Diversification Strategies in the Global Drinks Industry

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Abstract

The aim of this paper is to explain why despite following apparently very different diversification strategies, the world's leading multinationals in alcoholic beverages achieved large size and similar dominant positions by the beginning of the twenty first century. Drawing on Mark Casson's 'Systems View' this paper argues that a combination of physical linkages and knowledge linkages explains these distinct diversification strategies. Looking at the period from 1960 to 2002, it shows that while in their internationalisation strategies, the leading multinationals concentrated on the alcoholic beverages business, their diversification into other activities essentially took place in the domestic markets of the investing firms. The lack of very strong physical and knowledge linkages, and the higher risk involved in international investment, explain why firms did not combine strategies of unrelated diversification with geographical diversification. This paper also shows that the diversification followed by multinational firms within the alcoholic beverages industry evolved in cycles. While beer firms expanded into wines and spirits, spirits firms only invested in wines, and wines firms invested in spirits but modestly. The last beverage to become the target of multinational investment was wine. This demonstrates again the importance that the flows of knowledge in marketing and the management of brands may have in the growth and survival of MNEs.

Key words: Diversification strategies, global industry, multinationals, drinks, growth of firms.

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1 Introduction

Diversification has been an essential basis for the growth and survival of firms in the last half of the twentieth century, due to the vulnerability of the specialised firm to the fast and unexpected changes in the environment (Penrose 1959/1995; Marris, 1964; Whittington and Mayer, 2000). This increased relevance of diversification in explaining the changing profile of firms and industries led to the development of a vast body of research in various fields of social sciences (Chandler, 1962; Gort, 1962; Ansoff, 1957, 1958). In business history the seminal work of Alfred Chandler in *Strategy and Structure* created interest in this topic (Chandler, 1977, 1990). In international business Mark Casson and Peter Buckley's 'Internalisation Theory', later developed by Casson in a 'Systems View' also explored this issue of growth of diversified firms, though placing greater emphasis on the determinant role of the global environment (Buckley and Casson, 1976; Casson, 1990, 1991, 2000). Based on the statistical analysis of the world's largest multinationals in the early 1980s, Robert Pearce introduced the concept of double diversification, which refers to the strategies of those firms engaging in simultaneous in geographical and industrial diversification (Pearce, 1987, 1993).

This paper brings these different bodies of literature together in business history and international business, to explain why, between 1960 and 2001 despite apparently following very different diversification strategies, a group of firms in alcoholic beverages achieved large size and dominant leadership positions in the industry.

A definition of related and unrelated diversification

Diversification refers to the increase by a firm in the kinds of businesses which it operates, being that diversity either related to products, geographical markets or knowledge.[1] The definition of diversification used in this paper includes the changes in a firm's administrative structure, systems, and other managerial processes. Line extensions that are not accompanied by changes in administrative linkage mechanisms do not fall under this conceptualisation of diversification (Ramanujam and Varadarajan, 1989; Montgomery, 1994).

Studies of diversification often analyse the ownership advantages that diversifying firms must possess, considering that the speed and the economic feasibility of diversification are to a large extent determined by those advantages. They also look at the mode by which firms diversify - through organic growth, mergers and acquisitions or alliances (Dunning, 1981; Penrose, 1959/1995; Vachani, 1991).[2]

This study draws on the 'Systems View' to define diversification. It considers all viable diversification where physical linkages (in terms of products and geographical markets), and knowledge linkages exist between businesses to be related diversification (Casson, 2000; Penrose, 1959/1995; Wernerfelt, 1984).

Four categories of diversifying investments are classified as related diversification. One, when new investments involve similar products; two, when they lead to the vertical integration of complementary activities (corresponding to backward or forward integration)[3]; three, when firms internationalise by adding operations in foreign markets which involve similar products (even if these investments take place in culturally and geographically distant markets); and

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1 Growth on the other hand can be achieved not only through diversification, but also through scale and replication, with the firm reinvesting in traditional lines of business. It implies an increase in size or an improvement in quality as a result of a process of development of the firm. Penrose (1959/1995).

