not, however, connect to the internet³¹.

30. Hirstein, Andreas, 2015, Digitalfotographie: "Es war nur eine Spielerei". NZZ am Sonntag, 22.11. 2015 (available online: <http://www.nzz.ch/nzzas/nzz-am-sonntag/digitalfotografie-steven-sasson-interview-es-war-nur-eine-spielerei-ld.3183>).

31. Nick Hayek Jr. stroke a deal in 2015 with China Union Pay, the former Chinese bank card monopolist and the Chinese state-owned Bank of Communications.

The Swiss watch industry

As China has lifted the bank card monopoly in 2015, retailers are expanding their access to NFC technology and Chinese tech companies are collaborating with other watchmakers to ensure that they can attract users to their payment systems. Even though Apple was unable to strike a deal with China Union Pay earlier, it might do so with another company now. It could augment its Apple Watch with a credit card payment function.

The fact that a comprehensive smartwatch may offer all the functions and services of existing specialized wearables helps explain why even the highly successful company Fitbit specialized in producing fitness-trackers faces increasing losses at the stock exchange³². The market research firm Markit found parallels between the first generation iPhone and smartphones that were equipped with GPS and Google maps functions in 2007 and the new smartwatches with the integrated fitness trackers. In 2007 these smartphones rapidly undermined the businesses of Personal Navigation Device companies such as Tomtom or Garmin³³. The business of wearables with specialized functions could face the same fate with multifunctional smartwatches.

6.3.3 Inventory problems and short selling

Apart from facing stiff competition from smartwatches – not just from Apple, but also Samsung and Fossil – Swatch Group seems to face an increasing gap between production volumes and effectively realized sales. Inventories of Swatch Group are at an unprecedented level. At the end of December 2015, they amounted to an assessed value of CHF 6 151 million, equivalent to 46.4 per cent of the company's total assets³⁴. Until 2006, the latter number

32. Markit, 2015, Bears circle Swatch and Fitbit in battle for wrists, December 2nd 2015 (available online: <http://www.markit.com/Commentary/NewsCommentarieFile?CMSID=2f6d7ca1c32343e78a24f245794bdf64>).

33. Ibid.

34. Swatch Group, Annual Report, released March 10, 2016.

was always below 30 per cent and it was still below 40 per cent in 2012. Such high inventories bind a lot of capital, generate high logistics costs, bear risks of obsolescence and are a clear sign that the company has a problem on the sales-side. Data from the annual report of 2015 reveals that Swatch Group has inventories on stock equivalent to the production output of one full year³⁵.

Another trend is the short selling of Swatch shares which stood at 10.08 per cent in February of 2015³⁶ and has steadily increased to an unprecedented high level of 29.6 per cent in February of 2016³⁷. This means that almost every third share is now out on loan. Among Swiss shares Swatch Group ranks first among the top ten short selling titles. Short sellers are betting that smartwatches are taking market share away from the lower-priced brands of Swatch and that the share price therefore will further decline³⁸.

6.3.4 Pending lawsuit

In addition, Swatch Group faces a risk of losing a costly lawsuit with the US jewelry maker Tiffany & Company. It could cost the company an additional CHF

35. This can be calculated as follows from data in the Annual Report 2015: Semi-finished (CHF 1 970 million) and finished goods (CHF 2'959 million) in inventories (p. 190) amount together to CHF 4 929 million. This number is compared to the value of production in 2015: Taking net sales of CHF 8 451 million (p. 10) and subtracting the operating result of CHF 1 451 (p. 10) total costs of CHF 7 000 million result. If one further deducts from this 50 per cent of personnel expense of CHF 1 194 million (p. 184, as 50 per cent of personnel is employed abroad) and 50 per cent of total other operating expenses of CHF 1 284 million (p. 184, as 50 per cent of employees are abroad) totaling CHF 2 476 then production costs of CHF 4 524 result.

36. Müller, Dietegen, 2015, Swatch Group ziehen weiter Leerverkäufer an, Finanz und Wirtschaft, 27.02. 2015 (available online: <http://www.fuw.ch/article/swatch-group-ziehen-weiter-leerverkaeuer-an/>).

37. Lanz-Carl, Claudia, 2016, Leonteq stehen neu im Fokus der Leerverkäufer, Finanz und Wirtschaft, 26.02.2016 (available online: <http://www.fuw.ch/article/leonteq-stehen-neu-im-fokus-der-leerverkaeuer/>).

38. Gertler, Corinne, 2016, Swatch Short Interest Near Record on Smartwatch Threat: Chart, Bloomberg Business, February 1, 2016 (available online: <http://www.bloomberg.com/news/articles/2016-02-01/swatch-short-interest-near-record-on-smartwatch-threat-chart>).

The Swiss watch industry

402 million³⁹. In 2013, the Swatch Group acquired the Harry Winston luxury jewelry and watch brand for roughly US\$ 1 billion. This was important to compensate for the failure to cooperate with Tiffany & Company in the jewelry and luxury watch business. Yet, compared to Richemont, the Swatch Group has still a small presence in the luxury business outside watches.

Finally, Baselworld 2016 showed that none of the luxury Swiss watch brands have embraced a modular concept that would allow customers to obtain a tailor-made version of a luxury watch offered by the particular brand. This seems odd in view of the trend toward high-value tailor made products in other consumer good businesses (cars, sailboats, luxury housing, etc).

Instead of responding to new market trends, Swatch Group seems to be more concerned with maintaining its dominance in the Swiss watchmaking industry through the elimination of domestic competition.

6.4 Strengthening “Swissness” rules, the usual corporatist response

Relying on the global popularity of the “Swiss made” label and the premium it fetches for its emotional and prestige value, Swatch Group together with other well-known Swiss luxury watch companies in FH lobbied to enhance the local content requirements initially from the existing 50 per cent to 80 per cent. Finally, the new “Swiss made” ordinance requires a 60 per cent value criteria that applies to the watch as a whole and its parts (Box 7 in Chapter 8).

39. Back in 2013 a Dutch arbitration court ended the dispute between Swatch Group and US jewelry maker Tiffany regarding their failed joint venture to produce and market watches. The joint venture was intended to give Tiffany much greater access to the luxury watch market. As the partnership did not result in profitable business for either company, the deal ended in 2011. The arbitration ruling at that time was in favour of Swatch Group that reaped an award of CHF 402 million from Tiffany. Yet, the company did never communicate to its shareholders that in the Netherlands it is possible to redraw an arbitration ruling to an ordinary court. Tiffany took advantage of this possibility. An Amsterdam-based district court scrapped the arbitration ruling in March 2015. Swatch appealed and a final decision is awaited for fall of 2016. If the decision will be in favour of Tiffany, Swatch Group will have to pay back the CHF 402 million (Tagesanzeiger, 16.03.2015, Millionen-Frage im Streit Swatch gegen Tiffany).

Such regulation is often touted by Swiss politicians and members of FH as being in the public interest. The argumentation is that structural change is inevitable and the Swiss watch business can only survive in global competition through strict quality control, consolidation and industrial concentration. It is assumed that requiring Swiss companies to increase the share of value creation in Switzerland would result in more domestic jobs for skilled Swiss people. Since the early 1930s, this has been a recurrent line of argumentation in Swiss corporatism to justify state intervention to protect the interests of the watch industry, often to the disadvantage of Swiss consumers, taxpayers and the competitiveness of the Swiss watch industry.

The new so-called “Swissness” regulation, which is expected to come in force in 2017, is likely to become a job killer rather than a job creator in Switzerland because it forces many Swiss companies to dispense from the “Swiss made” label altogether and move more production abroad⁴⁰. This will be addressed in more detail in Chapter 8.

40. Bürgler, Erich, 2016, Die Swissness wird zum Jobkiller. Sonntagszeitung, 3.4.2016.

Chapter 7

Market and political power of the Swatch Group

In the 1970s, the global challenges related to the automation in the production of mechanical watches and the quartz revolution made the Swiss government realize that “Swissness” alone will not save the industry. As a consequence, the government eased the corporatist grip on the watch industry and this made it eventually possible for ASUAG to respond with path-breaking innovation.

The corporate response to today’s new competition from smartwatches comprises regular announcements by the executive board of Swatch Group about path breaking innovations that will eventually take place, and reassuring words for the shareholders that the company is in good shape despite the difficulties that are exclusively attributed to external factors such as the strong Swiss franc and slow growth in China. The company’s main strategy to counter these adverse external effects is to further strengthen its corporatist grip on the Swiss watch industry through its monopoly power and tougher “Swiss made” rules.

Via the Federation of the Swiss Watch Industry (FH), Swatch Group was successful in its efforts to tighten “Swiss made” rules for watches that is likely to undermine the position of globally integrated, cost-effective and innovative smaller Swiss watch companies. In other words, the company relies on its market and political power as well as its exclusive distribution channels to ensure its high-margin sales (Figure 10 in Annex).

7.1 Market power of Swatch Group

The dominant position of the Swatch Group in the Swiss watch industry has

been reviewed by the Swiss Federal Competition Commission (WEKO) in 2013¹. Figure 10 in the Annex shows the presence of the Swatch Group in the different segments of the value chain.

7.1.1 Swatch Group market power in production and distribution²

Swatch Group accounts for a volume-based market share of 60–65 per cent in the low- to mid-end watch segment, dominated by quartz watches, and 50–60 per cent in the segment of mechanical watches up to a price range of CHF 2 000–3 000. Above this price range, the market share of Swatch Group is estimated to be 10–20 per cent. In terms of the total number of mechanical watches sold, Swatch Group is the leader among Swiss companies, with a market share of more than 30 per cent.

Swatch Group has its own retail stores. This rather costly sales strategy allows for a more effective price policy. Grey markets can be reduced and a better capitalization of the brand is possible. A more recent strategy to bring Swatch Group's brands closer to wealthy consumers in Switzerland, is to acquire large areas in Swiss luxury resorts, expensive shopping streets, and airports in Switzerland. Securing exclusive marketing rights in such spots also ensures less exposure of wealthy Swiss and foreign tourists to luxury shops and watch brands that do not belong to Swatch³. In addition, Swatch

1. The Swatch Group dominates the low-end (quartz) watch segment with the Swatch selling high volumes but at moderate margins. The Swatch accounts according to Vontobel bank for 9 per cent of the company's sales. In the mid-end segment the brand Tissot accounts for 13 per cent of Swatch Group's sales. The low to mid-end watch segments together make up for roughly 25 per cent of the company's sales. In the mid-price range one can assume that in order to produce a competitively priced watch, the company has to rely also on foreign materials and production stages that are performed abroad, such as in China. In the price range above CHF 2 000–3 000, Richemont and Rolex each have higher market shares of 20–30 per cent than Swatch Group. Among luxury brands Swatch is facing competition since the other groups also have very strong brands.

2. Wettbewerbskommission, 2013, Verfügung der Wettbewerbskommission vom 21.10.2013 in Sachen Swatch Group Lieferstopp. p. 63–65.

