IMD
INTERNATIONAL

IMD-3-1649
14.03.2007

BUSINESS LEADERSHIP: THE CASE OF NICOLAS G. HAYEK SR.

Research Associate George Rädler prepared this case under the supervision of Professor Preston Bottger as a basis for class discussion rather than to illustrate either effective or ineffective handling of a business situation.

This case is an abridged version of case no. IMD-3-1648, "Nicolas G. Hayek and the Swiss Watch Industry: Business Leadership over Two Decades."

This is an example of long-term, big-picture business leadership: that of Nicolas G. Hayek Sr. (Hayek). We describe how this charismatic CEO saw new business opportunities and backed up his high ambition with drive and courage. Not only did he re-make his company; he strongly influenced an entire industry.

In 1985 – at age 57 – Hayek invested a substantial part of his wealth to buy into SMH, the merged company that later became the Swatch Group. The initial success of the Swatch watch saved the Swiss watch industry and set the foundation for the success of the Swatch Group. Interestingly, Hayek was able to maintain the momentum for almost two decades.

For the Swatch Group, 2006 was yet another successful year. The Group obtained the best results in its history: Gross sales increased by 11.7% to SFr 5.05 billion (up from SFr 4.5 billion the previous year) and net income was expected to exceed the 2005-record of SFr 621 million.

Many outsiders continued to misunderstand the company and thought of it as a producer of cheap, plastic watches with good advertising. However, the Swatch brand was only one of the Group's 18 brands. The Group owned some of the best-known brands in the industry, including Blancpain, Breguet, Longines, Omega and Rado (*refer to **Exhibit 1** for an overview*).

Although Hayek's son Nick took over as CEO of the Swatch Group in 2003, Hayek Sr. himself was now responsible for running the luxury Breguet brand. This watch had been a favorite of Napoleon Bonaparte. And now, 200 years later, it had become one of the fastest-growing brands in the watch industry. Besides running the coveted Breguet brand, Hayek remained Chairman of the Group.

By studying the business leadership of Hayek, who has been described by many as the savior of the Swiss watch industry, readers will see an unusual combination of mastery of business insight, organization and people management.

Hayek's Early Days

Hayek grew up in Lebanon, studied mathematics, physics and chemistry in Paris and in Zurich, where he eventually settled. His first job was in a reinsurance company. He "found it a bit difficult to integrate" and when his father-in-law got sick, he jumped in and ran his foundry. This led to the establishment of his consultancy, specializing in foundries. The consultancy later moved to industries and functions outside the foundry business.

"Hayek Consulting" started making its first assessment of the Swiss watch industry in 1981. When the two largest Swiss watch companies merged, Hayek stayed on and oversaw the integration of both companies. In 1984 a banker offered him the possibility of buying a stake and it took him almost a year to make up his mind. By 1985, Hayek and a group of investors bought into SMH, the company that later became the Swatch Group. Hayek remembered his early actions:

> We made the investment in SMH in 1985, and we were free to act. I pushed out practically the entire management of Omega. I fired a lot of people. I got the reputation as a brutal guy. I am not a brutal guy. But the organization was so full of arrogance and stupidity that I didn't have much choice.[i]

Understanding the Swatch Group's Transformation

Hayek's term as CEO (1985-2003) can be described as having three key stages. Each stage had its specific management problems and characteristics. Although the first stage was about survival, the following stages were about positioning the brands for long-term success by going upmarket and increasingly moving into retailing. ***Table 1*** summarizes the different stages.

Stage 1: Taking control and pushing Swatch	**Stage 2: Moving upmarket by buying top-end brands**	**Stage 3: Moving into retailing**
- Launching the Swatch, rapid product introductions (new lines, new material). - Centralized production for various brands (economies of scale/improved quality). - Three competitive bids for every major purchase, bills over a certain amount had to be signed by Hayek. - Giving freedom to marketing and sales. - Expanding market coverage by entering new markets (e.g. Omega launching female watches), new regions (Asia) and new product lines (jewelry).	- After attempts to launch the "Louis Brand" (named after the founder of Omega) failed, Hayek started to buy various luxury brands (year of acquisition in brackets): o Blancpain (1992), o Léon Hatot (1998), o Breguet (1999), o Glashütte Original (2000), o Jaquet Droz (2000).	- The watch industry is changing from its traditional focus on technical complexity to an emotional positioning, Hayek decided to invest in retail outlets including: o flagship stores. o Multi-brand boutiques for the luxury watches. o Some of the luxury brands also added jewelry. This helped to generate additional traffic in the stores.