2 For further analysis on these topics see Lopes (2002a).

four, when the new business shares intangible assets such as marketing knowledge, patent-protected technology, product differentiation, superior managerial capabilities, or routines and repertoires (Nelson and Winter, 1982; Winter, 1987). Marketing knowledge may be shared among businesses producing completely distinct products. As a result of this wide definition of relatedness firms may look like conglomerates (i.e. firms with unrelated business components), as both the products they manufacture or services they render are quite disparate. Nonetheless, they may actually still be related by the knowledge linkages that they share (Richardson, 1972). Such linkages are often hard to identify. By contrast, the physical linkages that may be created when a firm diversifies, for example shared markets or distribution systems, are more easily identified. Consequently, physical linkages have traditionally been used in studies of diversification as they provide a clear-cut mode for measuring and comparing relatedness between industries (Montgomery, 1982; Caves *et al*, 1980). This study, however, also considers knowledge linkages as these help to explain diversification in the alcoholic beverages industry

In addition to the four types of related diversifying investments, four different levels of diversification are considered: non-diversification or low diversification, medium diversification, high diversification and conglomerate or unrelated diversification. Firms are considered to be non diversified and low diversified if not less than 80 per cent of sales come from one basic business. Such firms are, then, heavily committed to a single activity. Medium diversified firms are those that have diversified to some extent but still obtain their revenues essentially from a single business. In these, less than 80 per cent but more than 70 per cent of sales are generated by that business. In highly diversified firms no one business accounts for more than 70 per cent of sales. Firms are considered to have conglomerate or unrelated

[3] Activities are considered as complementary when they represent different phases of a process of production and require in some way or another to be coordinated.

businesses when they are diversified into areas where no physical or knowledge resources are shared, other than financial (Stopford and Dunning, 1983; Wrigley, 1970; Rumelt, 1974).

The classification used in this study considers all geographic diversification to be related diversification, despite the differences that may exist in markets physically and culturally distant where communication, and control costs, as well spill-over effects and operational complexity which result from 'foreigness' may exist (Buckley and Casson, 1976). These issues are not considered in this study as it aims not to analyse the implications for the firm of its diversification decisions, but instead to understand why firms diversify by internalising intermediate product markets and achieve similar size.

Geographical diversification is considered to be low when less than 20 per cent of total sales are produced outside the continent where the MNE has its headquarters. Geographical diversification is considered to be medium when it corresponds to between 20 per cent and 35 per cent of total sales, and it is high when it corresponds to more than 35 per cent. In this study geographical diversification is calculated as the percentage of sales produced outside the continent of the home country of the multinational firm (Stopford and Dunning, 1983).

Although it is acknowledged that there are limitations in using a binary system to measure product and geographical relatedness, these were the best indicators found to deal with the limitations of data availability.[4] Despite using original databases based on published annual reports or company records (depending on the firm), frequently firms did not record and systematize the information about their activity with the same level of detail.

2 A Systems View of diversification

The 'Systems View', which is a development of Buckley and Casson's 'Internalisation Theory', considers the extent to which firms are integrated in the global economy and are

[4] For an alternative measure of relatedness applied to technological innovation see Cantwell (2002).

linked by a complex web of product and knowledge flows. This is particularly useful to analyse the international diversification of MNEs, such as those in the alcoholic beverages industry. According to this theory the global economy is characterised by imperfections in markets and in firms. These imperfections create costs that affect firms' efficient operations in multiple ways. In the case of imperfections in markets, in order to minimize these costs and simultaneously take advantage of the benefits that the internalisation of new linkages might provide, firms often substitute market transactions for the hierarchy or for hybrid governance structures (Teece, 1980). In the case of imperfections in firms they additionally may lead firms to internalise linkages that before did not exist, not even through the market. Drawing on these concepts from the 'Internalisation Theory' and the 'Systems View' Figure 1 was created to provide a descriptive explanation of how the Systems View works.

Insert: Figure 1 - Explaining diversification in alcoholic beverages using a Systems View

The two types of imperfections result from different kinds of changes. These are imperfections in markets and in firms. Imperfections in markets are created by changes in the external environment. They include declining demand, competitive shocks, country barriers, and policy distortions (such as tax and antitrust policy and taxes). These prevent the firm from economically exploiting ownership advantages in other markets in any way other than by internalising the market (Williamson, 1975, 1979; Klein *et al*, 1978; Buckley and Casson, 1976). Imperfections in firms are created by changes that occur inside the firms. They include the development of excess resources (tangible, intangible or financial), or shifts in managerial motives and shareholder interests (Rumelt, 1974). These two different forces which may lead to diversification are not mutually exclusive. In fact change may simultaneously produce imperfections in markets and in firms. The appearance of these imperfections in markets and in firms creates costs for firms if they maintain their existing boundaries. Such costs will affect a firm's efficient operation and ultimately it long-term survival. Thus a firm will internalise to reduce the costs and ensure survival.

