Scenarios

GETTING FUTURE WATCH DISTRIBUTION RIGHT – THE FATE OF AN INDUSTRY

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Statements by industry professionals made some 15 years ago reveal that even experts had only a vague idea about what watch distribution would look like today. No wonder, as our ability to forecast what lies ahead has become increasingly difficult. In a complex (meaning complicated and rapidly-changing) world, driven by the highly dynamic digital revolution, how can we be sure that the former and current values, structures and procedures of our social and economic lives will still apply tomorrow? Hence, predictions about the watch industry's future in general and its distribution in particular will likely be scenarios with relatively fuzzy probabilities. And yet, it is tempting to take a look into the crystal ball. The sad destiny of other high-end product categories such as writing instruments, porcelain, the gentleman's wardrobe, antiques and silverware, not forgetting the recent travails of the watch business, clearly indicate that no one can take a safe future for granted.

The past decade

In the decade from 1990 to 2000 the watch industry's business model was still mainly classical. Although the quartz watch revolution of the 1970s had initiated a painful restructuring process in Switzerland, creating the first dominant player in the Swatch Group, the industry's post-World War II structure remained intact: the flow of merchandise followed the manufacturer-distributor-wholesaler-consumer trajectory (NB: including some grey market and corporate business).
The industry was full of independent brands forming a coherent pyramid with a few top-end, more middle-end and a larger number of low-end priced offerings. They would serve brick-and-mortar watch stores and jewellers in small, medium and big cities.
At that time, the American consumer would have no knowledge about watches and pricing in China, Chile or Australia – and vice versa. As a matter of fact, one had to go to the painstaking effort of pounding the aisles of Baselworld once a year to collect enough catalogues and price lists to get some kind of global overview (in those days they were still given away for free…). And the decade of the 1990s witnessed the first still tentative steps into potentially huge but virgin markets, eastwards of the established ones.

The heyday

Around the turn of the millennium, five major forces started to impact the industry and, consequently, watch distribution:

- The renaissance of the expensive mechanical timekeeper,
- the introduction of more modern branding,
- the internet revolution,
- an accelerating process of concentration at the manufacturing and wholesale level,
- a shift in the commercial focus.

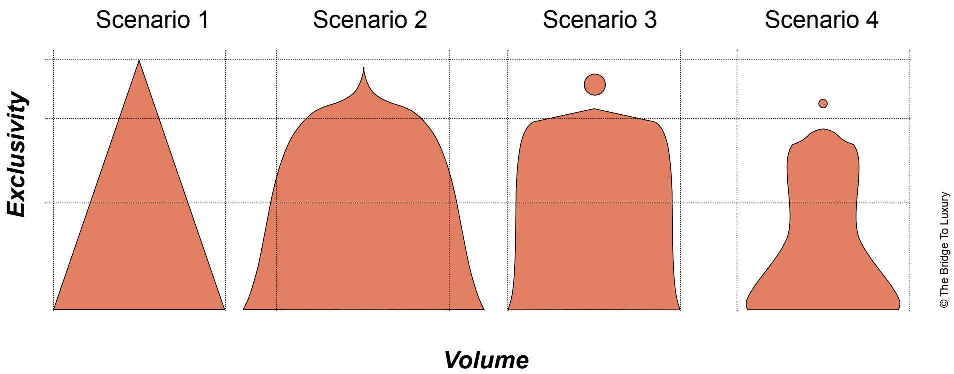
Despite the quartz crisis, the Swiss watch industry had fortunately preserved its ability to invent and manufacture traditional fine mechanical movements, when consumers' interest in traditional watchmaking returned suddenly in the early 1990s.
With companies such as Blancpain *("Since 1735 there has never been a quartz Blancpain, and there never will be")* and TAG Heuer *("Don't crack under pressure")*, branding was modernised to offer consumers devices that would indicate not only the time, but also their social status. The internet started to give birth to new communication platforms that could spread information about brands, new products and their availability on a global scale. Collectors could share their enthusiasm internationally in pioneering forums like timezone.com or LOG (Lange Owners' Group).
Due to their substantial resources, worldwide networks and manufacturing abilities, the bigger groups were able to leverage their business and initiate a process of brand acquisition and concentration (e.g. Les Manufactures Horlogères/Richemont, 2001) and supplier integration (cases, dials, hands etc.).
On the distribution side, smaller family-owned brick-and-mortar stores outside of the big cities started to vanish, while a few in metropolises grew into national, sometimes even international chains. Reaching the markets through distributors or agents became a secondary priority for groups and brands. They now preferred establishing their own regional hubs and dealing with wholesalers directly.
This led to new forms of partnerships with classical watch and jewellery stores, translating into more co-funded and co-organised marketing efforts in advertising, PR and events. To enhance recognition and image further, these partners were asked to install the suppliers' branded showcases, displays and shop-in-shops – leading often to awkward-looking patchworks. And, in their quest for even more ways to boost sales and profits, brands commenced to truly integrate vertically towards the customer by opening boutiques (retailing), first as franchised projects with wholesalers, and later as their own stores.
Furthermore, some brands experimented with factory outlets as a way of liquidating old stock. And based on the 1990s' groundwork in emerging markets, major players were now able to benefit from the huge interest in Swiss and by then also German fine watchmaking in the former Soviet Union, the Middle East and, particularly, the Peoples' Republic of China – while often neglecting their traditional markets.

