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SWISS ARMY: DIVERSIFYING INTO THE FRAGRANCE BUSINESS

Professor Ilan Alon, Associate Professor Marc Fetscherin and Claudia Carvajal wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In 2005, Victorinox, the manufacturer of the famous Swiss Army Knives, acquired its main competitor, Wenger S.A. The acquisition also included Wenger's watches, luggage and its fragrance label. By acquiring Wenger, Victorinox became the world's main manufacturer of the famous Swiss Army Knife as well as a key player in sales of the Swiss Army Watch (some smaller competitors sold watches under the "Swiss Army" or "Swiss Military" label). Urs Wyss, head of marketing at Victorinox, was asked to assess how to handle the acquired fragrance business unit. Should Victorinox design a business strategy to enter the fragrance industry? Should Victorinox diversify into the fragrance business and, if so, how? Should the firm attempt to transfer its existing brand attributes to fragrance products or should it sell fragrances under another brand name? Urs Wyss was asked to present a plan to Carl Elsener, the CEO of the company, regarding how best to deal with the newly acquired fragrance business unit.

COMPANY ORIGINS

In 1884, Karl Elsener, the great-grandfather of the current CEO, opened a cutlery workshop in Ibach-Schwyz, Switzerland, to deliver knives to Swiss Army soldiers. He designed a product that included various functions and tools, all in one simple and easy-to-carry knife. Since then, Victorinox had been responsible for the many innovative features of the famous "Swiss Army Knife."¹ Millions of people throughout the world associated Victorinox with typical Swiss values such as innovation, reliability, functionality and quality.

For over 120 years, Victorinox had remained true to its mission, which was the driver behind the company's culture and orientation: "to provide our fellow human beings all over the world with practical, functional, reasonably priced and top-quality products."² Victorinox was identified and known by its brand names, "Victorinox" and "Victorinox Swiss Army" (the two umbrella brands). In the dynamic global marketplace, where products were becoming increasingly similar and imitations of innovations were standard practice, a strong brand could develop its own orientation, making differentiation possible. Therefore, each product category and its constituent products united a number of core company values: quality, innovation, functionality and iconic design (see Exhibit 1). Victorinox was the largest employer

¹ "Ibach-Schwyz (Switzerland), 2012," Victorinox, www.victorinox.com/us/content/Heritage_page_default, accessed February 6, 2014.

² *Ibid.*, accessed March 7, 2014.

in the canton (state) of Schwyz, as well as the largest knife manufacturer in Europe. About 28,000 Swiss Army Knives and 32,000 Multi-Tools were produced daily, leading to an estimated annual total production output of six million Swiss Army Knives and seven million Multi-Tools. In addition, 60,000 household and professional knives were manufactured daily. Approximately 90 per cent of Victorinox's total production was exported worldwide.

ACQUISITION OF WENGER S.A.

Since 1893, Wenger's headquarters had been in Delémont, which is located in the northwestern corner of the French-speaking region of Switzerland. Wenger also produced multifunctional knives, posing serious competition for Victorinox. Wenger S.A. (acronym for "Société anonyme" in French, meaning "incorporated") had quickly established a good reputation due to its innovation, precision and outstanding craftsmanship. In 1997, the company expanded its product portfolio to produce watches, which were in high demand because of their reliability and multi-functionality.³ Furthermore, the company established business relationships with various market players that allowed other producers to manufacture products under Wenger's name. Unfortunately, the terrorist attacks of September 11, 2001, negatively impacted the global economic and political environments as well as international relations. After 2001, Wenger, which was less diversified than Victorinox, was barely surviving due to the dramatic decrease in knife sales. This led Wenger to the brink of bankruptcy and provided an opportunity for Victorinox to become the only Swiss Army Knife producer in the world. Due diligence and negotiations took a while, but in 2005 Victorinox acquired its competitor. The "Genuine Swiss Knife" was Wenger's most profitable product; by 2005 its knife sales totalled \$22 million, followed by its watch and fragrance product lines, at \$3.6 million and \$9.4 million, respectively. The Swiss Army fragrance was only available in the United States and Canada. (See Exhibit 2.)