These costs may be of two types – transfer costs or information costs. In this discussion only transfer costs are analysed. Transfer costs are the costs of actually moving the resources from one location to another. In the case of physical resources, transfer costs include costs of transport, tariffs and costs of overcoming non-tariff barriers. In the case of knowledge resources, transfer costs include costs of training.[5] It is these costs that lead firms to internalise physical or knowledge linkages.

As there are two types of transfer costs, physical and knowledge costs, so the linkages that result from the attempt to reduce these costs are of two kinds - physical or knowledge linkages. Physical linkages involve tangible assets and are characterised by one-way product flows (inputs or outputs), which run from the supplier to the consumer of those products. They refer for example to plant capacity and the equipment necessary to manufacture a product. Although tangible assets such as specialised manufacturing equipment may be difficult to imitate, they are not very flexible in facilitating diversification, because of their indivisibility and of excess capacity that might arise (Penrose, 1959/1995, Hoskisson and Hitt, 1990). Often, the excess capacity of these assets (plant and equipment) can only be used for very closely related products, especially those requiring highly similar manufacturing technology. Another limitation relates to the fact that they can only be used only up to the point where they are physically exhausted.

Knowledge linkages relate to the systematic processes which reside within firms human capital in the form of expertise (such as marketing knowledge), or technologies which can improve the business assets of a new domain being considered for investment. This study considers knowledge accrues to the firm over time, and that it involves intangible linkages. Not only these linkages flow from the supplier to the customer as established in Casson's Systems View, but it may also be accumulated by the supplier due to its linkage with its customer. Knowledge is easily transferred between essentially separate activities, is less imitable than physical assets, and can be repeatedly used in different products with little cost in the effectiveness of the original operations. It is this fungible character of knowledge assets, and the excess resources that the firm may generate that are critical in the understanding diversification of firms into new as well as existing lines of business operates.

In this study on alcoholic beverages particular attention is paid to one kind of knowledge - marketing knowledge. Marketing knowledge is both general and specific. General marketing knowledge is the accumulated by a firm about marketing methods, management of brands and distribution, irrespective of their geographic region. Specific marketing knowledge is knowledge about the characteristics of a specific brand and a particular national market. It includes, among other factors, the knowledge about its business climate, including relations established with local customers, suppliers, banks, and employees (Lopes, 2002a). It is important to note here that while general marketing knowledge can be shared among different industries, specific marketing knowledge is of more limited scope, being more relevant in the operation of particular geographical markets or in the industry for which it was developed, not being so easily shared with other activities.

3 Shifts in diversification strategies over time

The constant changes in the imperfections generated in markets and in firms, lead firms to concentrate and reassess their diversification strategies (Pearce, 1993). Consequently, it is

[5] Information costs may take the form of communication costs (which are costs of agreeing the price and quantity of the resource to be transferred, assuming honesty), or of assurance or transaction costs (which are

often very difficult to classify firms' strategies over long periods of time as being only of related or unrelated diversification. Nonetheless, despite the unique ways through which firms respond to those imperfections (Nelson, 1991), it is possible to find common patterns in their diversification strategies, not only in terms of products and geographical markets, but also in terms of vertical integration strategies and the knowledge linkages created. These are often combined, forming strategies of double diversification (Pearce, 1987, 1993).

The evolution of physical linkages and knowledge linkages

The shifts in the diversification strategies of the world's largest MNEs in alcoholic beverages tended to be gradual. In the beginning of the 1960s, physical linkages were more important in determining the diversification of firms. Hence in the 1960s most of these MNEs were either not diversified at all or had low levels of diversification. Over time, however, knowledge linkages gained increasing importance, leading many firms to evolve into medium or highly diversified businesses. By the end of the century firms were diversifying into areas where they could obtain cost efficiencies both through physical and knowledge linkages. Figure 2 which provides the ratio of sales in alcoholic beverages to total sales between 1960 and 2000, illustrates this development for a group of leading firms.