These five forces were the drivers of an astonishing success story: Swiss exports of mechanical watches with a value of more than 3,000 CHF per unit would grow by 12.2% from 2000 to 2015 – on an annual average! And this was done while simultaneously absorbing such disturbing events as 9/11, SARS, and the Lehman Brothers and Euro crises.

New realities

Today, the watch industry is in bad shape. It is struggling not with the usual cyclical economic downturn, but with an existential crisis. The reasons are related to the same five forces described above, while new ones have appeared alongside. Some problems have come upon the industry from the outside, and yet many have been homemade.

- The hype over the traditional and fine mechanical wristwatch as the industry's main growth driver is over. Since 2012, the share of exported expensive watches (value +3,000 CHF per unit) of all exports has remained stable at 60% (2000: 23%) – and if it were to grow again then it would be merely a statistical effect, as Switzerland continues to export less inexpensive timepieces.
- The consumer is changing. Across many related high-end product categories, shoppers simply care less about luxury and prestige (the "millennial" phenomenon). The customer base is shrinking as the demographic factor sets in (Europe, Japan, China). According to the United Nations, the growth rate of people aged between 25–59 years will be halved in the next 35 years, while the 60+ age group is expected to rise by 240%. Of course, the BRICs will continue to provide new middle-class consumers, but there will be far less potential than in the past.
- Examples of truly innovative marketing and product concepts from the traditional brands over the last 10 years are few and far between. Patek Philippe, Hublot, MB&F, Richard Mille and Nixon could be named as rare examples.
- The smartwatch meteorite has hit the industry completely unprepared. In the space of just a few years, Apple, Samsung & Co. now sell almost as many timepieces as Switzerland exports (21.1 million units in 2016). With high-end watch brands introducing Android-based timekeepers too (TAG Heuer, Montblanc), and the advent of 3D printing, LIGA, silicon et al., classical watchmaking continues to be replaced (e.g. cases). And with information being so abundantly available on the internet, the technical revolution will continue to downgrade the myth of the fine traditional wristwatch further. At the same time, omnipresent smartphones and tablets continue to render classical timepieces obsolete. At worst, the fine watch will become a niche collector's item like a Japanese maki-e fountain pen.



Exclusivity = price points; volume = size of business. Scenario 1: healthy industry; Scenario 2: bigger volume business is pushed by global groups, yet independent brands disappear; Scenario 3: a growing business yet a shrinking one at the high end, due to the indifference of luxury watch consumers; Scenario 4: an overall shrinking industry due to declining demand, substitution by the smartwatch and industry mistakes.

• Up to today, the industry has rarely passed up any opportunity for a commercial push. On an annual basis, some 1,500 brands introduce around 15,000 to 20,000 new models – consumer overkill. Many firms have followed the car industry in introducing every possible category from A to Z, in order not to miss out (sports and pilots' watches, traditional ones, master lines, ladies etc.).

• Wholesale, retail, online shops, factory outlets and so many new ways of selling watches create a complex multichannel environment in which ambitious sales targets lead to an overflow of merchandise, eventually fuelling discounting and grey markets. Today, the liquidation price tag offered by grey market and online dealers for the slow-movers of any watch brand is some mere 20 cents on the MSRP dollar – and that means at variable production cost! Investments into retailing aimed at controlling the flow of products, prices, services and so on obviously make no sense if at the same time parallel channels are heavily nourished.

The decisive factor

The key to the survival of brands, groups and the industry itself in this new, tough and perhaps even end game is very much related to the distribution question: commercial ambition and commercial discipline. Most of the industry's current problems are self-inflicted, and caused by one essential misstep: greed. The key to survival is control over distribution, which nowadays essentially means control of online commerce, which implies control of goods being sold, which is linked to a company's reasonable long-term business plan and the management team's ability and willingness to stick to it.

Some players have understood the challenge: in 2016, Richemont started to buy back merchandise from wholesalers to clean up the market. With a share in Net-à-Porter, the same group keeps a foot in the door of internet selling platforms to control online commerce – for the same reason LVMH has recently launched 24 Sèvres. Good moves. Richemont has created a foundation for preserving traditional craftsmanship, while LVMH is investing in small luxury start-ups to keep the luxury industry's offering alive and colourful. Good moves, too. Only if brand strategy and commercial ambitions are realistic, appropriate, long-term and converted into healthy distribution environments can the essence of the prestige of the luxury watch industry be defended: exclusivity!

The crystal ball

However, in a stagnant and saturated watch market that will grow only moderately in the future (basically in line with national GDPs), even the most disciplined brands may give in and make short-term compromises. Gaining market share will be king. But what if, following the experience of other luxury segments, the market for mid-end and high-end watchmaking even shrinks?

