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Article

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Selling luxury watches in Asia: the changing position of independent distributors

Asia has increasingly become the place to sell luxury goods as a result of economic growth. Swiss luxury watch groups have all turned to new Asian markets since the late 1990s, with the help of key intermediaries such as local distributors and retailers. However, facing the verticalization strategies of large groups to improve the control and even to develop in-house retail management, independent distributors have needed to change their business models and offer new kinds of services to access customers. This article gives two examples of local independent distributors' new strategies to cope with verticalization by large groups. While the first company, The Hour Glass, turned to mono- and multi-brand stores for independent luxury brands in South East Asia, the second one, Hengdeli, specialized in retail by running in-house shops for the market expansion in China of one of its main partners, Swatch Group.

Pierre-Yves Donzé, Thierry Theurillat

Distribution plays a key role in the luxury business and must be understood within the broader context of the strategy implemented by luxury companies since the late 1990s (Donzé & Fujioka, forthcoming). The transformation of the organizational structure experienced by this industry, characterized by the formation of groups and conglomerates such as LVMH (1987) and Richemont (1988), led these large companies to take control of their distribution and retail networks (Bonin 2012, Moore & Birtwistle 2004, Moore, Doherty & Doyle 2010). For example, the number of shops owned by LVMH went from 1,286 in 2000 to 3,708 in 2014 (LVMH 2000-2014). The expansion of the retail network is based both on the opening of new outlets and the takeover of existing shops. The objective of this strategy was not only to internalize profits (Okonkwo 2007), but also to control brand identity. Shopping spaces, in particular mono-brand stores, contribute greatly to building brands, such that their direct control has become a major issue in this industry. This feature is particularly important in emerging countries, where boutiques are important tools to educate customers about luxury goods in general and specific brands in particular (Zhan & He 2012).

Yet the verticalization of distribution by luxury big business has challenged the position of independent distributors and retailers. Literature in management on the process of internationalization in retail focused essentially on large Western distributors (e.g. Wal-Mart, Carrefour) and the way they adapted or not to local markets (Dupuis et al. 2006; Durand and Wrigley, 2009; Dawson and Mukoyama 2014). However, for some products such as luxury goods, we can still observe the existence of numerous small independent retailers. The

lack of studies about the distribution of luxury goods has been highlighted recently (Coe and Bok 2014).

Based on a case study of two independent retailers in this industry in East Asia, this article aims to demonstrate the strategies they followed to cope with verticalization by large watch companies and to keep their competitive advantage. It contributes to the understanding of the dynamics of the distribution of luxury goods since the 1990s, in relation to two topics of this special issue. We show that one retailer (The Hour Glass) re-positioned and specialized in offering new services to independent Swiss watch companies who had difficulties accessing Asian markets due to verticalization by large luxury groups. The second company's (Hengdeli) strategy relied on running in-house shops for the market expansion in China of one of its main partners, Swatch Group.

This research is a qualitative case study based on interviews carried out in 2014-2015 with representatives of Swiss watch companies and managers of independent distributing firms in Hong Kong, Singapore and Taiwan. Annual reports of these companies provided supplementary information.

The paper comprises three sections. At first, we present briefly the issue of verticalization of distribution in the watch industry. Then, the following sections discuss the new strategies adopted by the two companies (The Hour Glass and Hengdeli).

1. The shift to luxury and the new challenge of distribution in the watch industry

Three features characterize the evolution of the Swiss watch industry since 1990. First, there is the shift towards luxury. Foreign trade statistics express

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well this phenomenon. While the volume of watches exported by Switzerland declined from 43.7 million in 1995 to 31.9 million in 2010, at the same time their value increased from 6.8 billion CHF to 15.3 billion CHF (Federation of the Swiss Watch Industry 2016). Many authors have tackled this transformation, emphasizing that the new competitiveness of the Swiss watch industry relied on marketing strategy, called by some authors “non-technological innovation” (Jeannerat and Crevoisier 2011), which made it possible to greatly increase the value-added of the products (Kebir and Crevoisier 2008, Raffaelli 2013, Donzé 2014).

