Swatch, Supplier to Rivals, Now Aims to Cut Them Off

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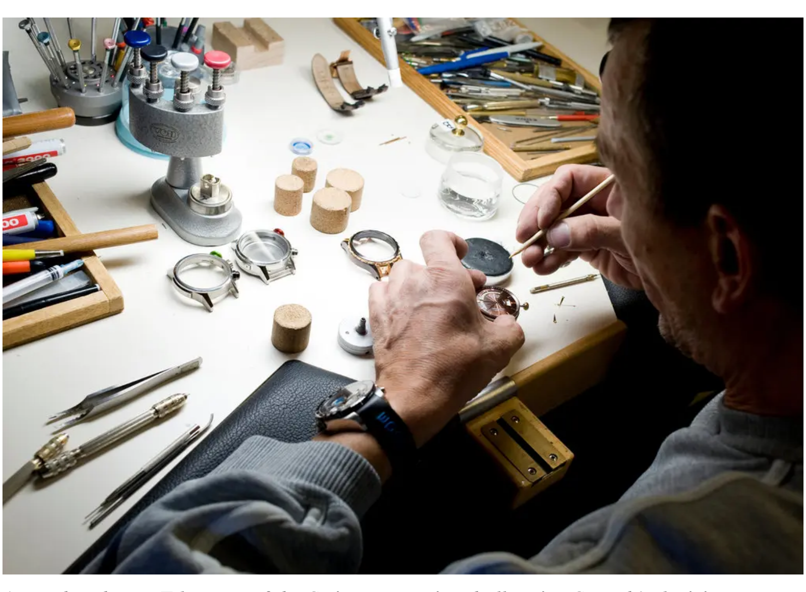

A watchmaker at Edox, one of the Swiss companies challenging Swatch's decision to stop selling timepiece components. Mathias Depardon for the International Herald Tribune

By Raphael Minder

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GENEVA — The Swatch Group may be best known for its playful, plastic watches. But it also produces mechanical movements and other watch components that it sells to most of its rival timepiece makers.

Starting Jan. 1, though, the company will begin to cut back, and possibly eventually end, its sales of the inner workings to competitors to concentrate on producing watches with higher profit margins and to make sure it has enough supplies on hand for its own brands, including Longines, Omega, Tissot and Breguet.

Swatch's move, which was approved by Switzerland's competition authority, is being challenged in court by nine watch companies, many of them small and without the financial wherewithal to produce their own movements.

The plaintiffs predict that several companies will disappear because they have few other options for the parts, which must come from Switzerland to keep the lucrative "Swiss made" label. They also argue that if Swatch goes through with its withdrawal, the result could be as wrenching to the Swiss watch industry as the arrival of Japanese digital watches, which almost led to the industry's collapse in the 1970s.

The dispute is fanning resentment of Swatch's clout and size in an industry that is showing exceptional strength, as demand from Asians who want to communicate their wealth and taste overcomes the worldwide economic downturn and the strong franc.

"A lot of companies will cease to exist while Swatch, the monopoly operator, will simply get stronger," said Peter Stas, the Dutch co-owner of Frédérique Constant, an independent watch company in Geneva that is one of the plaintiffs.

Mr. Stas acknowledged that it would have been nearly impossible for him to start out in watchmaking 23 years ago without access to Swatch's production platform.

Swatch's revenue last year of 6.44 billion Swiss francs, or about $6.95 billion, makes it by far the world's largest watchmaker. The company insists that its goal is not to strangle competitors. And it argues that its withdrawal will require rivals to raise their spending on manufacturing, thereby strengthening the quality and competitiveness of the Swiss watch sector as a whole.

"In no other industry do you have one company supply all the critical parts to the people who then compete directly with it," Nick Hayek, Swatch's chief executive, said in an interview this year. Swatch said it had no further comment on the issue.

Swatch is probably best known for its colorful, inexpensive watches, but it owns higher-end brands that compete against companies that buy its movements. Arnd Wiegmann/Reuters

The Swiss watch industry is on course to easily surpass the record 17 billion francs' worth of watches exported in 2008, according to Jean-Daniel Pasche, president of the Federation of the Swiss Watch Industry. The group includes about 500 companies, ranging from the behemoth Swatch to boutique companies that make about 100 timepieces a year but sell them for more than $300,000 each.