The Swiss watch industry

Group has a lot of bargaining power with respect to independent retailers since it has watches in each price segment and offers after sales services⁴. Their products are thus found in almost all watch stores.

The Swatch Group has primarily inherited its market dominance from SSIH in the field of finished watches and from ASUAG in the field of movements and assortments. Nicolas Hayek who had been appointed on top of the watch business by the Swiss establishment in banking and finance, and later acquired majority stakes in SMH through clever financial engineering, thus essentially converted a former state monopoly (ASUAG) into an even more powerful private monopoly with the tacit approval of the Swiss government.

7.1.2 Monopoly of Swatch Group in different markets of the watch industry

ETA Company, which became competitive under ASUAG, was the largest manufacturer of movements and continues to do so under the Swatch Group today. Apart from producing these movements for the finished watch brands that belong to Swatch Group, it sells them also to the rest of the industry. Rolex

3. Ruh, Boas. 2016. Luxuriöses Einkaufen auf dem Bürgerstock. NZZ 25.02.2016 (available online: <http://www.nzz.ch/schweiz/swatch-nistet-sich-auf-dem-buergenstock-ein-1.18701191>).

4. The lower the price of a watch, the more sales points are required: Tissot has 13 500 sales points, Longines has 4 000 and Omega 1 800. For service points the same logic holds; the higher the price the lesser the number of service centres. Longines has 1 000 service points, while Omega has 450, and Breguet 45 (Geoff Gannon, Swatch's Moat, available online: <http://gannonandhoangoninvesting.com/blog/2015/5/19/swatchs-moat>). The Swatch Group also has a strong presence in the internet. Online sales channels according to the Deloitte watch study 2015 continue to grow. 38 per cent of respondents consider that e-boutique will be the most important sales channel, up from 21 per cent in 2014. This can help to reduce the attraction of grey markets. Product counterfeiting is still a problem. But in the high price segment online, sales have been weak as high prices are an obstacle. Social media has become the most important channel for marketing and bloggers are now an integral part of the communication environment. This is especially advantageous for independent brands with limited marketing budgets. However, when it comes to product placement and brand ambassadors they are mostly used by large brands that can afford them. (Source: <http://www2.deloitte.com/content/dam/Deloitte/ch/Documents/consumer-business/ch-en-consumer-business-deloitte-swiss-watch-study-2015.pdf>)

is one of the few exceptions that produces its own movements as well, but does not sell outside of the company.

In the market for mechanical movements accessible to third-party customers, the Swiss Federal Competition Commission (WEKO) estimates ETA company to account for a market share of 80–90 per cent (annual production volume: 5 million), followed by movements from Sellita 10–20 per cent, and from Soprod and others each 0–5 per cent⁵. Recently, the Swiss company Ronda announced that it will again produce mechanical movements. A production volume of 100 000 is planned for 2016, in addition to its quartz movements production⁶. ETA production capacities and the variety of mechanical movements available remain, however, unmatched by any other company in Switzerland. ETA is producing and distributing mechanical and quartz movements as well as the Swatch watch⁷.

The market share of the Swatch Group-owned company Nivarox in the production and sale of assortments, the heart of the watch movement⁸, is even more dominant. The company's dominant market power for assortments that

5. Wettbewerbskommission, 2013, Verfügung der Wettbewerbskommission vom 21.10.2013 in Sachen Swatch Group Liefertstopp. p. 35.

6. Schuppli, Stefan, 2016, Ein Paukenschlag: Ronda produziert wieder mechanische Uhrwerke. Basel landschaftliche Zeitung, 18.03.2016.

7. To make the production of watch movements economically viable, mass production is required as the initial cost of installation and machinery is very large. The higher the volume of production, the lower the unit cost price per movement. Know-how per se is not an entry barrier as many patents especially for the production of mechanical (ETA) movements have expired. ETA Company is producing them already for several decades. It is not a fast paced market subject to recurring fundamental changes due to innovation.

8. The assortment is the regulating organ of a mechanical watch movement. The accuracy of the watch depends on it. The assortment encompasses the escape wheel, balance wheel, hairspring, anchor lever, pallet stones, and associated bridges. These are typically mounted together on a bridge and can be sourced separately from the "ébauche" (movement blank). The accuracy of the watch depends on the assortments; the hairspring, for example, is what makes the balance wheel oscillate, and it is that constant rhythm that ensures the precision of the watch.

The Swiss watch industry

are sold to third-party customers also enhances its market power for movements, since smaller competitors in this market, such as Sellita, depend on the supply of assortments from Nivarox as well.

WEKO noticed already back in 2006 that Nivarox had a dominant market share in assortments. For 2010, it estimated Nivarox's market share to be 90–100 per cent. It thus has a (quasi)-monopoly on assortments that is also related to the outstanding quality and the high-volume production at competitive prices⁹. Through its 100 per cent ownership of Nivarox, the Swatch Group can ensure that non-vertically integrated independent watch companies, some of which are also members of FH do not oppose its proposed policy position papers. Rolex is one of the few companies making its own assortments, but they are only in few cases direct competitors of Swatch Group and share many common interests in the market for low-volume, high-value Swiss watches.

Speaking *de-facto* on behalf of FH makes the Swatch Group's lobbying for favourable regulatory outcomes quite effective since politicians can hardly distinguish between industry-wide interests and the special interests of the Swatch Group. This may also explain why no policy maker has ever looked critically at the decision of the Swatch Group to suspend the supply of spare parts of their brands to any independent watch repair shop inside and outside of Switzerland by 2016. Even though the company assures to be merely concerned with the enforcement of quality standards and thus the protection of the reputation of its brands, it is clear that the main goal is to appropriate the profits generated in the field of post-sale quality and repair services. The welfare loss for customers is, however, potentially significant since tailor-made watch repair will be more difficult. Moreover, thousands of independent watch repairers in Europe may feel compelled to accept the expensive terms set by the watch

9. Wettbewerbskommission, 2013, Verfügung der Wettbewerbskommission vom 21.10.2013 in Sachen Swatch Group Lieferstopp. p. 49.

companies to obtain replacement parts (training courses, certificates etc)¹⁰. The European Commission determined in July 2014 that there is little evidence that Swatch Group AG and other luxury watch makers had thwarted competition by refusing to supply spare parts to independent repair shops and closed its investigation. However, the European Confederation of Watch & Clock Repairers' Associations (CEAHR) appealed against the Commission's decision on 12 January 2015¹¹, also in view of Swatch Group's announcement to stop selling spare parts to independent watch repairers on 31 December 2015.

7.1.3 WEKO's decision regarding Swatch Group's market power

In 2002, ETA announced that it would no more be willing to supply the Swiss watch industry with movements blanks, also called "ébauches". This marked the end of the implicit mandate of ETA to supply the watch industry with movements, as it existed since the 1930s when ASUAG was founded with the support of the Swiss government. Obviously, the Swatch Group is not a state but a private monopoly and could therefore make such an announcement. The argument was that Swatch Group would have difficulties to supply its own watch companies with sufficient movements, that producing movements is not as difficult and capital intensive as it used to be, and that Swiss watch companies need to be weaned off from their passive reliance on movement blanks from ETA. The initial plan was to stop delivering movement blanks by 2006 and instead only sell completely assembled movements. WEKO and Swatch Group reached a mutual agreement in 2004¹². It pointed out that ETA was the only supplier of mechanical movement blanks for prices below CHF 300 and that 75 per cent of Swiss mechanical movements contain movement blanks from ETA. Considering a market share for movement blanks of 95 per cent at that time, WEKO concluded

10. Lancaster, Ambrose, 2015, Watchmakers protest, CEAHR vs. Swatch Group. Time transformed, July 3, 2015.

11. Available online: <http://roschier.com/sites/default/files/newsletters/ac3d420a9ed9dc720961092e0c32ffac.html#article2>

12. WEKO, 19.11.2004, Press release (available online: <http://www.news.admin.ch/NSBSubscriber/message/attachments/14462.pdf>).

The Swiss watch industry

that a phase out time of three years was too short of an adjustment period for the Swiss watch companies that relied on movement blanks from ETA. The deadline was therefore extended to 2010. At that time the Swatch Group management decided to continue its policy to gradually phase out the supply of complete movements and assortments to its competitors¹³. Depending on the demand for Swiss watches, this often led to shortages of available Swiss movements among Swiss watch companies that did not belong to Swatch Group and were unable to produce their own movements. In 2009, WEKO looked again at the dominant market position of ETA and whether it discriminates independent watch companies compared to intra-group companies¹⁴. The investigation was interrupted in 2011, when WEKO started to inspect Swatch Group as a whole. After all, its dominant market position is not just limited to movement blanks but also assortments (Nivarox) and watch hands (Universo)¹⁵.

In October 2013, WEKO announced that it did not find sufficient evidence for discriminatory behaviour by ETA and therefore decided to let ETA's supply obligation for mechanical movements expire on December 31, 2019¹⁶. WEKO's demand for the stepwise reduction is criticized by Law Professor Marc Amstutz as an inadmissible form of market engineering (Box 6).

In July of 2014, WEKO closed also its investigations regarding ETA's pricing policy for mechanical movements that was in place since 2009¹⁷. The leniency

13. Donzé. P.-Y., 2014, A Business History of the Swatch Group: The Rebirth of Swiss Watchmaking and the Globalization of the Luxury Industry. Palgrave Macmillan.

14. WEKO, 15.09.2009, Press release (available online: <https://www.news.admin.ch/message/index.html?lang=de&msg-id=29027>).

15. Steffen, Charlotte, 2012, How Firms Profit from Acting in Networked Environments: Realising Competitive Advantages in Business Clusters. Rainer Hampp Verlag, München und Mering.

16. WEKO, 2013, Verfügung der Wettbewerbskommission vom 21.10.2013 in Sachen Swatch Group Liefertopp (available online: <https://www.news.admin.ch/message/index.html?lang=de&msg-id=50702>).

17. WEKO, 31.07.2014, Press release (available online: <https://www.news.admin.ch/message/index.html?lang=de&msg-id=53879>).

with which WEKO treated Swatch Group is striking in view of the fact that it abandoned the original policy of ASUAG to supply Swiss watch companies with movements and assortments on equal terms. In order to ensure that no price discrimination or supply restrictions take place, WEKO should ask Swatch Group to become more transparent by publishing the prices of the pieces produced in each segment.

The company Sellita may be seen as an emerging competitor that produces alternatives to ETA movements. Yet, Sellita still depends to a considerable extent on ETA calibres that are subsequently reassembled and resold. Moreover, dependence on the supply of Nivarox assortments is still higher¹⁸.

The Swatch Group intends to start negotiations with WEKO by mid-2016 about the stepwise reduction of deliveries of assortments from Nivarox to third-party customers. The goal is to find an agreement with WEKO by mid-2018¹⁹. So far there is no single manufacturer in sight in Switzerland that could provide assortments of sufficiently high quality and quantity at comparable costs to the ones provided by Nivarox.