Table 1: Summary of the three stages

Stage 1: Taking control and pushing Swatch: The launch of the Swatch was well documented. Swatch watches became popular for their low price, colorful designs and rapid model introductions. This helped to keep the brand "hip" over years. At the same time, production of the various brands was centralized in order to reach economies of scale and improve the quality. In the factories, investment decisions were made only after three competing bids were evaluated. Purchasing orders over a certain amount had to be signed by Hayek himself. Hayek soon earned the nickname "Scrooge." He did not mind. After all, purchasing and logistics accounted for around 40% of total costs at the time. Over the years, the Swatch brand moved into related product lines (jewelry), while some other brands moved into completely new territories (e.g. Omega into watches for females).

Stage 2: Moving upmarket: the Swatch Group first tried to launch its own luxury brand ("Louis Brand," named after the founder of Omega), but this met with only limited success. Instead, Hayek and his team started in 1992 buying various top-end brands. Over the years, they accumulated an interesting selection of brands including Blancpain, Léon Hatot, Breguet, Glashütte Original and Jaquet Droz.

With the watch industry changing from its traditional focus on technical complexity to an emotional positioning, SMH had to react. **During Stage 3: Moving into retailing**, the Group decided to invest heavily in retail outlets. For Swatch, it fully restructured the distribution channel. In the US, Swatches were sold exclusively in their own stores – the one in New York City sold more than 85,000 Swatches per year. The retail revolution led to SMH opening retail boutiques for various brands:

- Single brand boutiques: Breguet, Blancpain, Glashütte Original and Omega.
- Multi-brand boutiques called "Tourbillon": offering a selection of high-end, luxury watches (Breguet, Blancpain, Jaquet Droz, Glashütte Original, Léon Hatot and Omega) in addition to the Swatch brand.

With this selection of successful brands, the Swatch Group was able to grow considerably over the following years (*refer to **Exhibits 2** and **3** for the financial development of the group*).

While the business transformation was structured around these three stages, the management style and the management principles played a very important role in supporting it.

Management Style over Two Decades

"The Flow of Information is the Most Important Part of an Organization" [ii]

Hayek had his view on what was important for an entrepreneur:

> There are different types of entrepreneurs. But the best, the most wonderful, the most satisfied is the one who succeeds in motivating the people around him to love him, even when he criticizes them.

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> If you succeed in not irritating the people around you, with all the conflicts, all the situations in which someone annoys someone else, then you are a great judge of character. And then you remain honest to yourself, without which people would not have followed you.
>
> But it is not enough to communicate in order to inspire people – you also have to quickly implement what was communicated. Only the combination of successful communication and the realization of an idea or product creates enthusiasm.[iii]

To improve the rapid roll-out of ideas, most of the nine members of the management board had – in addition to their functional responsibility or brand responsibility – regional responsibilities.

The CFO, Edgar Geiser, was also responsible for the Swatch Group in the UK; Arlette Emch was responsible for Calvin Klein watches/jewelry and Léon Hatot also had regional responsibility for the Group in Japan and Korea.

This system of multiple responsibilities was introduced for most members of the extended board, too. As a consequence, board decisions could be quickly implemented in the various parts of the company. The management board met once every two weeks, while the extended board came together once a month. The management board was the company's highest decision-making committee.

The various brands enjoyed their independence including all decisions to do with product design, marketing and distribution. But all brand communication had to go through Hayek himself.

SMH also had a powerful IT system for managing over 440 reporting units.[iv] Sales figures were available as of the 6th of every month. Profit and loss statements were available about 10 to 15 days later. Hayek commented:

> The moment anything looks strange, we react very quickly, very decisively, very directly.[v]

Of special importance were the annual budget meetings. The whole budgeting process could easily last for two months. While these could be lengthy debates, it was important for Hayek to keep a good atmosphere. He commented:

> People will not love you if you are weak, if you are someone who agrees to everything. People will love you if you have an opinion, if you are fair and if you stick to your values.
>
> I am a specialist in praising people, but I can also critique their shortcomings without attacking them as a human being. I always preach that differences in opinion about technical issues or a product […] should *not* be a reason for personal hostility.[vi]

He was not afraid of confrontation, as long as it was in the best interests of the company.