"We are thankfully in a situation where demand, particularly from Asia, is growing faster than supply," Mr. Pasche said.

Swatch's dominance of watch manufacturing dates to the early 1980s, when Nicolas G. Hayek, father of the current chief executive, was entrusted by banks to take over two indebted watch companies. He merged them and turned the combined business into a mass-volume production platform for what the company's Web site describes as "a low-cost, high-tech, artistic and emotional 'second watch' — the Swatch," as well as for other brands.

The merger received the blessing of the competition authorities and was seen as a last-ditch attempt to save a sector whose work force had shrunk almost two-thirds in 15 years, to 33,000 employees in 1984.

Employment has since climbed back to 49,000, and watch companies now face the problem of recruiting enough qualified staff to meet their orders.

In June, the Swiss competition authority ruled that Swatch would be allowed to lower its deliveries of mechanical movements to third parties next year to 85 percent of the 2010 levels, pending an antitrust investigation and a final ruling on whether Swatch could stop supplies altogether. That ruling is expected in the second half of next year.

Mr. Hayek's arguments are even endorsed by some former executives turned competitors.

Thanks to Swatch, "there is no other industry with such cheap entry costs," said Jean-Claude Biver, who spent 12 years on Swatch's executive committee before becoming chairman of Hublot, which is now part of LVMH Moët Hennessy Louis Vuitton, the world's largest luxury goods company and one of Swatch's main rivals.

Hublot has been using Swatch components, but since 2007 it has invested 40 million francs to develop its own manufacturing capacity. It is on track to ensure that 75 percent of its revenue will come from watches made entirely in-house within three years, compared with 37 percent now.

But, Mr. Biver acknowledged, "the example of Hublot isn't valid for everybody because you have to have a certain critical mass to justify such a heavy and long-term investment." Hublot makes 29,000 watches a year, sold at an average of $27,000 each.

Companies with neither the margins nor the deep pockets of LVMH fear the worst. "We might as well close now if the only alternative is for us to have to invest in our own production," said Alexandre Strambini, managing director of Edox, another plaintiff. The company produces 70,000 to 90,000 watches a year, with an average price of $1,600 to $2,200.

Workers at Edox, whose managing director fears it will close if Swatch ends its role as a supplier. Mathias Depardon for The International Herald Tribune

Even if Edox worked with other watchmakers to invest jointly in production, "I'm really not sure that we would reach sufficient volumes to make such a venture profitable," Mr. Strambini said. Furthermore, he said, "this is a closed industry, with very little sharing among competitors."

Outside the big watch fair events, "I have never met a director from another company," he added with a wry smile. "We all somehow seem to believe that we are better than the others."

In fact, the plaintiffs against Swatch filed their lawsuits separately. The largest among them, TAG Heuer, also owned by LVMH, recently withdrew its complaint. It declined to comment on its decision.

"So many companies are somehow reliant on Swatch that there should have been 100 plaintiffs," said Miguel Garcia, owner of Sellita, the second-largest maker of movements in Switzerland.

Sellita joined the plaintiffs because it, too, is dependent on Swatch: it currently buys 50 percent of its movements from ETA, a Swatch subsidiary, which it then resells to watch companies.

Sellita is building a new factory, but production is not expected to start until 2015, which would leave some of Sellita's 200 clients short of deliveries because of the cuts imposed by Swatch, Mr. Garcia said.

"We've accelerated our investment and production plans, but it's like asking somebody to find overnight the secret formula to make Coca-Cola," he said.

Olivier Müller, an independent watch consultant who also runs Laurent Ferrier, a boutique watch firm, said he expected Swatch's arguments to prevail.

"This whole battle is the result of people completely underestimating the risk that at some stage Swatch could cut off rivals, which is a legitimate decision to make in a free market," said Mr. Müller, who was a Swatch executive until 2001.

Swatch, he added, established "a quasi-monopoly not because of any ambition to control the market," but because "everybody else was perfectly happy to spend everything on marketing rather than building up their own production."