VICTORINOX PRODUCT PORTFOLIO

Victorinox was one of the few companies able to transfer their brand attributes of quality, innovation, functionality and iconic design to other product categories.⁴ The features of the company shaped the guiding concepts for its product development and market approach in its five product categories: Swiss Army Knives; household and professional cutlery; timepieces (watches); luggage (travel gear); and fashion. Despite the differences among these product categories, they had one thing in common: they were all an expression of the philosophy and values behind the legendary original "Swiss Army Knife." They combined high quality with outstanding reliability, functionality, innovation, refinement and iconic design. The company was characterized by its broad product portfolio due to its diversification strategy.⁵ (See Exhibit 3.)

Swiss Army Knives, Household and Professional Cutlery

This product category included the original Swiss Army Knife as well as household and professional cutlery. The product range included over 360 products with up to 80 functions. Over the last few decades, Victorinox had added even more features, special functions and models such as the Swiss Champ, with 33

³ "History," Wenger, <http://int.wenger.ch/en/company/history>, accessed March 7, 2014.

⁴ J. Melik, "Swiss Army knife adapts to remain a cutting-edge tool," *BBC*, 2012, www.bbc.co.uk/news/business-18005145, accessed February 2, 2014.

⁵ *Ibid.*; L. Zonco, "On the Cutting Edge," *Swiss Style*, www.swissstyle.com/victorinox-cutting-edge, accessed February 3, 2014.

functions, the SwissFlash USB pocket knife, with up to 8-Gigabyte storage capacity, a pocket knife with the smallest laser pointer in the world.

In addition to the original Swiss Army Knife, Victorinox produced around 540 different household and professional cutlery models mainly targeting households or professional chefs and butchers. This cutlery was of the highest quality and was ergonomically designed for ease of handling. The assorted cutlery covered a broad range of standout collections of perfectly balanced forged knives.

Timepieces (Watches)

For over 400 years, Switzerland had been the world's largest manufacturer of watches. After a major crisis in the 1970s, the Swiss watch industry was able to recover its former success.⁶ It was estimated that the country accounted for about half of the world's production of high-quality watches,⁷ among which Victorinox's watches were a major player. Victorinox watches were carefully designed using the high standards the company was known for delivering: quality, functionality and innovative and distinctive designs.⁸ There were over 180 different models, divided into the following segments:

- Active styles targeting dynamic people with modern, active lifestyles
- Classic styles targeting sporting- and luxury-oriented customers
- Professional styles targeting those who demanded the utmost in performance and functionality as well as technically advanced movements

The Swiss Army Watch brand was created and launched by Victorinox's American partner in 1989. The Swiss Army brand enjoyed a brand awareness level of over 90 per cent in the United States. However, in other markets Victorinox enjoyed higher brand awareness for products other than watches. After integration of the Swiss Army brand into the Victorinox brand portfolio, the company used the combined name Victorinox Swiss Army, which increasingly gained international recognition and brand awareness. The manufacturing of the watches was done in the company's own facilities, which were located in the canton of Jura, which was the heart of the Swiss watch-making region.

Luggage (Travel Gear)

The Victorinox luggage collections included a wide range of luggage, lifestyle bags, business cases, travel accessories, backpacks and personal leather goods. Each piece was designed to handle intensive travel and stood out for its highly developed technology, functionality and durability, all of which were core brand values of Victorinox. Under a licensing agreement, Victorinox Travel Gear was manufactured by the TRG Group, which was headquartered in St. Louis, Missouri. The company, which focused on quality, innovation and attention to detail,⁹ had been producing a wide range of luggage and bags for Victorinox since 1999. Victorinox Travel Gear brought together in a single concept the Swiss tradition of innovation, functionality and durability with models for various lifestyles, activities and tastes. The products were available in more than 90 countries throughout the world.