Second, this sector was marked by a deep transformation of industrial organization. The number of watch companies amounted to 572 in 1990 and was averaged 589 for the years 2000-2013. Besides, the average number of workers per company increased at the same time (59.3 in 1990, 64.9 in 2000 and 100.2 in 2014) (Convention patronale 2014). Likewise, most of these companies were gathered into large holding companies and groups, the most famous being Swatch Group (founded in 1983) and Compagnie financière Richemont (1988), while French luxury big business entered watchmaking through the merger of

Swiss companies, as did LVMH (1999) and Kering (1999). Today, there is a high concentration in the global watch industry, and companies established in Switzerland dominate. In 2014, the three largest companies (Swatch, Richemont and Rolex) controlled nearly half of world markets (47.5%). Of the ten largest companies, accounting for 72.6% of market share, all except Seiko

Independent luxury watch distributors in Asia face a process of verticalization by large Swiss luxury groups and need to offer new services.

and Casio base their production subsidiaries in Switzerland (Vontobel 2015).

Third, this transformation went together with the emergence and growth of new markets, particularly in Asia (Donze & Fujioka 2015). Trade statistics show the key position occupied by Hong Kong, with an average share of 16.4% of Swiss watch exports in 1990-2014. Japan was a key market during the years 1990-2003 (9%), then slightly

declined, but was still the no. 4 outlet in 2014 (6%). As for China, which had been constantly below 1% until 2002, it emerged in the mid-2000s, and peaked at 8.5% in 2011 (6.3% in 2014). Altogether, Hong Kong, Japan and China had a cumulative market share of 19.6% in 1980, 26.1% in 1990, 23.3% in 2000, 31.4% in 2010 and 30.8% in 2014.

The vertical integration of wholesale and retail was the consequence of this threefold transformation. It has progressed since the late 1990s. The idea is to improve the quality of distribution rather than to increase the number of sales outlets. Accordingly, the Omega distribution network was restructured in 2005-06 in the German, British and Japanese markets, where the number of sales outlets was reduced by 20 to 25 per cent. At the same time, groups started to create new sales subsidiaries around the world. Swatch had 23 such units in 1998, but their number had virtually tripled to 65 by 2009 (Donzé 2014). Among them, many were opened in emerging countries after 2000, for example in India (2001), Thailand (2002), Taiwan (2004) and the United Arab Emirates (2006).

In addition, a reference should be made to the engagement in retailing. Since 2000, SG, Richemont and independent companies like Rolex and Patek Philippe developed their own network of flagship stores. The number of Richemont's mono-brand stores went from 320 in 1995 to 1,370 in 2009. In 2009, the company directly held 797 stores (58.2% of the total), the remaining 573 being managed by local partners. The number of Richemont's directly owned stores grew to 1,056 stores in 2014. This will to control retail also led SG to take interests in retail firms, in particular in Thailand (2002), in the United Arab Emirates (2008) and in Saudi Arabia (2010).

Foto: Unternehmen



2. The re-focus on retail for high-end independent watch companies (The Hour Glass)

The first model observed in East Asia is the re-focus of independent distributors towards the needs of specific customers: Swiss luxury watch artisans and independent companies. They did not verticalize distribution, for strategic reasons or lack of capital, and accessing markets in Asia became a major challenge for them, due to the domination of large groups over retail networks. Hence, several independent distributors, like Cortina in Singapore and South-East Asia, or Dickson in Taiwan, offer since the late 1990s new services (rent of shopping spaces, management of mono-brand boutique, and access to retailers) to such watch companies, and make it possible for them to be present in Asian markets. This sec-

tion presents the case of The Hour Glass, a major independent watch distributor based in Singapore and active in all South-East Asia.

The Hour Glass (THG) is a family business established in 1979 in Singapore by Henry Tay and Jannie Chan. It experienced its evolution until today in three major phases.