Hayek said about himself that he was willing to deal with criticism, as long at it was not destructive or intended to harm. For him, it was important that criticism showed the way forward. Fairness was hugely important and he wanted the following on his grave stone: "He was fair, or at least he always tried to be fair."[vii]

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Working with Hayek

For people working with Hayek, it was clear that he would hold them personally responsible for things they committed to. The CFO summarized his interaction with Hayek:

> It is direct in that he shows you your strengths and weaknesses; it is quick in that he reacts immediately, and in that he can be reached around the clock; it is open in that he tells you always exactly what he thinks, and in that he uses the same language for financial analysts, assembly-line employees, or board members.[viii]

Hayek explained:

> As a consultant, I saw that management and leadership cultures were extremely important. Positive targets and easy-to-understand messages draw people to your company and into your stores.
>
> Previously successful companies stopped being successful because they forgot that a company has to have an emotional message. If ambitious goals are sought persistently as well as with heart and emotion, you motivate people. Companies like IBM and GM forgot this for many years.
>
> Famous business schools carry part of the responsibility for this. Instead of teaching the importance of emotion and heart, they focus mainly on trying to rationalize, analyze, and systematize everything. They forget that intuition and emotionality are key ingredients to a successful business venture.[ix]

For Hayek it was easy to mingle with employees at various levels. It was not unusual to have daily contact with his top managers and to visit the shop floor. His enormous wealth did not hinder communication with employees at lower levels. He said: "Money is and remains for me an important working tool."[x]

Hayek was also a big supporter of project teams. The company selected the best people for special assignments and put them together for a short period of time. They let them tackle a problem and then moved on with business. Hayek was tough on issues, but fair and encouraging with his people.

Understanding Hayek's Management Principles

A study of Hayek's public statements about how he ran his company yielded interesting results. Of course, like any entrepreneur, Hayek had his critics. But there appeared to be a strong and clear line in his leadership, values and behavior. He spelled out the three key principles below:

Principle 1: We Will Keep Our Promises, in Detail and with Speed

Within the organization, there was a clear understanding that strategy was nothing other than a work program and plan to reach a clearly defined goal. For the strategy to work, it was of the utmost importance to meet these defined goals. This attention to detail and keeping promises was embedded through the entire company. It was clear that once you made a promise, you would stick to it.

Deadlines in proposals were for real, but Hayek often felt that things could be done faster. Managers would often receive proposals back from the CEO's office with a stamped sentence: "Speed is an important part of each strategy." Hayek had this stamp in four languages in his office: English, French, German and Italian. For everyone in the company, it was clear what it meant.

This approach also became apparent in management seminars, where he invited managers of all profit centers for open discussions. He set the agenda, explained the situation, and analyzed the problems that the main profit centers were facing. By the time these issues translated into the budgets, it was clear to the managers that there was not much room for surprises.

Principle 2: No Firing without Looking for Other Ways to Reduce Costs

In Hayek's view, the company's responsibility went beyond the traditional view. Hayek believed that employees' identification with the company was crucial and required new approaches:

> Every good company gives its employees a big sense of identification, security and safety. […] Slowly and more and more often, corporations and work places are taking over the function of creating a sense of community, security and safety and giving the individual an identity.
>
> This is the reason why we as entrepreneurs cannot destroy firms which could survive, nor forget that new jobs are only created based on new products and innovations. People do not want social welfare, but jobs, security and perspectives.[xi]

In Hayek's view, the combination of record profits and firing people had an unimaginable knock-on effect for managers:

> But what do today's managers do when they have to cut cost – even in times of record profits? They simply fire some employees. This has disastrous consequences for companies: their trust and their convictions about quality get lost. Trust is the most important factor. [xii]
>
> Employees will not act in solidarity with the entrepreneur anymore. And soon you won't have anybody who will advance the company, as they will fear that the same could happen to them sooner or later. As a result, morale drops quickly, which leads to rapidly falling levels of enthusiasm within and for the company.[xiii]

Hayek tried to imagine what the termination talk would have been like if some of his managers had got their way in firing one employee:

> It was nice. You worked hard for us for 19 years. Competitors repeatedly tried to hire you, but you remained loyal to the Swatch Group. Sometimes, you worked all day and all night, but […] now we do not need you anymore. You will soon find a job somewhere else.[xiv]

It was clear that this approach was not acceptable for SMH.