⁶ P. Feubli, E. Gachet, P. Hänggi and D. Künzi, "Swiss Watch Industry," *Credit Suisse Global Research*, 2013, <https://www.credit-suisse.com/media/production/pb/docs/unternehmen/kmugrossunternehmen/uhrenstudie-en.pdf>, accessed February 6, 2014.

⁷ "Watches," *Federal Department of Foreign Affairs, Presence Switzerland*, www.swissworld.org/en/economy/key_sectors/watches, accessed February 3, 2014.

⁸ J. Pitsch, "Interview: Victorinox Timepiece Division CEO Alexander Bennouna," *Professional Watches*, 2013, <http://professionalwatches.com/2013/05/interview-victorinox-ceo-alexa.html>, accessed February 2, 2014.

⁹ TRG Group, www.trgcorporate.com, accessed February 3, 2014.

With its innovations and application of the latest technologies, Victorinox, in collaboration with the TRG Group, had become the leading innovator in the luggage market. At times it held about 60 pending or registered patents, including the ergonomically designed curved handle system and the unique 360-degree rotating swivel handle. The TRG Group had received many awards for its innovative market performance. To a large extent, materials used in manufacturing the Victorinox Travel Gear originated in Asia. Production was carried out by the world's leading manufacturers in Asia under Victorinox's supervision of their inspection teams. This guaranteed that the company's highest quality standards were maintained.

Fashion

In 2001, male and female fashion collections were developed that could be used throughout all seasons of the year. Each collection offered new materials and colours for travel and performance-friendly outerwear for a range of environments and situations. Victorinox's male and female customers were active and engaged, and they demanded both flexibility and quality. Functional design combined with innovative materials ensured comfort and ease as the wearer engaged in travel, business or leisure activities. The innovative and durable materials and careful manufacturing satisfied their daily needs. Victorinox worked closely with renowned manufacturers from around the world to develop and create new styles and materials. Textiles and patterns primarily came from Europe and Japan. The world's leading textile manufacturers produced clothing under Victorinox's supervision.

Sales

Victorinox's sales took place in a large number of shop-in-shop retail locations. These sales were supplemented by a newly opened Victorinox brand store in New York. Victorinox had sales subsidiaries in eight countries and distribution partnerships in over 100 countries on five continents (see Exhibit 4).

The distribution of Victorinox fashions was exclusively carried out through carefully selected sales channels. Furthermore, distribution partners were exclusive retailers as well as e-commerce sites for luxury products. (See Exhibit 5).

AN OVERVIEW OF THE GLOBAL FRAGRANCE INDUSTRY¹⁰

The global fragrance industry saw a significant decline in profits during the early 2000s due to the underperformance of the American economy resulting from high unemployment and fears of war.¹¹ In addition, fluctuations in the prices of primary products, such as oil and chemicals, affected its profit margins. However, there were positive industrial forecasts due to the growing middle classes in emerging markets. As their income increased, consumers in these markets were able and willing to spend money on non-necessary products, such as fragrances. The BRIC countries (Brazil, Russia, India and China), with large populations ranging from about 140 million (Russia) to 1.2 billion (China), all had strong economies and growing middle classes. Furthermore, demand for fragrances was rapidly growing among consumers in their late teens to middle age (Generation Y), who were increasingly interested in beauty products,

¹⁰ "Global Cosmetics Manufacturing," IBISWorld, 2013,

<http://clients1.ibisworld.com/reports/gf/industry/default.aspx?entid=730>, accessed February 21, 2014.