First, the phase of early development was characterized by a positioning in a niche market and the attempt to grow through the expansion of markets and diversification of activities. THG started with a single multi-brand store in Singapore (1979). It opened new stores in the following years, essentially in Singapore during the 1980s, and then elsewhere in South-East Asia (e.g. Indonesia in 1991, Thailand in 1996) and Australia during the following decade. In 1994, it owned a total of 20 stores, of which 11 were in Singapore. These

shops distributed a wide range of Swiss luxury brands through a retail network of multi-brand stores. In 1990, THG opened a wholesale division, to distribute luxury watches throughout South-East Asia. It had, for example, the license for Christian Dior and Burberry watches during the 1990s. Moreover, THG bought two small Swiss watch companies, Daniel Roth SA (1994) and Gérald Genta SA (1996), the objective being to take control of their retail network outside of Asia (Europe, Middle East, Russia, and the US). Besides this expansion of retail network, THG diversified their activities to include Italian restaurants in Singapore (1989; closed in 1995), sales of perfume in the US (1990), and of jewelry in Asia (1990). The objective was to become a diversified company in luxury business.

Second, the years 1997-2003 were a period of deep mutation. THG was

MALMAISON by The Hour Glass watch boutique at Knightsbridge in Singapore.

Management Summary

Independent luxury watch distributors in Asia face a process of verticalization by large Swiss luxury groups and need to offer new services. This article focuses on two major independent retailers (The Hour Glass, based in Singapore, and Hengdeli, based in Hong Kong). While the first company, The Hour Glass, turned to mono- and multi-brand stores for independent luxury brands in South East Asia, the second one, Hengdeli, specialized in retail by running in-house shops for the market expansion in China of one of its main partners, Swatch Group.

affected by the Asian financial crisis. Gross sales dropped from 434 million S\$ in 1996 to 256 million in 2003, while operating profits amounted only to an average of 2.7% in 1997-2003. These difficulties led THG to sell the American wholesale subsidiary as well as the two Swiss companies Daniel Roth and Gérald Genta to Bulgari in 1999. Moreover, it disinvested from the perfume business (2001) and closed down unprofitable watch stores. In 2000, THG had only 13 stores left.

Third, since 2003, THG re-focused on Asia and retail, rather than wholesale. It offers two kinds of services to Swiss watch companies. The first is the management of mono-brand stores, especially for companies outside of the large groups, like Chopard, Parmigiani,

Patek Philippe, Rolex and Ulysse Nardin. For these firms, the stronger control of distribution by luxury groups makes it more difficult to access markets, and THG provides them a service to benefit from mono-brand stores, even if they do not own them. THG also

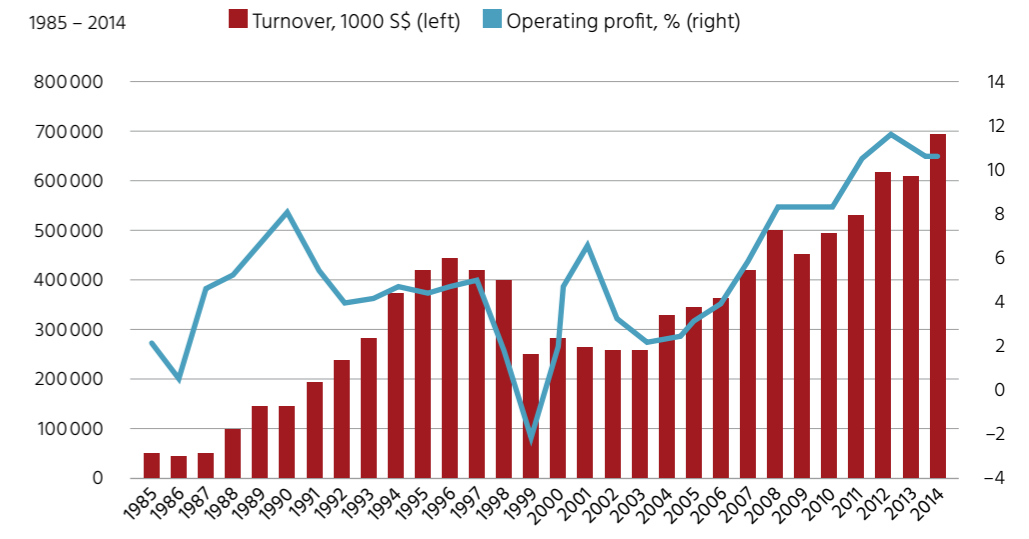
works for groups, but such relations are instable. For example, in 2011, THG lost its contract for four Montblanc boutiques because Richemont had decided to control directly this brand's retail. The second service is the access to a new kind of multi-brand store which