In view of the growing uncertainty about the supply of watch parts provided by the Swatch Group, the Swiss watch company TAG Heuer signed an agreement with the Japanese company SEIKO in 2012 to at least secure the springs for its watches and thus became less dependent on Nivarox²⁰.

But securing parts from abroad may also become a problem in view of the Swatch Group's successful lobbying efforts to increase the local content

18. Maillard, Serge. 2016. Mechanical – who will succeed ETA? (available online: <http://www.europastar.com/watch-knowledge/1004087450-mechanical-who-will-succeed-eta.html>).

19. WEKO, 2013, Verfügung der Wettbewerbskommission vom 21.10.2013 in Sachen Swatch Group Lieferstopp. p. 117–118.

20. Donzé. P.-Y., 2014, A Business History of the Swatch Group: The Rebirth of Swiss Watchmaking and the Globalization of the Luxury Industry. Palgrave Macmillan.

The Swiss watch industry

requirements stipulated in the more stringent “Swiss made” regulation planned to come into force by 2017.

The decisions by WEKO have to be seen in light of the existing Swiss Cartel Act (Anti-trust law). This Act aims to prevent economically or socially damaging effects of cartels and other restrictions of competition, and thus to promote competition in the interests of a free market economy. Even though the Act proved rather ineffective in enforcing merger control to prevent detrimental effects to the Swiss economy²¹, promoting more competition does not seem to be at the forefront of Swiss politics. The revision of the Cartel Act fell through in Parliament in 2014. The permissive nature of the Cartel Act stands in strong contrast to the EU anti-trust legislation which uses the so-called SIEC-Test (Significant Impediment to Effective Competition).

It is not very likely that the “moat” around Swatch Group – as Geoff Gannon²² calls it – will be curtailed in the near future. The “moat” refers to market-entry barriers that market-dominating companies try to establish in order to maintain pricing power and the monopoly rents. The moat of Swatch Group is particularly pronounced in the market for mechanical movements, assortments, and watches in the mid-priced segment, which is described in this chapter. A recent article in the economist highlights how such moats result in consumer welfare losses, less innovation due to decreased competition through new market-entries, increased spending of the incumbent companies on unproductive lobbying in order to shape regulations in their favour, and so on. The bottom line is that “a new commitment to competition could be the source of optimism [...]. After all, it is only a healthy dollop of greed and a

21. Botschaft zur Änderung des Kartellgesetzes und zum Bundesgesetz über die Organisation der Wettbewerbsbehörde vom 22. Februar 2012 (available online: <https://www.admin.ch/opc/de/federal-gazette/2012/3905.pdf>).

22. Gannon, Geoff, 2015. Swatch's Moat, May 19 (available online: <http://gannonandhoangoninvesting.com/blog/2015/5/19/swatches-moat>).

Box 6 WEKO's decision from 20.10.2013 in light of the Cartel Act

According to professor Marc Amstutz from the University of Fribourg, the provisions of the Cartel Act suggest that the monopolist (of movements) can be obliged to continue to deliver third-party-customers as long as the company is dominating the market. This has been the practice of WEKO in the past. WEKO's decision regarding Swatch Group/ETA is, however, relying on market engineering with the goal to foster the entry of new suppliers of assortments and movements.

According to professor Amstutz, such centrally planned market engineering measures do not comply with the law: first, WEKO has no authority to prescribe structural measures for an entire industry. It only can do so for individual companies (e.g. unbundling).

Second, the mutual agreement between Swatch Group and WEKO boils down to an exemption regulation that is not provided for in the Cartel Act. Through the phase-out process Swatch Group can gradually withdraw from its supplier obligations. This right is meant to put pressure on alternative movement producers to be ready by 2020 but there is no evidence that Swatch Group/ETA might lose its dominant market position by then.

Third, the assumption that there will be an established alternative supplier that is able to meet the demand for movements outside the Swatch Group is rather unrealistic. Marc Amstutz concludes that WEKO willingly accepts that the Swatch Group is allowed to fundamentally alter the structure of the watch industry in a way that may strengthen rather than weaken its dominant market position.

Source: NZZ, 13.03.2013, Unzulässiger Eingriff der Wettbewerbsbehörden, Gastkommentar zum Weko-Uhrwerke Streit von Marc Amstutz, Professor für Wirtschaftsrecht.

The Swiss watch industry

belief in a better future that prompts people to start from scratch and try to cross the moat that has been dug around corporate America²³. This also holds for the Swiss case. To spur innovation and revitalize the Swiss watch industry such that it can keep up its market share also in numbers of timepieces, not more regulation is necessary but more competition from entrepreneurial outsiders challenging the rather complacent insiders.

23. The Economist. 2016. Too much of a good thing. Profits are too high. America needs a giant dose of competition, March 26 (available online: <http://www.economist.com/news/briefing/21695385-profits-are-too-high-america-needs-giant-dose-competition-too-much-good-thing>).

Chapter 8

The revision of the “Swiss made” regulation

8.1 The revision of the “Swiss made” regulation for watches

Based on the new “Swissness” bill¹ that was passed in parliament in 2013, the Swiss Federal Council approved the revised “Swiss made” regulation for watches in September 2015. It is scheduled to enter into force on 1 January 2017. The “Swissness” bill defines new minimal requirements for industrial goods required for the use of the “Swiss made” label, which also applies to watches. At least 60 per cent of the manufacturing costs of the product must occur in Switzerland, whereby research and development costs may also be included in the calculation. In addition, at least one essential manufacturing step must have taken place in Switzerland².

The revised “Swissness” regulation for watches will be much stricter than the prior “Swiss made” regulation for watches from 1971 (see Chapter 3.1 and Box 2). Increasing the requirements to earn the “Swiss made” label for watches is justified as a stronger kind of collective guarantee for what consumers expect from watches that are being manufactured in Switzerland. It is argued that enhancing the required share of local content would ensure domestic investment in new buildings, extensions and refurbishments of the watch industry.

1. According to the Swiss Federal Institute of Intellectual Property (IPE) the objective was “to create a basis for effectively safeguarding and preserving the added value of the ‘Swiss label – the ‘spearhead’ in the advertisement of Swiss products and services – for the long-term future”.

2. Swiss Federal Institute of Intellectual Property. 2015. The new “Swissness” legislation (available online: <https://www.ige.ch/en/indications-of-source/swissness.html>).

The “Swiss made” label is extremely attractive for luxury watches and has been a magnet for foreign direct investment. According to studies, the label provides for impressive price premia of up to 50 per cent for mechanical watches³. It is a marketing tool that boosts the bona fides of watches, arguing that the term goes hand in hand with quality, expertise and innovation.

Luxury brand producers have thus been strongly in favour of raising regulatory bars designed to fend off counterfeiting and to reap even higher premia. Yet, it is not obvious why Swiss content beyond the already existing requirement of 50 per cent would be more effective in fighting counterfeiting, why it should automatically translate into better timepieces, and why it is the “Swiss made” label rather than the Swiss brand itself that fetches the high premium.

A few small and mid-sized Swiss watch companies under the lead of Montaine have created the organization “IG Swiss Made” to fight the 60 per cent value criteria. They point at the cost implications of the new regulation for companies that produce watches in the low- to mid-price range. The requirements for obtaining the “Swiss made” label are indeed costly and complex and likely to increase concentration in the watch industry (Box 7).

Recently, FH did not object to a watering down of the “Swissness” criteria. In order to ensure that companies will be supplied sufficiently with components Swatch Group and FH lobby for an exception clause. Different components such as dials, hands, or watch cases shall be excluded for two years from the “Swiss made” calculation. Swiss manufacturers who have invested in this area are concerned because they are currently facing overproduction in view of lower sales of Swiss watches. Ronnie Bernheim, CEO of the independent Swiss watch

3. Swiss Federal Institute of Intellectual Property. “Swissness” Legislative Amendment: background, goal and content (available online: https://www.ipi.ch/fileadmin/user_upload/Juristische_Infos/e/Swissness_Legislative_Amendment-Content.pdf).

Box 7 The complex and costly new “Swiss made” label for watches

Several criteria have to be fulfilled to win the “Swiss made” label. The new core requirement is that 60 per cent of the manufacturing costs of the watch have to accrue within Switzerland. This includes R&D, treatment of raw materials, assembly, as well as quality assurance and certification. Not included are expenses for batteries as well as services such as packaging, distribution, or marketing. The 60 per cent value criteria for “Swissness” does not only apply to the movement (as it was the case in the 1971 “Swissness” law with its 50 per cent criteria), but to every component of the watch (including dials and cases).

Newly included in the “Swiss made” criteria are the mechanical construction and the prototyping of the movement as well as the conception of the software or the display, if carried out in Switzerland. The new regulation extends also the definition of what a watch is: a time measuring device worn on the wrist. This would also include smartwatches.

Source: Institut für Geistiges Eigentum IGE, 2015, Revision der Verordnung über die Benützung des Schweizer Namens für Uhren, Dokumente zur Vernehmlassung 2015 (available online: <https://www.ige.ch/de/herkunftsangaben/swissness/branchenverordnungen/swiss-made-verordnung-fuer-uhren/vernehmlassung-2015.html>).

company Mondaine agrees that there is currently no scarcity of “Swiss made” components, but he would still be unable to obtain the desired quality. The exception clause would therefore be necessary⁴. The quality problems combined with the lower demand are having an impact on the unemployment rate in the watch industry. Unemployment has been persistently increasing after 2012 and reaches 9 per cent, the second highest after the restaurant sector

4. Vonplon, David, 2016, Verkehrte Welt. Jahrelang hat die Uhrenindustrie für scharfe Regeln gekämpft. Jetzt lässt sie Verwässerung zu. Handelszeitung, 4. Mai 2016.

(Figure 13 in the Annex). This points to a structural problem in the industry that is very different from the unemployment peak during the financial crisis 2009/10.

8.2 The role of the Federation of the Swiss Watch Industry (FH) in the design of new “Swiss made” regulation for watches

FH played a crucial role in the definition of the “Swissness” criteria for watches. In September 2015, the Swiss Federal Council followed the recommendation of FH and approved the more strict and complex “Swiss made” regulation for watches. The strong lobbying of FH was never considered to be an issue of concern since the organization was thought to represent the watch industry as a whole. Yet, the influence of the Swatch Group within FH is striking. Thanks to its monopoly in the supply of watch parts, it is essentially able to force watch companies that represent the innovative low to mid-range price segment, as members of FH, to endorse the interests of the members that represent the high price segment for watches, which mainly relies on the high premia for “Swiss made” (Box 8). “IG Swiss made” wrote a letter to the Swiss Federal Institute of Intellectual Property Rights (IGE) pointing out that FH does not represent the entire Swiss watch industry but merely the luxury segment⁵. Since FH was able to define what “Swissness” means for watches in terms of local content requirements, it is clearly biased towards the preferences of the luxury segment and may undermine the competitive position of innovative watch companies that could possibly challenge the ETA monopoly position in movements and assortments if they are able to produce more cost-effective, which will be difficult in view of the enhanced local content requirements. The letter further points out that the new 60 per cent local content requirement is contrary to Swiss legal practice as well as opposed to the numerous international trade agreements that Switzerland has signed and ratified since the 1970s. Alas,

5. Available online: https://www.ige.ch/fileadmin/user_upload/Juristische_Infos/swissness_vl/10802046.pdf

Box 8 The position of the Swatch Group within FH

The balance of powers in FH is clear: As of 2014, there are six members of the Swatch Group in the Board of FH. In addition to these six votes of the Swatch Group, Richemont, Rolex, and Patek Philippe have together six votes. They represent the luxury segment that is highly in favour of “Swissness”. The remaining watch companies or suppliers hold seven votes in the Board. The Board then submits issues to all 59 members at the General Assembly of FH for approval. The General Assembly is again dominated by Swatch Group with a total of 13 votes, more than any other company. Swatch, Rolex and the other high-end brands have together 32 votes compared to 27 votes that represent the remaining companies.