¹¹ "Retailing: Specialty," Standard & Poor's, 2003,

www.netadvantage.standardandpoors.com/NASApp/NetAdvantage/showIndustrySurvey.do?code=res&date=/res_0303/res_0303.htm (login required), accessed July 11, 2014.

including fragrances. With the growing desire in consumers to present better self-images, beauty product manufacturers had started to enjoy a growing demand for their products. One characteristic of these buyers was their “brand-consciousness” (good quality for low prices), meaning that demand for products that boasted a “good value for the price” was growing rapidly, especially among the better-known brands. In general, with the exception of certain individual countries, the fragrance industry as a whole was not very regulated. There were no global standards for fragrances; therefore, companies had to abide by local rules that varied by country. Such rules and regulations were primarily related to the components in the products, the labeling information and the packaging materials. In addition, in the fragrance industry most developed countries did not impose tariffs as barriers. However, in emerging economies some tariffs existed. As for technological advances, the industry required a moderate level of technology, and a wide range of chemicals was used in the manufacture of personal care products and cosmetics, such as cleansing agents, waxes, fats, oils and surfactants. Innovation was important due to the maturity of the industry and the rapidly changing consumer behaviour.

The fragrance industry required substantial start-up funds. It was difficult to establish relationships with distributors and consumers since the major players already had a strong presence and relationships. In addition, new brands of cosmetics and fragrances were not rapidly adopted by consumers since the major brands enjoyed strong brand loyalty.¹² The quality of ingredients was very important, since the production of fragrances required special chemicals that were appropriate for use on the skin. Compared to large manufacturers, suppliers of primary materials were small; therefore, established relationships were important in order to receive “better” treatment and secure the best ingredients. As for advertising, in order to build brand awareness and create brand loyalty, manufacturers advertised directly to consumers. Therefore, retailers often stocked up on popular brands. However, perfumes were seen as luxury (non-necessary) items, and there were lower-priced substitutes, such as deodorants and body sprays, which were more accessible to price-sensitive consumers, as well as counterfeit products, especially in emerging markets.¹³

The global fragrance industry generated revenues of about \$23.5 billion in 2005 (see Exhibits 6 and 7). In 2005, the premium fragrance market accounted for a total of \$15 billion, and the mass fragrance market accounted for \$8 billion (see Exhibit 8). In this competitive industry, companies used pricing, promotion and distribution strategies as well as innovative packaging to target consumers and capture market share. Department stores and specialty stores were the most dominant distribution channels, constituting over 50 per cent of sales (see Exhibit 9). Moreover, the market was dominated by several key players, such as L’Oréal, Coty, Procter & Gamble, Avon and LVMH, which by the end of 2005 had captured almost 40 per cent of the global market, followed by many smaller niche players, such as Liz Claiborne, Mary Kay, Revlon and Bulgari (see Exhibit 10).

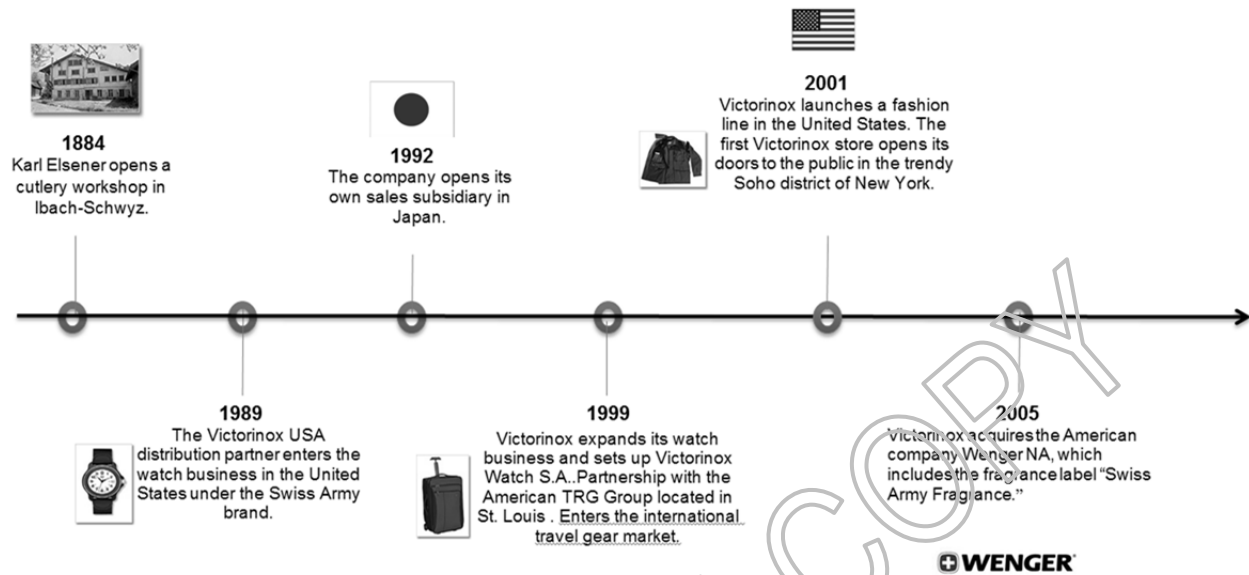
WHAT SHOULD BE DONE NEXT?