Lessons Learned

- Strengthening the co-development of marketing and real estate strategies between luxury watch distributors and local distributors and retailers.
- For Asian distributors and retailers: training the local staff of retailers to Swiss watch tradition.
- For Swiss watch companies: internalizing knowledge about urban development in East Asia.

offers a particular atmosphere to emphasize the tradition and uniqueness of Swiss mechanical watches (e.g. classic design of the boutique, display of old tools and instruments to make watches). The thematic salons L'Atelier and Malmaison, opened in Singapore after 2010, notably provide shopping spaces for high-end products of independent craftsmen (like MB&F and Uhrwerk), together with the top end brands of luxury groups (like Breguet and Hublot). Hence, THG presents itself on its website as a "cultural retail enterprise" (<http://www.thehourglass.com/>). THG's new shops display watches in an environment that emphasizes Swiss traditional watchmaking. For example, watchmaker artisan's workshops were re-created, showing the Swiss han-

Fig. 1: Turnover and operating profit of The Hour Glass company



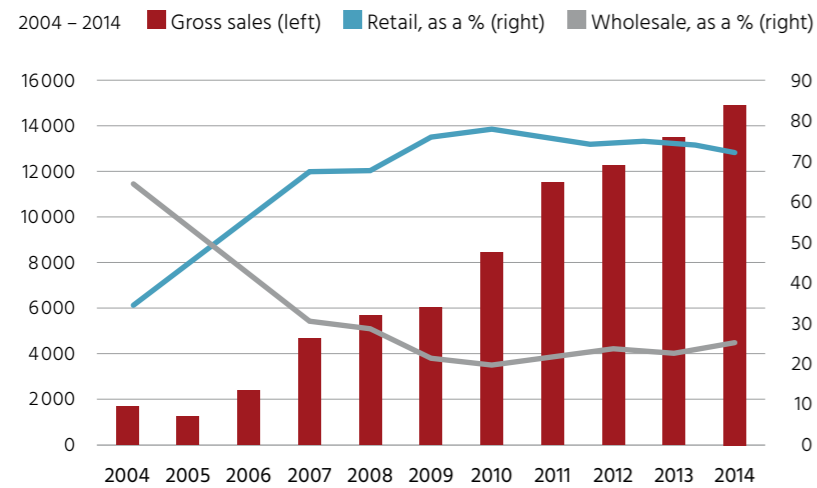
Source: The Hour Glass, Annual report, 1985-2014

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Fig. 2: Gross sales of Hengdeli Holdings, in million RMB, and shares of wholesale and retail as a %

Source: Hengdeli Holdings, Annual report, 2004–2014.

dicraft authenticity to customers. This new strategy is very profitable. THG entered a new phase of growth in 2004. Growth sales went from 320 million S\$ that year to 683 million in 2014, while operating profits skyrocketed from 1.9% in 2004 to 9.9% in 2014.

3. The investment in retailing in China (Hengdeli)

A second model of the new services offered by independent retailers to Swiss luxury watch companies is embodied by the Hong Kong based enterprise Xinyu Hengdeli Holdings. It consists in providing access to shopping spaces through negotiations with the developers of luxury shopping malls. This pattern can be observed particularly in Mainland China, where the expansion of sales of luxury goods relies on a new network of shopping outlets built within the context of urban development (Wang et al., 2006; Wang, 2009). Swiss luxury watch companies,

large groups included, lack the knowledge and the power necessary to negotiate with local landlords and developers, so it is necessary to work with intermediaries. Hengdeli is precisely such a firm, one of the major intermediaries between European luxury companies and Chinese customers.