Insert: Figure 2 - Percentage of sales in alcoholic beverages to total sales, 1960-2000

In each decade the incentives for internalisation were created by different imperfections in markets and in firms. For example, in the 1960s Seagram, as well as IDV, were non-diversified, only producing and marketing spirits and wines. For Distillers, the alcoholic beverages business accounted for between 80 per cent and 91 per cent of its annual sales during the 1960s. The remaining sales resulted from investments made in chemicals and biochemicals. It had diversified into these businesses almost since its foundation in 1877, as

costs incurred in dealing with misinformation or dishonesty). Casson (1997, 2000).

some of the firms that merged to form Distillers already produced alcohol for industrial use. It was this available knowledge that served as the basis for investments in the manufacture of organic chemicals and in biochemicals. By the end of the 1960s Distillers started to re-focus divesting from these non-alcoholic beverages businesses following the litigation over the sleeping pill Thalidomide (which caused birth defects when taken by pregnant women). The poor performance of these chemicals businesses ultimately led to their sale to the oil group BP in 1969 (Weir, 1995; Bamberg, 2000).

Other firms such as Guinness in the UK were already diversified, but like Distillers, their levels of diversification were low. Guinness produced essentially beer. It also had small investments in other businesses such as confectionery (butterscotch, nougat, among other lines), pharmaceuticals, and property, and was vertically integrated in the British market where it had marketing and distribution activities. However, unlike most British brewers such as Allied Breweries, Bass and Whitbread, it was able to grow without diversifying into the ownership of pubs (Gourvish and Wilson, 1994).

There were nonetheless other firms showing higher levels of diversification into other businesses, for which it was not possible to obtain systematic data and so they are not included in Figure 2. For example the US firms Schenley and Heublein were diversified as a consequence of Prohibition (which lasted from 1920 to 1933). The governmental restrictions imposed on consumption and on production during Prohibition left firms during that period with excess resources (such as production capacity and human capital). While many firms closed down and sold their stocks as a result of that, others, especially those that had flexible resources, were able to survive by diversifying into other areas which frequently involved high levels of risk. Heublein, traditionally a spirits producer by the 1960s also had an important food business. This business, too, had been developed during the time of Prohibition, when the firm started producing a steak sauce from an operation acquired in 1918, which tuned out to be very successful (Downar, 1980).

But Prohibition also caused many US firms to integrate vertically, by diversifying into the wholesale distribution of alcoholic beverages once Prohibition was repealed. Vertical integration into distribution allowed firms to obtain scope economies in distribution and leverage their own brands through joint sale with successful foreign brands. Schenley, a wines and spirits firm formed in 1933, developed initially very rapidly out of acquisitions of US whiskey firms or of the stocks of firms which closed down due to Prohibition, and subsequently out of alliances formed with foreign firms to import and distribute their wines and spirits in the domestic market. An example of a successful alliance is that formed with Distillers Corporation - Seagram Ltd. in 1936 to distribute Dewars White Label Scotch whisky. Despite also engaging in various other non-alcoholic beverages activities (such as the production and sale of cooperage and farm feeds since the 1940s), in the aggregate these were not very significant in relation to the overall operations of the firm.[6] By the 1960s around half of Schenley's alcoholic beverages business related to the distribution of imported brands.

During the 1970s three different kinds of shifts took place in terms of the diversification strategies of firms in alcoholic beverages. One group of firms originally concentrating in alcoholic beverages started to diversify into other industries. Another group, owners of successful brands, increased in size by remaining focused in the alcoholic beverages industry, by merging and consequently consolidating their positions in the domestic market. A third group of well-established firms operating in other industries entered the alcoholic beverages business through the acquisition of existing firms in that industry.

Allied Breweries acquisition of J. Lyons & Co, a leading food specialist in 1978, is an example of the first group. It made a large investment into another industry. Allied hoped to

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[6] Schenley, *Annual Report and Accounts* (1963, 1965, 1969).

assure a steady cash flow for the firm and to spread risk by diversifying.[7] Lyons had a vast array of businesses not only in cakes, biscuits and other confectionery, where it owned firms such as Donut Corp., but also operated in grocery and frozen and chilled foods. Apart from these, Lyons also had services and leisure businesses in Africa, where it owned Embassy Hotels, J. Lyons Catering Ltd and Lyons Brooke Bond (in Zambia and Zimbabwe). In the US, Lyons had major firms in different food sectors. It owned Baskin & Robbins ice cream, DCA Foods (a cereal mixes firm), and Tetley Inc, (a leading tea, coffee and frozen foods producer). In 1991, after the company incurred a 147 million pounds loss caused by currency portfolio mishandling and low returns on investment it was generating, Allied sold the Lyons business. Since then the firm re-focused its activities towards its core businesses in spirits and retail (pubs and international franchised service).