Source: FH, Annual Report 2014, pp. 40–42.

the group was unable to influence Swiss policy makers, who associate Swiss watches with either the Swatch or the luxury segment.

8.3 Impacts of the new “Swiss made” regulation for watches

The proposed “Swiss made” regulation for watches increases local content requirements enormously, including far-reaching prescriptions that undermine economic freedom and entrepreneurship. This is especially troubling for manufacturers in the middle price segment such as Mondaine but also for the producers of quartz watches in the lower price segments where international competition is fierce and production costs matter a great deal. Companies in the lower and middle price segments are much more integrated into global value chains than producers of mechanical watches. They must take advantage of the international division of labour and invest in innovation to remain competitive. The proposed “Swiss made” regulation would not only negatively affect them but also watch companies abroad – especially foreign manufacturers of parts, especially in Europe and Asia. Figure 5 (see Annex)

The Swiss watch industry

shows that imports of watches and parts thereof have been growing steadily and amounted to over CHF 3.8 billion in 2015. This is equivalent to 18 per cent of the Swiss watch export value for the same year.

China is the largest producer of watches and its parts on a global scale. As Switzerland heavily imports watch parts from China, Switzerland could potentially come under fire also from that side. In the bilateral free trade agreement between Switzerland and China that came into force in 2014, the rules of origin allow for a maximum of 40 per cent of foreign precursor materials⁶. This is the precondition from a customs point of view to win the Swiss origin in order to enjoy reduced tariffs at the stage of import into China. However, the “Swiss made” rules in the new “Swiss made” regulation for watches that will come into force in 2017 are stricter. It needs to be seen how the Chinese will react once Swiss watch companies will reduce sourcing watch parts from China due to the regulatory changes favouring companies in Switzerland over foreign suppliers.

The revised “Swiss made” regulation shows incompatibilities with the bilateral Swiss-EU watch agreement and also with Article III GATT (national treatment) as it is conditional upon priority use of domestic products over imports, designed to protect geographical indication. This could potentially lead to trade disputes.

The Swiss federal government claims that the proposed regulation is in accordance with WTO law because the “Swiss made” label is voluntary. That

6. According to Annex II, clocks and watches meet the condition of substantial transformation if their “Value of Non-Originating Material” does not exceed 40 per cent, i.e. if the value of components not originating from Switzerland or China, respectively, does not exceed 40 per cent of the total ex-works price of the watch (“VMN 40%”). Source: A Practical Guide to the New Free-Trade Agreement between Switzerland and China (available online: http://www.wenfei.com/fileadmin/pdfs/China_Publications/Wenfei_FTA_Publication_December_2013.pdf).

may be true if it would be a private standard created by FH, but it is actually based on government regulation and thus de-facto binding for all Swiss watch companies who do not want to risk their “Swiss made” premia. The new local content requirements for obtaining the “Swiss made” label must therefore be considered non-tariff barriers from a trade policy perspective. Consequently, it may be contrary to the principle of national treatment (Article III GATT) which is asking for equal treatment of domestic and imported materials⁷.

7. Aerni, Philipp, 2015, Stellungnahme zur Revision der Verordnung über die Benützung des Schweizer Namens für Uhren. Brief vom 2. Dezember 2015 an das Schweizerische Institut für Geistiges Eigentum, Bern.

Chapter 9

The Swatch Group: high on reputation, low on corporate governance

Compared to other listed Swiss multinationals, the Swatch Group does not release much information on production, prices and sales. Its lack of transparency is reflected in corporate social responsibility ratings. In the CSRHUB ratings¹ for corporate governance, the company reaches a score of 44 out of 100 and has the lowest rating among the watch companies listed at the stock exchange.

9.1 Corporate governance problems

From a corporate governance standpoint Swatch Group shows several deficiencies. For one, the Hayek Pool as the majority shareholder does not only control the governing board but at the same time also occupies the CEO position. This constellation allows only for a limited supervision of the executive management. This is also reflected by the fact that the company does not have an organization chart depicting who is responsible for what.

Transparency does not seem to be what the Swatch Group is aiming for. At the general assembly, voting is still done by raising hands. This is criticized because then no voting results are available and the company does not know the share of no-votes. Regarding the latter, shareholder counselors advocate

1. Available online: www.csrhub.com

that even a share of 15 per cent no-votes would have resulted in changes – for example in the compensation policies in other companies².

As of the end of 2015 the Hayek Pool controls 40.1 per cent and Esther Grether's group 5.9 per cent of the votes (together 46 per cent of votes). For the Hayek Pool as the majority shareholder it suffices to hold only 22.6 per cent of the share capital. This in fact makes Swatch Group attractive for a company takeover as an investor would have to take over a fraction of the share capital to control the entire company. In the case of Sika company the Burkard family controls 52.4 per cent of the votes with only 16.1 per cent of the share capital. This is why Saint-Gobain is ready to pay a much higher price for the family shares than what they are actually worth at the stock exchange (the other shareholders would not profit from the offer)³. However, the offer by Saint-Gobain is only possible because the statutes of Sika contain an opting-out clause. The general rule is that when a transferee surpasses 33 1/3 per cent of the voting rights – according to articles 32 and 52 the Swiss Federal Stock Exchanges and Securities Trading Act⁴ – a mandatory takeover offer has to be made to all shareholders. With the opting-out clause such a mandatory takeover offer is not required even though the threshold level of 33 1/3 per cent of voting rights is surpassed. This is what makes it possible that a buyer can get in control of a listed company without having to consider the non-majority shareholders. Internationally, this is a unique provision.

Swatch Group has in its statutes not an opting-out but an opting-up clause. The latter allows that a transferee does not have to make a mandatory takeover

2. Möckli, Andreas, 2016, Das lange Sündenregister der Swatch Group, Tagesanzeiger, 27.05.2015 (available online: <http://www.tagesanzeiger.ch/wirtschaft/unternehmen-und-konjunktur/Das-lange-Suendenregister-der-Swatch-Group/story/21197688>).

3. AWP, 2014, Sika will an Investorenpräsentation informieren, Finanz und Wirtschaft, 17.12.2014 (available online: <http://www.fuw.ch/article/sika-erlautert-lage-an-investorenpräsentation/>).

4. Schweizer Bundesgesetz über die Börsen und den Effektenhandel (BEHG, SR 954.1).

The Swiss watch industry

offer to all shareholders when surpassing the 33 1/3 per cent voting rights but needs to do so only at a higher threshold level (maximum 49 per cent). In the case of the Swatch Group this may make it possible for a transferee to buy up to 49 per cent of voting rights without having to make a takeover offer to all shareholders. As the Hayek Pool and Mrs Grether together possess 46 per cent of the votes they may easily pass over their voting rights to a buyer who could take control of the company with only a fraction of the shareholder capital (about 25 per cent) without having to make an offer to minority shareholders.

An additional reason for the low Corporate Governance ratings is related to the company's decision in 2013 to switch from the International Financial Reporting Standards (IFRS) back to the Swiss GAAP FER as the first company listed on the SMI. Swiss GAAP FER has been primarily designed for small and medium sized enterprises (SMEs) involved primarily in domestic business in Switzerland while IFRS is generally recommended for multinational corporations listed at the stock exchange.

Deloitte analyzed the financial statements of the seven companies which switched in 2013 from IFRS to Swiss GAAP FER⁵. Deloitte finds that on average the length of consolidated financial statements were reduced by 22 per cent. This has to do with the fact that Swiss GAAP FER rules encompass about 200 pages while IFRS has 2000. Further, reported total equity declined after the restatement in Swiss GAAP FER, in the case of Swatch Group it was 8.3 per cent.

9.2 What Swatch and Volkswagen may have in common

Despite poor transparency and low corporate governance scores Swatch Group has an excellent reputation rating. In the GfK Business Reflector monitoring of

5. Available online: <http://www2.deloitte.com/content/dam/Deloitte/ch/Documents/consumerbusiness/ch-en-consumer-business-deloitte-swiss-watch-study-2015.pdf>

the reputation of Swiss companies, Swatch Group was in first place in 2011 and 2013, in second place in 2012 and 2014⁶. Only in 2015 its rating dropped to third place.

It indicates that the company still enjoys enormous public trust. Swiss watches may be considered as part of Swiss identity and criticizing how the company is run may be confused with an attack against the quality of Swiss watches.

Something similar can be observed in the case of Volkswagen, a national champion and object of pride in Germany. The cheating of the company during laboratory emissions testing of its diesel cars was discovered in the United States while, in Germany, it was a sort of a well-known secret that could not be disclosed for fear to appear unpatriotic (meaning being against Volkswagen). The scandal clearly reflected the amount of self-complacency that large companies with a high reputation and strong ties to their respective governments had developed over time in a corporatist system⁷. Despite the environmental scandal and the obvious corporate governance problem, Volkswagen remains popular in Germany⁸.

What Volkswagen and Swatch Group seem to have in common is what sociologist Diane Vaughan coined “the normalization of deviance”⁹. It refers to a corporate behaviour that clearly goes against the self-proclaimed values and

6. Tagesanzeiger, 2015, Die 20 beliebtesten Firmen der Schweiz, 01.04.2015 (available online: <http://www.tagesanzeiger.ch/wirtschaft/Die-20-beliebtesten-Firmen-der-Schweiz/story/15758179>).

7. Der Spiegel, 2015, Manipulierte Abgasanlagen: VW soll schon vor Jahren gewarnt worden sein. 26.09.2015 (available online: <http://www.spiegel.de/wirtschaft/unternehmen/vw-wusste-in-abgas-affeere-schon-frueh-bescheid-a-1054926.html>).

8. Gibbs, Alexandra, 2015, Volkswagen's brand value still high with Germans: Survey. CNBC, 20.10.2015 (available online: <http://www.cnbc.com/2015/10/20/volkswagens-brand-value-still-high-with-german-consumers-survey.html>).