Hengdeli is a former State-owned company, purchased in 1997 by the Zhang family, active in the trade of watches in Hong Kong since the 1980s. It dominates watch distribution retail business in China, and after 2000 became the local partner of Swatch Group, LVMH and Richemont to enter the Chinese market. Swatch and LVMH took a stake in Hengdeli, respectively 20.6% and 6.4% of capital in 2013 (Xinyu Hengdeli 2013), but Swatch is the only one to have a member on the board of directors and to have founded joint ventures with this Chinese partner. Both companies co-founded two major companies for the exclusive distribution of Omega and Rado watches (2003) (Donzé 2014).

Main Propositions

- Cultural retail enterprise (The Hour Glasse): THG's new shops display watches in an environment that emphasizes Swiss traditional watchmaking (e.g. re-creation of watchmaker artisan's workshops), showing the Swiss handicraft authenticity to customers.
- Real estate business (Hengdeli): Providing access to shopping spaces through negotiations with the developers of luxury shopping malls, particularly in China.

This partnership is very important in the twofold context of the fast growth of the Chinese market and Swatch's will to control retailing. Figure 2 shows that Hengdeli's gross sales increased from 1.5 billion RMB in 2004 to 14.8 billion RMB in 2014 and that such a development was based essentially on retailing, whereas Hengdeli had specialized in wholesale until then. The number of stores managed by Hengdeli went from 65 in 2005 (all in mainland China) to 513 in 2014 (428 in China). Hence, the share of retailing in gross sales grew from 34.9% in 2004 to 71.9% in 2014. To set up these shops, Hengdeli partnered with local Chinese developers (tier 3 and 4 cities) and large developers from Hong Kong and China (tier 1 and 2 cities), choosing the developer to partner with for a particular shop on a case-by-case basis.

In 2007, Swatch and Hengdeli founded an equally-owned subsidiary to take charge of retail business in China. On this occasion, Zhang Yu Ping, chairman

of Hengdeli Holdings, argued that "this agreement establishes a closer bond between Xinyu Hengdeli and the Swatch Group, as the two parties fully utilize their resources to strengthen their relationship in the Chinese retail market." (Xinyu Hengdeli 2007). Yet, such a strategy requires an involvement in real estate business, to secure stores in new shopping malls. Consequently, in 2010, Swatch took a 50% stake in Beijing Xin Yu Heng Rui Watch & Clock Co., a subsidiary of Hengdeli specialized in real estate in China (Xinyu Hengdeli 2013).

Conclusion

This article highlights the change of business models since the mid-2000s of two independent distributors that used to be traditional key intermediaries between Swiss watchmakers and local markets in South East Asia and China. Facing a process of verticalization by large Swiss luxury groups, both companies needed to offer new services.

The Hour Group, which focuses on various markets in South East Asia, turned towards independent luxury watchmakers to provide them some multi- and mono-brands shops based on a design and atmosphere that emphasizes the tradition and authenticity of Swiss mechanical watches. Hengdeli, whose main market is China, changed its business model from wholesale to retail. Thanks to a close partnership first with Swatch Group and second with LVMH, Hengdeli could increase its number of in-house shops all over China since 2007, based on negotiations with Chinese as well as Hong Kong developers.

The control of outlets as part of the verticalization strategy by some groups goes hand in hand with the evolution process in accessing new markets and countries. In the original phase, inter-

national groups need to have local partners - keeping in mind that they are often institutionally forced to do so – to get knowledge and skills relevant to local markets. Then they would tend to improve the control of the supply chain by getting rid of some intermediaries, not only to increase profits but also to better control the image of the brand. In the case of Swiss luxury brands, the way large groups negotiate directly with some of high-end shopping deve-

lopers in South East Asia and China is still under-researched. In this case, some Hong Kong developers shifted to high-end shopping malls, and Swiss luxury brands are a key part of the commercial mix, bringing the best rental income. This positioning is part of a new phase of commercial expansion since mid-2000, mainly in China, where the shopping environment and design for luxury goods plays a more significant and credible role. +

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