The industry's homework for the future will obviously include more refined customer segmentation and marketing (including the elderly target group), truly creative branding concepts with epic story-telling, synergies and cost-sensitive lean operations, better customer service at reasonable prices, innovation and so on.

But most importantly, the industry needs to leave its comfort zone and admit that the glorious past cannot be extrapolated any more. Yes, national banks change currency exchange rates and yes, governments introduce anti-corruption rules without informing the watch industry in advance. While it is a common industry experience that, every three to four years, major external calamities hit, most budgeting cycles from the corporate profit and loss statement down to single business plans for brand boutiques are based on a time horizon of generally no more than three years. Under such procedures, who feels obliged and is encouraged to bother about the next 10 to 20 years and to incorporate contingency plans for likely crises? The industry will be best served if – for a change – it expects the worst. So what can be expected from the future? ◆

THE FUTURE OF DISTRIBUTION – 10 SCENARIOS

The distribution system will remain turbulent. Technology will impact further and require more interest and investment from industry actors. On the one hand, flexibility, creativity and speed will be important, while on the other, strategy and commercial discipline must ensure that money is spent wisely.

1 NEW CHANNELS:

a) The digital revolution will create new distribution and communication platforms like call centres with brand video-conferencing, for more and cheaper 1-to-1 communication with consumers.
b) Virtual reality boutiques with virtual solutions for watch fittings.
c) Home stores: direct selling on the "Tupperware" model.
d) Subscription stores: subscribers receive a new watch after an agreed period of time at a reduced price. Some subscription brands may even offer lease options.

2 OLD WHOLESALE CONCEPTS REIMAGINED:

a) Fusion stores: lifestyle-orientated multi-category points of sale. These could be co-branded stores with thematically related offerings. This is valid for intra-brand line extensions too: new product categories will demand more complex branding and experience-orientated store solutions (e.g. Shinola).
b) Pop-up stores and mobile points of sale.
c) "Gallery" stores: showrooms for presenting and testing the products physically.

3 NEW COMPETITION AND DISTRIBUTION PLAYERS:

Information platforms (e.g. WatchAdvisor) will increase and transform themselves into paid agents, connecting brands and consumers.

4 OMNI- AND MULTI-CHANNEL MANAGEMENT:

Enabling customers to shop anytime, anywhere, in whatever channel they want. All market players will take advantage of all distribution channels available. Online brands have started to venture into offline (e.g. Daniel Wellington), while brick-and-mortar stores are trying out online selling, increasing the need for professional multichannel management.

5 NEW (OLD) TERRITORIES:

To reverse the trend of luxury mainly being sold in the major cities (according to Bain, more than 50% of all luxury sales occur in the top 20 global metropolises), groups and brands will have to rediscover the neglected "mid-west".

6 NEW EFFICIENCY:

As market concentration continues, players will have to adapt their organisations to be cheaper, faster, more flexible, leaner and better. One special focus point: inventory management, with more globally integrated logistics chains and warehouse hubs.

7 NEW BUSINESS MODELS:

Global centralised logistics will reduce classical wholesaling further. By becoming a "gallery" (hidden retailing), brick-and-mortar stores will no longer have to purchase collections. The wholesalers' revenues will consist of commissions and/or retainers. Consumers will receive truly new watches delivered to their home from central brand warehouses, and headquarters will take full control over the customer relationship. After a likely difficult period of adaptation, groups and brands will be able to reduce inventory cost, increase stock rotation and better allocate watches to where the demand is.

8 RE-SELLING OF RETAIL:

As not all retail is providing enough profitability to please shareholders, some car manufacturers (e.g. Mercedes-Benz) have started to re-sell parts of their retailing network to external investors. However, such outlets will continue to be under the indirect control of the brands, through contractual leverage regarding collections to be carried, pricing, corporate identity and design, etc.

9 HYPER-SEGMENTATION AND DEMANDING CUSTOMERS:

Consumers will ask for more focused and better branding efforts at any touch point. With more demanding customers, point-of-sale experiences will have to evolve in parallel (e.g. home delivery of Hublots with a Ferrari; fragrance space at Harrods; the art of Ai WeiWei at Le Bon Marché). Branding fun, information provision, product testing and availability will have to be further harmonised; integrated marketing will be as important as ever.

10 MARKET RESEARCH AND SMART STORES:

a) So far, the watch industry has been very hostile concerning market research and external consultancy. However, institutes such as Responsio's "Watch Monitor" offer completely new and relevant consumer insights that will help the industry better understand the outside world.
b) The smart store: with more market research and (digital) consumer data available, CRM systems will become more powerful and able to manage consumer relationships throughout the entire sales cycle. Artificial intelligence will ensure that offerings are more personalised at the point of sale.

As was the case some 15 years ago, it is difficult today to foresee the near future in watch distribution. However, if the industry is now ready to learn more from past mistakes, especially regarding overly ambitious sales objectives, it will be better prepared to survive – and, of course, there will always be a demand for mechanical, prestige and luxury watches. Yet, renewed efforts in terms of strategic wisdom, operational flexibility, marketing and service creativity, and a great deal of investment will be needed – and not just in distribution. The future will belong to those brands that persevere.