9. Vaughan, D., 1996, The Challenger launch decision : risky technology, culture, and deviance at NASA. Chicago: University of Chicago Press.

norms. This behaviour eventually becomes routine and converts into an unquestioned “script”. It allows managers and engineers of the company to carry on as if nothing was wrong¹⁰. It illustrates how a growing corporate bureaucracy induces its employees to live with double standards. They may be aware of the gap between the claims and the reality of the company, but they do not allow it to come close to them. As such, the corporation can conceal wrongdoing not only from the public but from itself¹¹. These kind of corporate governance failures may be especially difficult to detect if a company is popular and strongly embedded in a corporatist system that is publicly accepted.

10. Useem, Jerry, 2016, What Was Volkswagen Thinking? On the origins of corporate evil—and idiocy. *The Atlantic Monthly* Jan/Feb 2016 (available online: <http://www.theatlantic.com/magazine/archive/2016/01/what-was-volkswagen-thinking/419127/>).

11. Aerni, Philipp, K.-J. Gürn, and Irina Kummert, (eds), 2015, *Schwierigkeiten mit der Moral*. Springer Gabler.

Chapter 10

Conclusions

The invention of the Swatch was decisive for the rebirth of the Swiss watch industry in the 1980s after its deepest crisis in history. The path-breaking product and process innovations associated with the development, production and marketing of the Swatch made it a great commercial success and enabled the Swiss watch industry to regain global visibility.

Swatch was a product that ran counter to what the Swiss would understand as a Swiss watch in the 1970s, it was not a mechanical watch and it was not expensive. In fact, it was a fashionable plastic watch. In this sense, it did not represent the conservative culture of traditional Swiss craftsmanship in watchmaking but proved to the world that the Swiss watch industry also stands for the power of innovation.

The success of the Swatch also proved that Swiss innovation in one watch segment may also help increase sales in another segment that is still primarily based on traditional craftsmanship. After all, the omnipresence of the Swatch across the world was crucial for the revival of the (expensive) mechanical Swiss brands in the 1990s.

In this paper, we showed that the emergence of Swiss corporatism in the watch industry after World War I undermined rather than enhanced the ability of the watch industry to effectively respond to new global economic and technological challenges through innovation in technology and management. The stakeholders involved in corporatist decision making were mainly concerned with the preservation of jobs, and the support and protection of domestic watch

The Swiss watch industry

production. The foundation of ASUAG in the 1930s as a state monopoly in charge of the production of watch movements and assortments was a first significant step towards corporatism in the Swiss watch industry. State intervention was justified by the public interest to keep watch production in Switzerland. The public mandate of ASUAG was to ensure that domestic watch companies have access to quality input products at affordable prices.

After World War II, laws were passed with the purpose of reopening the Swiss economy to foreign competition. The watch industry was, however, able to protect its interests through the so-called Watch statute in 1951, which was revised in 1961 and eventually abolished in 1971. In that period, ASUAG gained a dominant market position not just in the production of movements and assortments but also the production and export of mechanical watches. ASUAG and the other large Swiss watch company SSIH that sold famous finished watches of brands such as Omega and Tissot dominated the market for premium watches in the world.

Yet, the reliance on the “Swissness” premium also led to complacency. Even though Swiss engineers made many important contributions to the development of quartz and digital watches and created the first prototype of a quartz watch, it was the Japanese that created the first automated assembly lines for mechanical watches and successfully commercialized the quartz technology, which took over pin-pallet escapement technology of mechanical watches in market share at the end of the 1970s.

Apart from the strong appreciation of the Swiss franc after the collapse of the Bretton Woods system in 1971, foreign competition was the main reason for the decline in global market share of Swiss watches, which eventually ended in the watch crisis in 1981, when the global market was flooded with cheap quartz watches. Yet, the Swiss government realized back then that the crisis cannot be merely resolved through more regulation. Even though it did take

an effort to protect the value of the Swiss brand by means of a first “Swiss made” regulation in 1971 for watches alone, requiring 50 per cent local content, the government decided to gradually withdraw from ASUAG, so that the company could become more entrepreneurial and innovative. The withdrawal of the state ran in parallel with the rising influence of the Swiss banks who became the main creditors of the watch industry, eventually converting debt into equity.

The great leap of innovation in the watch industry happened at the end of the 1970s under the leadership of Ernst Thomke and his team of managers, designers, marketing experts and engineers. Ernst Thomke, who was then in charge of ETA, the ASUAG-owned company that produced the mechanical watch movements, pushed for the development of automated assembly lines, not just for mechanical but also for quartz movements. Moreover, he shared the belief with Pierre Renggli, the then president of ASUAG, that an inexpensive Swiss watch that is based on a quartz movement has the potential to establish Swiss dominance in watch production not just in the higher but also the lower-middle price segment of the world market.

So when the watch crisis hit Switzerland in 1981, ASUAG may have suffered some short-term losses, but it was well prepared to assume market leadership in the production of movements, assortments as well as finished watches. In turn, the other large Swiss company, SSIH, that owned brands such as Omega and Tissot, continued to produce losses despite attempts by the Union Bank of Switzerland, UBS, to restructure it with the help of Hayek Engineering AG. The merger of SSIH and ASUAG was therefore a merger of unequals pushed by a consortium of Swiss banks that owned the majority of shares in both companies and had the primary interest to save SSIH. They knew that the bankruptcy of SSIH would also endanger the existence of many upstream companies that supplied SSIH and which were also indebted to the banks. Through financial engineering that would probably

The Swiss watch industry

be considered illicit by today's standards, they were able to convince the public that not just SSIH but also ASUAG would go bankrupt unless they are saved by the Swiss banks. They made their case by presenting an audit done by the "Schweizerische Treuhand Gesellschaft" that was owned 100 per cent by the Swiss Bank Corporation. The audit approved of the miraculous conversion of over CHF 590 million equity capital, as prepared for the tax statement of ASUAG in 1981, into a negative equity amount of CHF 22.5 million. In the subsequent merger, the value of the new shares held by minority shareholders of ASUAG shrunk to a tenth of the prior value, while the value of the shares of SSIH basically remained the same.

When Nicolas G. Hayek and a pool of other investors in 1985 bought a stake in the company from the Swiss banks, Hayek must have known that ASUAG was not in a dire state but actually a goldmine. After all, he himself published a report shortly before the merger. The report stated that ASUAG has a great potential to reassuming leadership in the global watch market in view of the successful restructuring under Ernst Thomke and his team¹. With the Hayek pool of investors gaining private ownership of the company resulting from the merger, a state monopoly essentially fell into private hands and the consequences for the industry as a whole are felt to date.

The company was first called SMH, and later renamed "Swatch Group". The Swatch Group took advantage of its dominant market position by announcing in 2002 that it would end of the original mandate of its subsidiary, ETA, to supply the watch industry with movements by 2006. Even though the Swiss Federal Competition Commission (WEKO) called for appropriate adjustment periods, it accepted the basic strategy of the company. By 2020, the Swatch Group will no more be obliged to sell mechanical movements to other Swiss watch

1. Asuag-SSIH (1983) An die Aktionäre: Bericht des Verwaltungsrates gemäss Art. 650/630 des Obligationenrechtes. Asuag-SSIH, Schweizerische Uhrenindustrie, Biel.

companies. WEKO assumes that by then, ETA will have lost its monopoly due to new competitors in the market. The current trends point in another direction, and it is questionable whether alternative suppliers will be able to meet the demand for mechanical movements by Swiss watch companies that do not belong to Swatch Group.

The new “Swiss made” regulation is scheduled to come into force in 2017. It requires not 50 per cent local content, as stated in the 1971 “Swiss made” ordinance and as generally accepted in Swiss legal practice as well as international trade agreements, signed and ratified by Switzerland, but actually 60 per cent. It was basically the FH that defined “Swiss made” for watches. The Swatch Group has a dominant position in FH, which primarily represents the interests of the watch companies in the high-end price segment as well as the producers of movements and assortments. They do not represent the more innovative companies in the lower and middle range price segments that depend on the external supply of movements and assortments.

In this sense, the new “Swiss made” ordinance is in the best tradition of Swiss corporatism in the watch industry. It was approved by policy makers because it would not just serve the watch industry but also the public interest. Swiss identity must be preserved and, with it, Swiss jobs in the watch industry. Fact is, however, that the ordinance was primarily designed to protect the incumbents at the expense of more innovative outsiders.

Somehow, the corporatist structure allowed for the transition of ASUAG from a state monopoly into an even more powerful private monopoly called the Swatch Group. But rather than a deal between employers and employees, for which corporatism is known and appreciated in the German-speaking countries of Europe, the deal primarily served the interests of the powerful stakeholders in Swiss finance and politics. It was done behind closed doors and involved complex financial engineering. The lack of transparency has

The Swiss watch industry

permeated into the corporate culture of the Swatch Group. Corporate governance ratings of the Swatch Group have been persistently low, while its public reputation remains high. This is not surprising considering the positive emotional value of the Swatch in public. The fact that the brand “Swatch” may even be conceived as part of Swiss national identity, makes it plausible to portray the protection of the private interests of the Swatch Group as protecting the public interest.

It is however questionable whether the new Swatch Group-induced “Swiss made” regulation is in the public interest since it further strengthens the monopoly power of the Swatch Group and endangers the survival of independent innovative Swiss timepiece makers.

The revised “Swiss made” regulation for watches is likely to accentuate the concept of sourcing at home and selling to the world at large, denying the advantages of global value chain integration. The new rules also disregard the fact that collaboration in R&D even among competing companies from different parts of the world can be very fruitful. This might be especially critical in the age of smartwatches where watchmaking is combined with IT.

This new type of corporatism creates non-tariff trade barriers (“Swiss made” regulation that goes beyond what has been agreed upon in international trade agreements) in the name of the public interest (keeping Swiss jobs at home). It may be a recipe for the next crisis, especially in view of the economic slowdown in China, and the rise of smartwatches as the disruptive new technology in the watch industry in 2015.

Swatch Group looks ill-prepared for the looming smartwatch revolution despite its strong market position and some efforts to make better use of information technology. Nick Hayek publicly announced that he would not seek collaboration with one of the giants in information and communication

technologies, since Swiss watches would not serve the same market like smartwatches. He argued that smartwatches are actually a hype that would eventually pass, ignoring the fact that the watch might indeed once become a complementary good of the smartphone².

When the share price of the Swatch Group declined substantially in 2015, Nick Hayek followed the tradition of his father by blaming external factors for the problems such as the strong Swiss franc and weak demand in important export markets. Yet, the losses in share value of the Swatch Group may have been more related to the fact that 8.1 million smartwatches have been shipped in the last quarter of 2015 alone, compared to 7.9 million watch units shipped out of Switzerland³. The other two multinational conglomerates in the luxury and watch business, Richemont and LVMH, were equally exposed to the same external factors but face less competition pressure from the smartwatch, which mainly hits the low/mid range watch price segment. In addition, these two conglomerates also seemed to enjoy more confidence with shareholders in view of the less pronounced declines in stock value, in the case of Richemont, and a fairly stable share price in the case of LVMH. The two conglomerates are also less targeted by short-sellers. The good performance of LVMH may also be related to the Swiss watch company TAG Heuer, owned by LVMH, that has reported a record high demand for its smartwatch in the range of CHF 1 500.