In the fall of 2005, Carl Elsener, CEO of Victorinox, called a meeting of his top management and posed to Urs Wyss and his team the following challenging questions: What should they do with their newly acquired fragrance business unit? Should they really diversify into the fragrance business? Should they attempt to transfer existing brand attributes or should they adopt a new brand to market their perfumes? Finally, how could they best compete and position themselves in this mature and competitive industry in which they had no prior experience or brand awareness?

¹² *IBISWorld, op. cit.*

¹³ *Ibid.*

EXHIBIT 1: KEY MILESTONES IN THE HISTORY OF VICTORINOX



Source: Victorinox.com, accessed October 30, 2014.

EXHIBIT 2: WENGER'S SALES

	Million CHF	Million (USD (est.))
Knives	22	18
Watches	5	4
Fragrances	13	9
Total	40	29
2005 Conversion Rate US\$1 = CHF1.3822		

Note: CHF stands for "Swiss franc."
Source: Company files.

EXHIBIT 3: PRODUCT PORTFOLIO

Examples of Swiss Army Knives



Examples of Cutlery Knives



Examples of Swiss Army Watches



Examples of Luggage



Examples of Swiss Army Fashions



Source: "Ibach-Schwyz (Switzerland), 2012," www.victorinox.com/us/content/Heritage_page_default, accessed February 6, 2014.

EXHIBIT 4: VICTORINOX'S NUMBER OF EMPLOYEES, 2005

Subsidiary	Number of Employees
Brazil	19
Chile	45
China/Hong Kong	138
India	63
Japan	84
Mexico	87
Poland	8
North America	290
Total	734

Source: Company files.

EXHIBIT 5: VICTORINOX'S SALES, 2005

	Million CHF	Million USD (est.)
Knives	230	166
Watches	20	14
Luggage	40	30
Apparel	10	7
Total	300	217
2005 Conversion Rate of US\$1 = CHF1.3822		

Source: Company files.

EXHIBIT 6: GLOBAL FRAGRANCE MARKET, 2005

	Million USD
Latin America	6,640
Western Europe	6,160
North America	4,500
Eastern Europe	2,150
Africa	2,150
Asia	1,898
Australia	2.5
Total	23,500.5

Source: Ibis World, Global Cosmetics Manufacturing, 2013,
<http://clients1.ibisworld.com/reports/gl/industry/default.aspx?entid=730>, accessed February 21, 2014.

EXHIBIT 7: GLOBAL FRAGRANCE MARKET, 2005

	Share %
Latin America	28
Western Europe	26
North America	19
Eastern Europe	9
Africa	9
Asia	8
Australia	1

Source: Ibis World, *Global Cosmetics Manufacturing, 2013*,
<http://clients1.ibisworld.com/reports/gl/industry/default.aspx?entid=730>, accessed February 21, 2014.