Principle 3: Our Employees Can Rely on Having the Right People in Charge

Within the Group, and in accordance with Hayek's other management principles, the question of trust was of utmost importance. Hayek saw this as a crucial starting point:

> You work with your colleagues everyday and with time you learn how to judge their reactions, as much as they learn how to judge yours. When [your colleagues] realize that you [as a superior] are fair and there is no favoritism, then this is a good beginning.
>
> If you are able to admit when you are wrong and to prove that you are looking for the truth and justice and you are not seen as following your own interests without considering others, then you are a good entrepreneur.[xv]

Hayek also saw being a role model and providing support as key pillars of his leadership:

> It is extremely important to lead by example, while at the same time providing young managers with human and emotional support.
>
> You can only really motivate and reward someone by showing that you really are his or her friend. You have to establish an emotional connection. You have to show your employees that you really care for them and that they can count on you.
>
> When somebody is in difficulties, I don't fire him or her, on the contrary, I immediately jump to his or her side, provide support, and push him or her to do better.
>
> In that sense, I am a leader, one whose leadership extends beyond the usual. I help my employees to enrich their lives and to feel proud about themselves.[xvi]

With this approach, SMH had few personnel changes on the board or in the company. This was particularly impressive, since the area around SMH's main plants in Switzerland had become a new cluster for manufacturing medical devices. And the medical companies needed the craftsmen from the watch industry to assemble pacemakers, among others things.

Principle 4: Self-confidence and Energy

From our study of Hayek, the authors would add a fourth principle – one we see in all effective business leaders, but well worth recognizing again in this particular case.

When Hayek was asked why he was successful, he had – as always – an opinion and an answer:

> I was absolutely convinced of my idea. And what was more, I was sure that it was the only way the industry could survive in Switzerland.
>
> I already had an established track record, thanks to my consulting practice.
>
> Because people always underestimate you, I had to deliver positive results quickly, which I did.

I led by example. I was always there. I was the first to start working in the morning and the last to leave. I was reachable around the clock. Don't ever ask people to do something that you don't want to do yourself.

I am not arrogant, I mingle with people, I am one of them.

I know how to lead. This capability rests on self-confidence, on education, on a little bit of talent. Not everybody can lead; you have to know your strengths and use them wisely.[xvii]

..*

In 2006, at the age of 78, Hayek remained full of ideas. Sometimes he wished he was 50 again, "then I would try to take over DaimlerChrysler with a few partners. The market capitalization is currently around €44 billion – a relatively good price."[xviii]

Exhibit 1
Brands of the SMH Group

Prestige and Luxury Range (and year of acquisition)	**High Range**	**Middle Range**	**Basic Range**
Omega	Longines	Tissot	Swatch
Blancpain (1992)	Rado	(CK) Calvin Klein Watch	Flik Flak
Léon Hatot (1998)	Union	Balmain	Endura (private label)
Breguet (1999)		Hamilton	
Glashütte Original (2000)		Certina	
Jaquet Droz (2000)		Mido	