Nick Hayek still seems to be in denial about the growing worldwide shift in consumer preferences toward smartwatches and has announced a long-term

2. Martel, Andrea, 2016, Nach einem enttäuschenden Jahresergebnis: die Swatch Group glaubt sich unterschätzt. NZZ, 3. Februar, 2016 (available online: <http://www.nzz.ch/wirtschaft/unternehmen/swatch-mit-weniger-gewinn-1.18688702>).

3. Mawston, Neil, 2016, Global Smartwatch Shipments Overtake Swiss Watch Shipments in Q4 2015, Strategy Analytic Press releases, Feb. 18, 2016 (available online: <https://www.strategyanalytics.com/strategy-analytics/news/strategy-analytics-press-releases/strategy-analytics-press-release/2016/02/18/global-smartwatch-shipments-overtake-swiss-watch-shipments-in-q4-2015#.Vt2KLEbQBKV>).

The Swiss watch industry

share buy back programme in February 2016 to shore up the share price, which he considers to be attacked by speculators that do not value the strengths of the Swatch Group⁴.

As the low-end mass production segment is extremely important for the visibility of the innovative capacity of the Swatch Group and the Swiss watch industry as a whole, an innovation breakthrough crowned with commercial success is needed. Otherwise, the high-price segment of mechanical watches where high premia are generated, could also suffer. It is a misconception that the Swiss watch industry could survive in future by merely relying on the premia for handcrafted expensive watches that might be full of incremental innovations but devoid of any effort to involve the customer to a higher extent by offering more customized products through a more modular approach to watchmaking.

Despite the rhetoric by Hayek Sr., and later by Hayek Jr., of challenging the Swiss establishment with groundbreaking and visionary innovation, there is not yet much to show for. The Smart Car was probably never meant to be commercialized by SMH in the 1990; and the latest announcement by Nick Hayek to make his father's dream come true by building environmentally friendly car batteries in Switzerland that would generate thousands of jobs and billions of revenues in the near future, faces some skepticism in view of the fact that the battery only exists so far as a prototype coin battery.

When Nicolas Hayek died in 2010, his alleged achievement of saving the Swiss watch industry was praised in the obituaries in Forbes magazine, the New York Times, the Guardian and many other global national daily and

4. Meisser, Pascal, 2016, Swatch Group setzt sich ambitionierte Ziele, Finanz und Wirtschaft, 05.02.2016 (available online: <http://www.fuw.ch/article/swatch-group-setzt-sich-ambitionierte-ziele/>).

weekly magazines. They portrayed him as an outsider that launched the Swatch, the greatest innovation in the recent history of the watch business, against strong resistance and skepticism from the corporate establishment. As “Mr Swatch”, he was characterized as an “eccentric showman, blithely wearing eight of his products simultaneously, four on each arm”⁵. With these gestures he demonstrated the emotional relationship the Swatch has to his owner. The message was that the product is a mere extension of oneself. “It was not for you, it is actually you”, as the sociologist Sherry Turkle explained the relationship between humans and their personal computers⁶. His marketing strategy was somehow focused on the generation of such personal emotions for the personal product worn at one’s arm wrist. This also helps explain how the popularity of the Swatch brand was also transferred to its supposed creator, Nicolas Hayek.

In this sense, obituaries for Nicolas Hayek are somewhat comparable to the ones for Steve Jobs, who died on October 5, 2011. True, global mourning for Steve Jobs reached another dimension because Apple products were not just nice gadgets to wear but were actually shaping the content and even the meaning of people’s lives.

But there are many similarities: both, Hayek and Jobs, were strongly focused on ruthlessly taking advantage of their market power and were known to be arrogant and vain. Moreover, both infused the story they told about themselves with the product they were selling. They did so by staging theatrical events announcing the next big thing and portraying it as a moral cause to support it.

5. Pope, Stephen, 2010, Swatch Billionaire Nicolas Hayek, Who Saved The Swiss Watch Industry, Dies. *Forbes Magazine*, 29.06.2010 (available online: <http://www.forbes.com/sites/billions/2010/06/29/swatch-billionaire-nicolas-hayek-who-saved-the-swiss-watch-industry-dies/#461d33fa4427>).

6. Turkle, Sherry, 2005, *The Second Self: Computers and the Human Spirit*. Twentieth Anniversary Edition, MIT Press).

The Swiss watch industry

They wanted to make consumers believe that to buy their goods also meant to do good⁷.

Yet, there are four major differences: (1) While both were consummate showmen, the theatrical media events of Steve Jobs were designed to launch real innovative products that proved to be scalable, while Hayek's events were primarily announcing the development of new products that, in most cases, never reached the stage of successful commercialization; (2) Steve Jobs and his colleagues were building up a business from scratch while Nicolas Hayek merely inherited a former state monopoly that he later converted into a private monopoly; (3) Steve Jobs was actually an outsider while Nicolas Hayek was brought into the watch business by the establishment; (4) despite all his flaws and recklessness, Steve Jobs was the genius and innovative entrepreneur who helped to transform the personal computer business into an ecosystem of fashionable electronic consumer goods that communicate with each other. In the watch industry, it was not Nicolas Hayek who revolutionized the watch business with the development and successful commercialization of the Swatch, but Ernst Thomke and his team. Even when it came to the successful marketing of "affordable luxury" in the late 1990s and early 2000, it was Jean-Claude Biver, the "nostalgia salesman", who restored Blancpain in the 1980s, and helped making Omega the flagship watch of the Swatch Group in the upper price segment in 2000. Thanks to those two brilliant entrepreneurs and their teams, the Swatch Group managed to establish itself as the leading watch company in the world in the 1990s even without introducing a single fundamental innovation in the technical field since the launch of the Swatch⁸.

7. Halpern, Sue, 2016, The Real Legacy of Steve Jobs. The New York Review of Books, February 11, 2016 (available online: <http://www.nybooks.com/articles/2016/02/11/the-real-legacy-of-steve-jobs/>).

8. Donzé, P.-Y., 2014, A Business History of the Swatch Group: The Rebirth of Swiss Watchmaking and the Globalization of the Luxury Industry. Palgrave Macmillan.

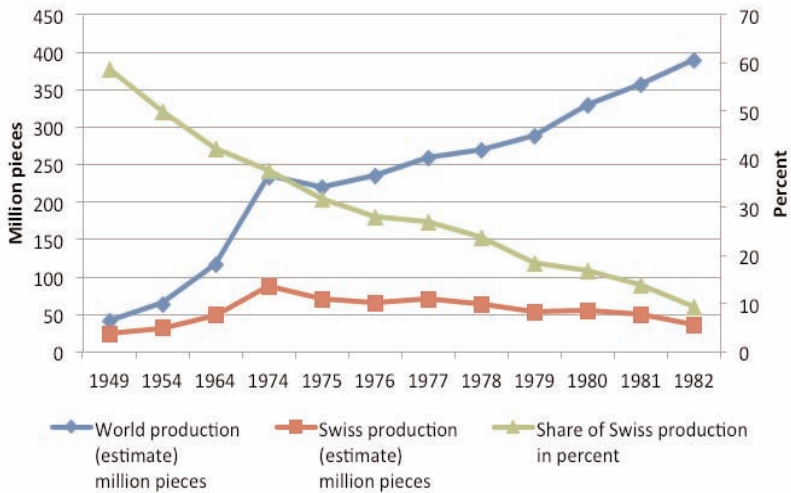
Yet, this dominant position might not last forever in view of the current economic and technological challenges in the global watch industry. The Swatch Group continues to rely on extracting monopoly rents and its marketing strategy is still based on the “affordable luxury” concept of the 1990s. As for the company’s answer to the coming information technology revolution in the watch business, it responds lukewarm with some gadgets here and there that are hardly scalable in future. The Swiss watch industry of today is much less prepared to face the challenges related to disruptive technologies than was the case in the 1980s when the industry had invested in microelectronics and had built the first quartz wristwatches⁹.

The Hayek family does not seem to worry because its members have reason to believe that Swiss corporatism will protect their business, allegedly in the “public interest”. The revised “Swiss made” regulation for watches approved by the Swiss Federal Council in fall 2015, and the WEKO decision in 2013 to allow the Swatch Group to stop selling mechanical movements to Swiss watch companies that do not belong to the Swatch Group, are strong indications that there is no interest to challenge the private monopoly of the Swatch Group and the resulting corporate governance problems. Swiss corporatism may have been praised in the past for its consensus-oriented approach in economic policy, but the dominance of the Swatch Group in the Swiss watch industry also reveals its shortcomings. Unlike in the 1970s when Swiss corporatism was still able to respond to the crisis by gradually abolishing the state monopoly, there is less willingness today to challenge the current private monopoly of the Swatch Group. This makes it not very likely that the Swiss watch industry will be once again able to renew itself through innovative leadership, as it happened in the 1970s.

9. Gareil, Gilles and Elmar Mock, 2016, *The Innovation Factory: Taking the Plunge*. Auerback Publications.

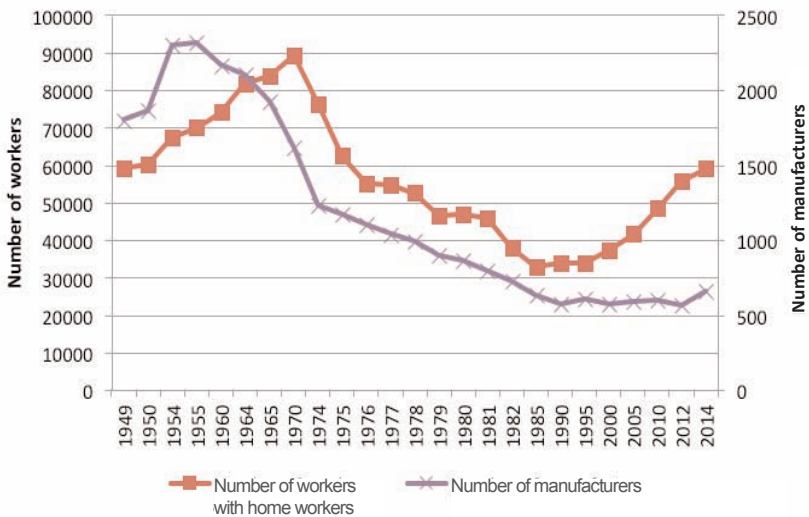
ANNEX OF FIGURES

Figure 1 Share of Swiss watch production in global output of finished watches and movement blanks, number of pieces, 1949–1982



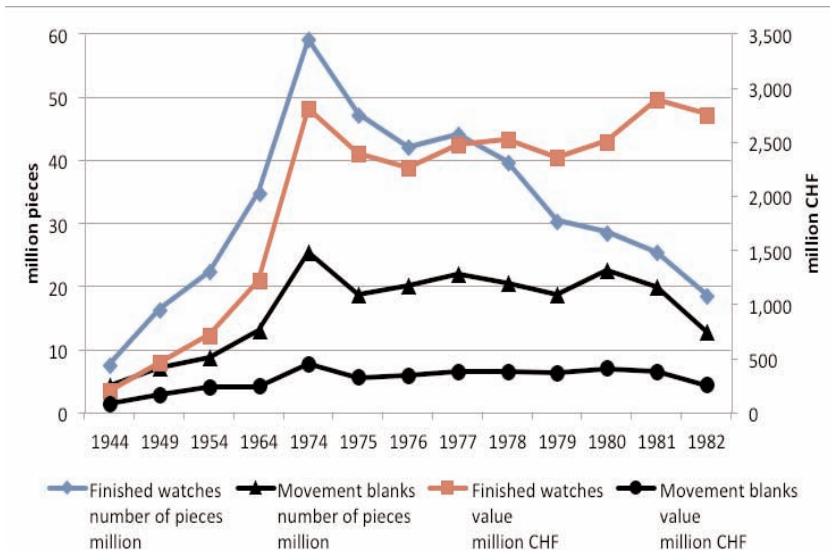
Source: FH in: BBI 1983 III 945. Botschaft über die Veräusserung der Beteiligung des Bundes am Aktienkapital der Allgemeinen Schweizerischen Uhrenindustrie AG vom 14. September 1983.