EXHIBIT 8: GLOBAL FRAGRANCE MARKET BY CATEGORY, 2005

	Million US\$	Share %
Premium women's fragrances	10,000	43.5
Premium men's fragrances	5,000	21.5
Total premium market	15,000	65
Mass women's fragrances	5,000	20
Mass men's fragrances	3,000	13
Total mass market	8,000	33
Premium unisex fragrances	300	1
Mass unisex fragrances	200	1
Total unisex market	500	2
TOTAL	23,500	100

Note: Numbers are rounded.
 Source: *Beauty and Personal Care, Euromonitor, from trade sources/national statistics.*

EXHIBIT 9: WORLD DISTRIBUTION OF FRAGRANCES BY CHANNEL (EARLY 2000s)

	Share %
Department Stores	27
Specialty Stores	29
Direct Sales	15
Pharmacies/Drugstores	14
Grocery Stores	9
Discounters	4
Outdoor Markets	1
Other	1

Source: www.eclipsecoloursparis.com/pdf/evafolorcompanyprofile.pdf, accessed November 13, 2014.

EXHIBIT 10: COMPANY MARKET SHARE, BY PERCENTAGE (2005 AND ESTIMATES)

Companies	2005	E2006	E2007	E2008	E2009	E2010
Other (less than 0.5% of market share)	26.7	26.4	25.6	26.4	29.3	30.1
Coty, Inc.	10.2	10.1	9.6	9.3	9	8.5
L'Oréal Group	8.7	8.8	8.5	9.7	9.4	8.6
LVMH Moët Hennessy Louis Vuitton S.A.	7.1	7.2	7.2	7.1	7.1	6.7
Procter & Gamble Co.	6.8	7.7	7.8	7.9	7.8	7.5
Avon Products, Inc.	6.1	6.3	6.9	7.1	7.3	7.3
Estée Lauder Co., Inc.	5.9	5.8	5.5	5.2	5	4.6
Chanel S.A.	4.1	4	4	3.9	3.9	3.8
Puig Beauty & Fashion Group S.L.	2.9	3.1	3.3	3.5	-	-
Natura Cosméticos S.A.	2.2	2.9	3.3	3.6	4.2	5.3
Elizabeth Arden, Inc.	2.1	2.1	2	1.7	1.7	1.6
Gucci Group NV	1.8	1.8	1.8	0	0	0
Botica Comercial Farmacêutica Ltda.	1.7	1.8	2.2	2.5	2.9	3.9
Shiseido Co. Ltd.	1.7	1.6	1.6	1.5	1.5	1.4
Limited Brands, Inc.	1.5	1.4	1.1	0.9	0.9	0.8
Clarins S.A.	1.4	1.3	1.3	1.2	1.2	1.1
Euroitalia Srl	1.1	0.1	0.1	0.1	0.1	0.1
Vorwerk & Co. KG	0.9	0.9	1	1.1	1	1.1
Oriflame Cosmetics S.A.	0.8	0.9	1.2	1.5	1.5	1.6
Corporación Belcorp	0.7	0.8	0.9	1.1	1.3	1.2
Mary Kay, Inc.	0.7	0.7	0.7	0.6	0.6	0.6
Liz Claiborne Inc.	0.6	0.6	0.6	0.5	0.6	0.5
Revlon, Inc.	0.6	0.5	0.5	0.4	0.5	0.5
Unilever Group	0.6	0.6	0.7	0.7	0.6	0.6
Yves Rocher S.A.	0.6	0.6	0.6	0.5	0.5	0.5
Arabian Oud Co.	0.5	0.5	0.5	0.6	0.7	0.7
The Body Shop Plc	0.5	-	-	-	-	-
Inter Parfums, Inc.	0.5	0.5	0.5	0.5	0.5	0.5
Private labels	0.5	0.5	0.5	0.4	0.4	0.4
Tupperware Brands Corp.	0.5	0.5	0.5	0.5	0.5	0.5

Note: Historical regional/global values are the aggregate of the country data in local currency at current prices converted into the common currency using year over year exchange rates.

Source: Beauty and Personal Care, Euromonitor, from trade sources/national statistics.