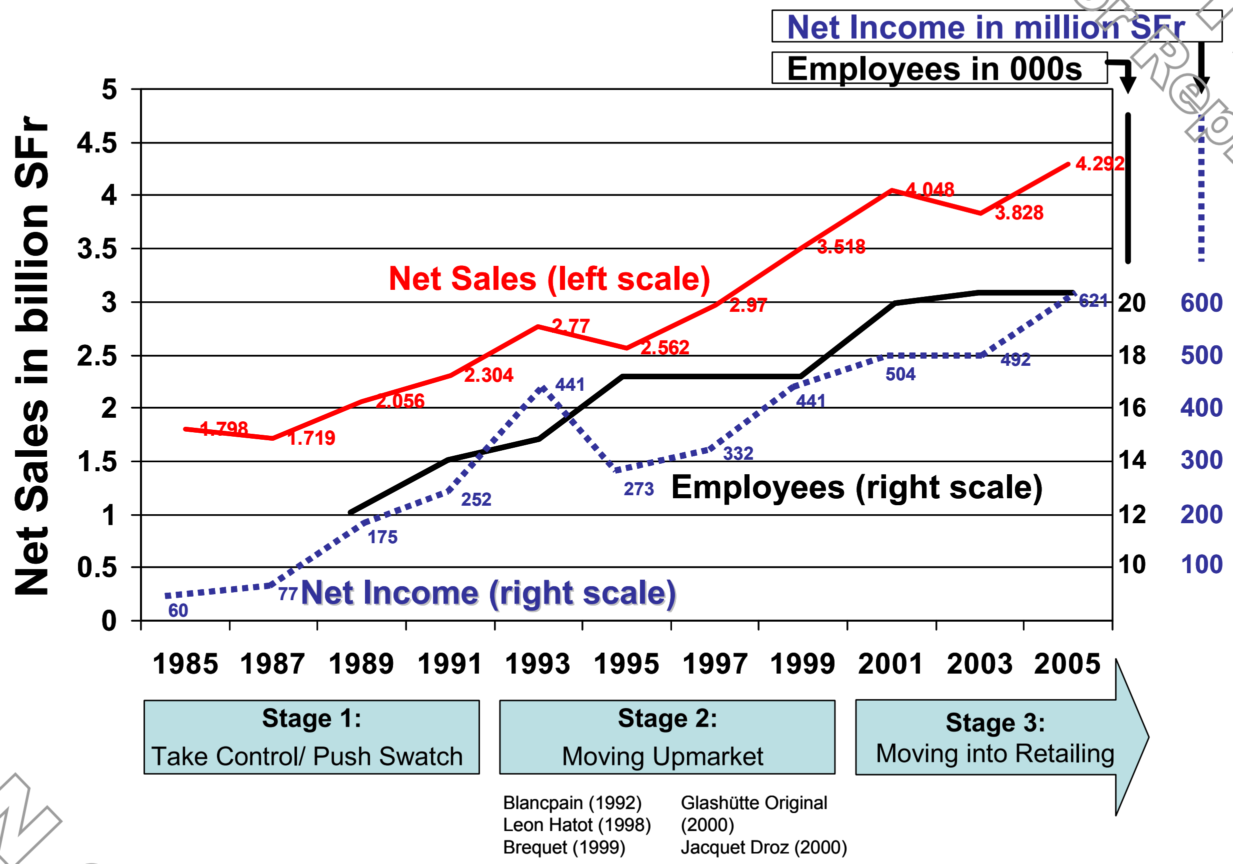
Source: Swatch Group Annual Report 2004; various newspaper articles.

Exhibit 2
Financial Development of the Swatch Group

		2001	**2002**	**2003**	**2004**	**2005**	**2006**
Gross sales	SFr	4,182	4,063	3,966	4,152	4,497	5,05
Net sales	SFr	4,048	3,933	3,828	3,981	4,292	
– change over previous year	%	(2.0)	(2.8)	(2.7)	4.0	7.8	
Net income	SFr	504	494	492	512	621	
– as a % of net sales	%	12.5	12.6	12.9	12.9	14.5	
– change from previous year	%	(7.7)	(2.0)	(0.4)	4.1	21.3	
Personnel on December 31		19,665	20,545	20,700	20,949	20,650	
Equity as a % of total assets	%	70.0	74.0	71.3	71.1	69.9	

Source: Swatch Group Annual Report 2005: 10; press releases.

Exhibit 3
Financial Development of the Swatch Group



Source: Various Annual Reports

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A number of the quotes in this case study are taken from: Bartu, Friedemann, and Nicolas G. Hayek. *Nicolas G. Hayek: Im Gespräch mit Friedemann Bartu: Ansichten eines Vollblut-Unternehmers*. Zurich: Verlag Neue Zürcher Zeitung, 2005, hereinafter referred to as Bartu, Friedemann and Nicolas G. Hayek. *Nicolas G. Hayek*. Zurich: Verlag NZZ, 2005.

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