Figure 2 Number of workers and manufacturers in the Swiss watch industry



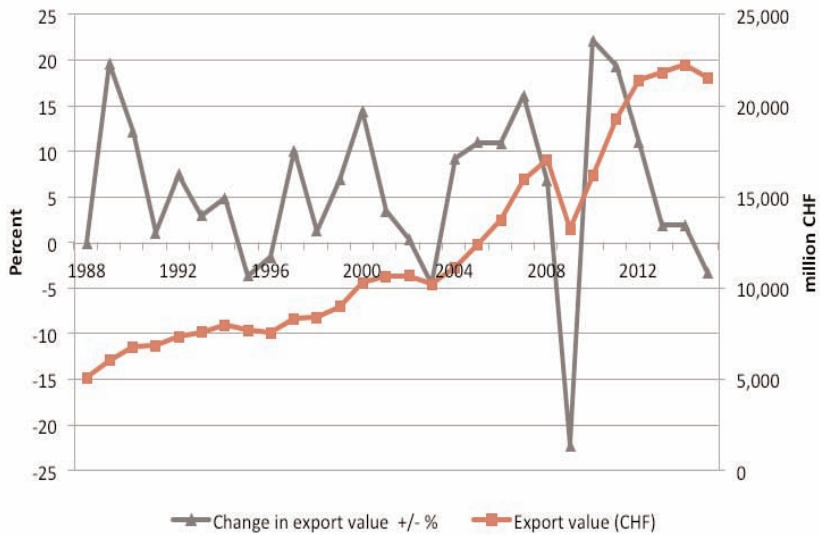
Sources: FH in: BBI 1983 III 945. Botschaft über die Veräusserung der Beteiligung des Bundes am Aktienkapital der Allgemeinen Schweizerischen Uhrenindustrie AG vom 14. September 1983; and Convention patronale (available online: http://www.cpih.ch/fichiers/files/politique-patronale/Recensement%202014_FR_vmedia_def.pdf).

Figure 3 Exports of Swiss finished watches and movement blanks, number of pieces and value, 1944–1982



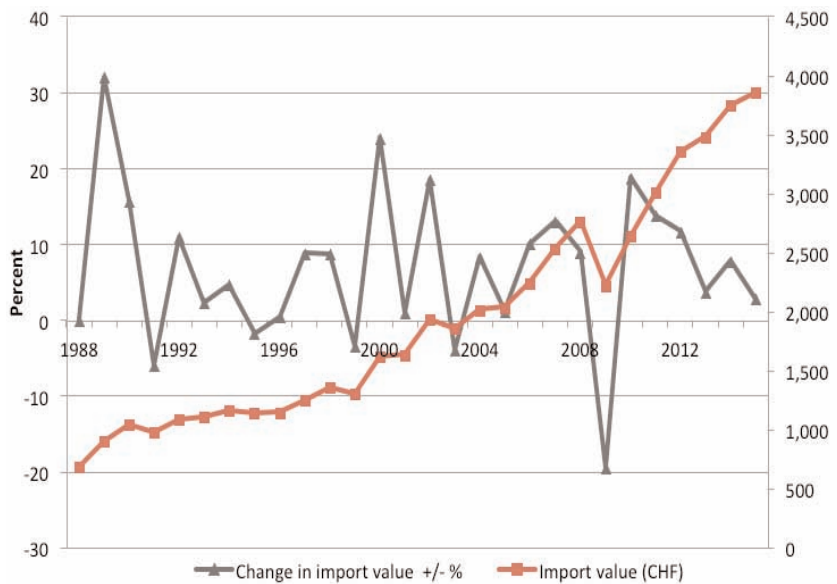
Source: FH in: BBI 1983 III 945. Botschaft über die Veräusserung der Beteiligung des Bundes am Aktienkapital der Allgemeinen Schweizerischen Uhrenindustrie AG vom 14. September 1983.

Figure 4 Exports of Swiss clocks and watches and parts, 1988–2015
(as reported in HS Chapter 91)



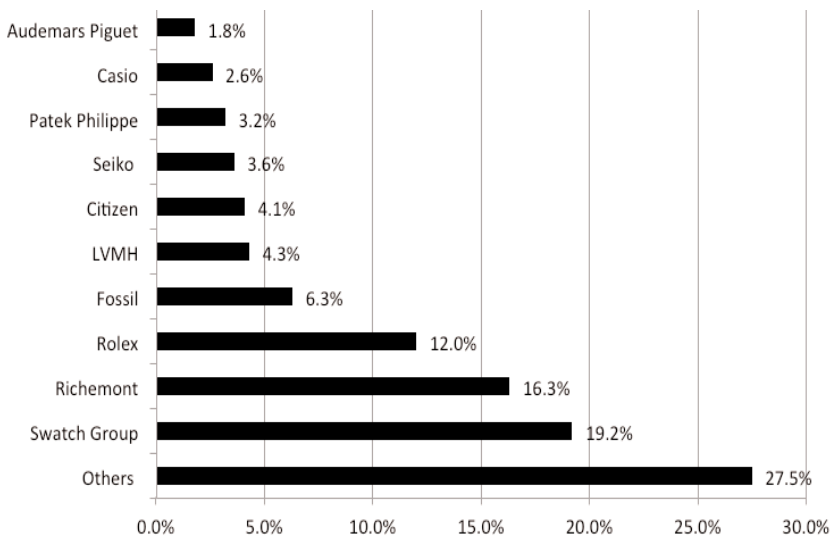
Source: Swissimpex, Oberzolldirektion, Berne.

Figure 5 Imports of clocks and watches and parts by Switzerland, 1988–2015 (as reported in HS Chapter 91)



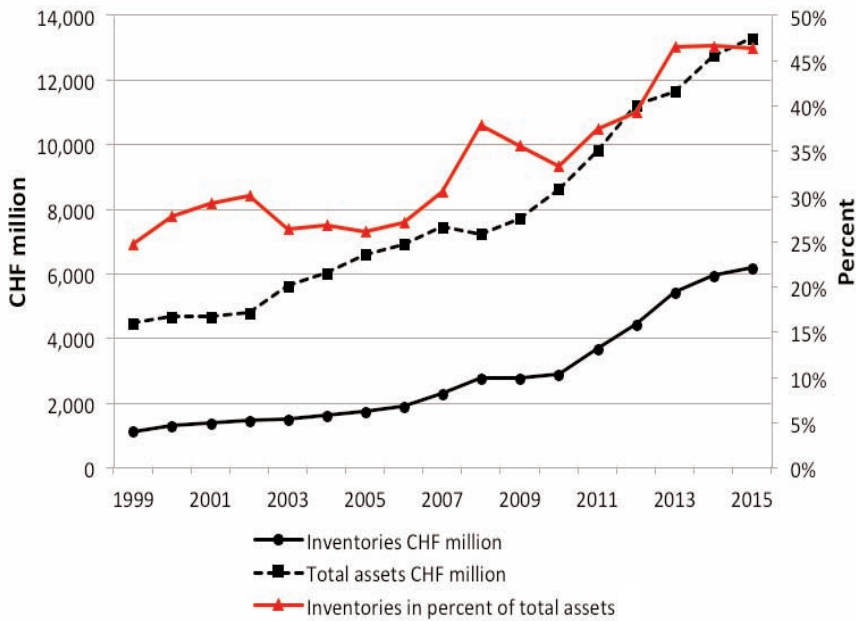
Source: Swisssimpex, Oberzolldirektion, Berne.

Figure 6 Leading companies in the watch market, market shares (%), 2014



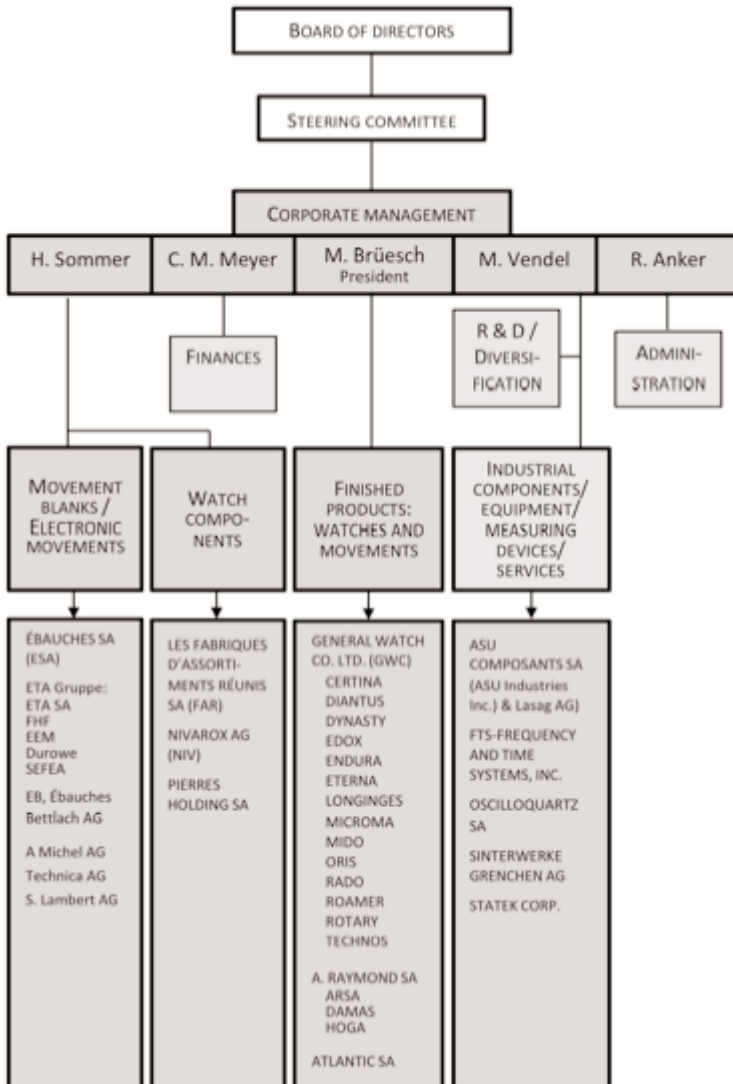
Source: Vontobel Bank, 2015, Vontobel Luxury Goods Shop 2015, Zurich (found in: Uhren von A bis Z - Montres Le Guide, Herausgeber: Ithaka Time SA, Beilage zu NZZ).

Figure 7 Development of inventories, Swatch Group, 1999–2015



Source: Annual Reports of Swatch Group.

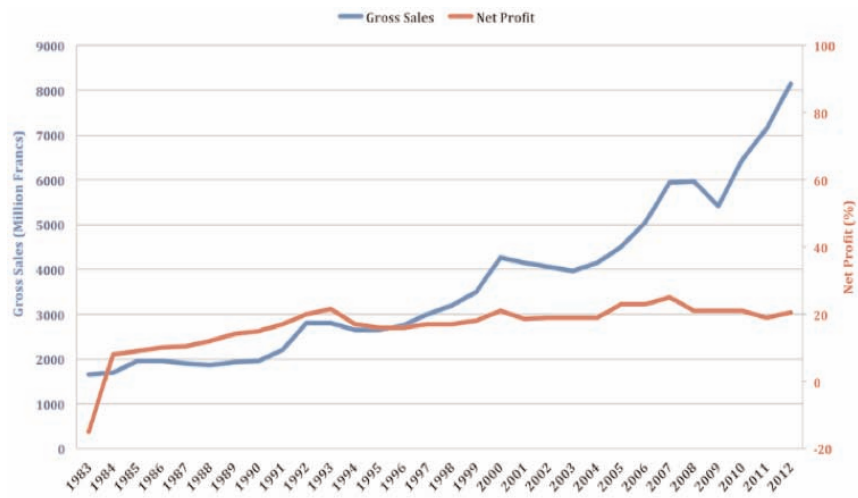
Figure 8 Organization of ASUAG, 1982



Source: ASUAG, 1982, Annual Report.

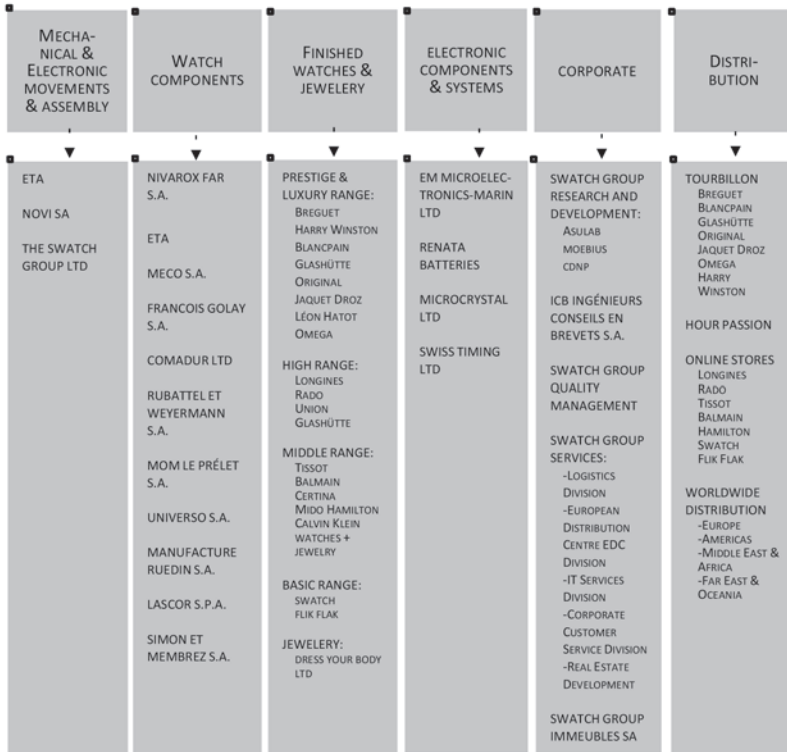
The Swiss watch industry

Figure 9 Swatch Group net sales and profits, CHF million / %, 1983–2012



Source: Swatch Group Annual Reports (found in: <http://www.ablogtowatch.com/a-brief-history-of-eta/2/>).

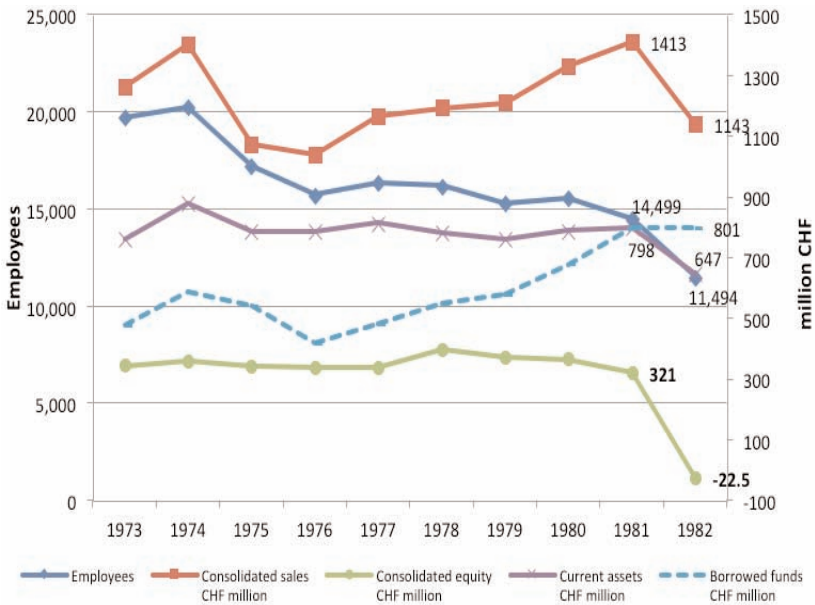
Figure 10 Companies of the Swatch Group



Source: Swatch Group 2016 (available online: http://www.swatchgroup.com/en/brands_and_companies/production).

The Swiss watch industry

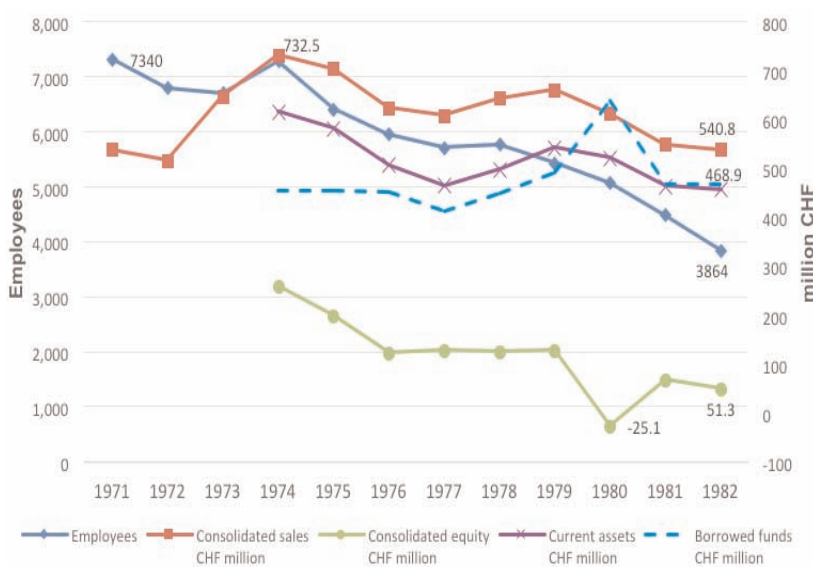
Figure 11 ASUAG in numbers, 1973–1982



Source: ASUAG, 1983, Geschäftsbericht 1982. Swiss Economic Archive Basel. p. 6.

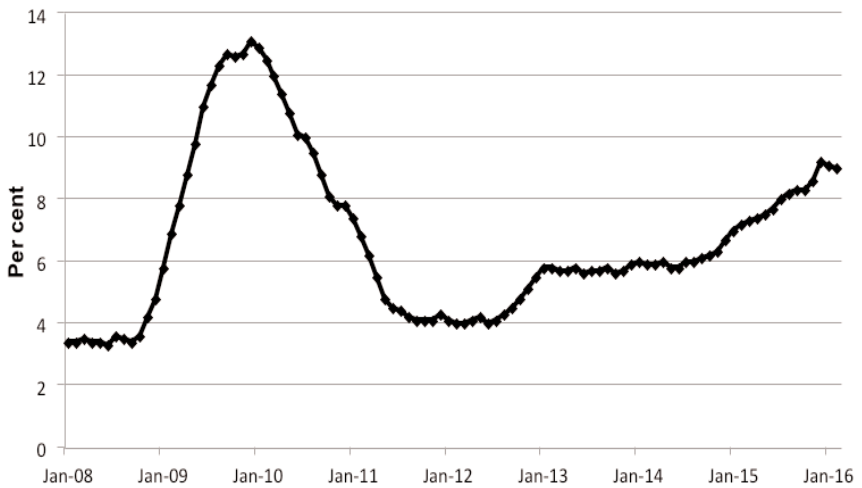
Note: Consolidated equity 1973 to 1981 according to carrying amount, 1982 according to internal values. Consolidated sales, equity and current assets per 31 December.

Figure 12 SSIH in numbers, 1971–1982



Source: SSIH, Geschäftsberichte 1980–1981 und 1982/1983. Zentrale für Wirtschaftsdokumentation, Universität Zürich.

Figure 13 Unemployment rate in the Swiss watch industry, 2008–2016



Source: SECO, 2008–2016, Die Lage auf dem Arbeitsmarkt (available online: <https://www.seco.admin.ch/seco/de/home/Arbeit/Arbeitslosenversicherung/arbeitslosigkeit.html>).

When corporatism leads to corporate governance failure

Corporatism is often seen as the way Swiss stakeholders in business and politics handle industrial challenges in a reasonable and flexible way. The following publication argues, however, that the emergence of corporatist structures in the Swiss watch industry has often encouraged rent-seeking and collusion at the expense of the creation of new markets through innovation. This legacy makes it currently difficult for the industry to effectively respond to new technological challenges and changing societal preferences in the global watch business.

The report draws on archival sources, accessible since 2015, that were also extensively discussed in the Swiss print media in early 2016. They provide increasing evidence of corporate governance failure in the 1983 merger of SSIH (*Société suisse pour l'industrie horlogère*) and ASUAG (*Allgemeine Schweizerische Uhrenindustrie AG*) that led to today's Swatch Group. The merger, induced by Swiss banks, was portrayed as a necessary step to save the two allegedly bankrupt watch companies. Yet, the archival sources show that ASUAG had already been successfully restructured and was ready to conquer global markets with its new product, the Swatch.

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