Within the group of firms originally from alcoholic beverages which diversified into other businesses, clearly different strategies of diversification emerge. While some firms sought to diversify risk by merging and acquiring other firms and exercising control over their management, others sought only financial investments in other firms. In both instances firms attempted to substitute markets by spreading their portfolios of investments indirectly. The argument was that if investors recognised this service, then the benefit would be reflected in the stock price of the firms (Williamson, 1975; Severn, 1974; Caves, 1982). In these cases where diversification meant financial investments the linkages (either in terms of physical assets or knowledge) tended to be very low or non-existent. An example of that is the acquisition in 1980 of Home Oil Company by Hiram Walker, a leading Canadian bourbon producer. Apart from spreading risk, this acquisition also prevented Hiram Walker from being taken over by HCI Holdings, which had begun making large purchases in the firm’s stock. Another example of unrelated diversification where there was no control of the management

[7] Interview with Michael Jackaman, former Chairman of Allied-Domecq, Somerset, 8 December 1998.

nor share of physical or knowledge linkages is Seagram's 21 per cent interest in the capital of Du Pont in 1981.[8] The lack of physical of knowledge linkages between the oil and gas and chemicals businesses (which basically deals with commodities) and the alcoholic beverages business led firms to realise that it was costly to keep these financial investments. In the case of Hiram Walker the oil business was disposed right after the firm was acquired by Allied Domecq in 1986. In the case of Seagram, the financial investment in Du Pont was sold in 1995 when the firm entered the entertainment and leisure industry, which its managers believed was more closely related.

A second group of firms diversified in the 1970s merging with direct competitors originally from the same domestic markets. Pernod Ricard, a French firm formed in 1975 as a result of the merger between two leading family businesses in anis and pastis (Pernod and Ricard) is an example of this group. As a result of the merger, the firm became a leading producer of anis pastis, as well as major exporter of Australian wines and producer of Irish whiskey. Apart from these investments in wines and spirits Pernod Ricard was also a large producer of non-alcoholic drinks. In 1973 Pernod had acquired JAF juices. This business was later expanded with the acquisition of SIAS-MPA fruit preparation business (in 1982) and Orangina, a soda maker (in 1984).[9] This diversification into soft drinks, which had been a reaction to the changes that were taking place in the alcoholic beverages industry (of a stagnation in consumption and an increase in competition), was however not cost efficient. The firm ended up selling these soft drinks firms in 2001 and 2002.[10]

Grand Metropolitan and Phillip Morris are examples of the third group of firms mentioned above. Each entered the alcoholic beverages industry during the 1970s. Grand Metropolitan, a

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8 However, this interest of Seagram in the oil and gas business dated as far back as 1947. Hiram Walker, *Annual Report and Accounts* (1980); Bronfman (1998), chapter 1.

9 'Will Pernod mix its drinks?', *The Independent on Sunday* (17 October 1999).

10 Pernod Ricard, *Annual Report and Accounts* (1991); *Financial Times* (11 January 2002).

hotel and real estate firm, gradually increased its investments in the alcoholic beverages industry by making more mergers and acquisitions with firms already established in that industry. This ultimately led to the divestment of the original business of the firm. Phillip Morris, originally a tobacco firm, acquired the brewing firm Miller and kept that in its wide portfolio of businesses, with tobacco remaining as its main activity. Phillip Morris eventually sold Miller in May 2002. Liggett & Myers another US tobacco company also entered the alcoholic beverages business but, unlike Phillip Morris's case the alcoholic beverages business became increasingly more important in the total activity of the firm. Its diversification into alcoholic beverages started in 1964 after Liggett & Myers had suffered a decade of declining sales in the tobacco business.

The 1970s is also a period where many leading firms did not survive independently, having been acquired by other firms. In the US, as a result of the changes that were starting to take place in distribution (with a high concentration of wholesaling and retailing), the alcoholic beverages firms were not able to keep efficient wholly owned distribution channels. This and the small size of their own portfolio of successful brands, as well as the little marketing knowledge they had accumulated from managing their own brands internationally, explain many disappearances. For example, in 1971 Schenley was sold to Glen Alden Corporation, a conglomerate, operating in a multitude of businesses from consumer products to textiles, construction materials and motion pictures.

During the 1980s new market and firm imperfections arose in the Western World creating excess capacity in the industry. This led firms with the adequate resources to diversify further into new geographical regions and new industries.

In Japan alcoholic beverages firms not only increased the number of alliances with Western firms, though also started to internationalise in alcoholic beverages and non-alcoholic beverages but that internationalisation always remained low. Japanese firms also intensified their investments in the soft drinks industry (in particular in the health and supplement ‘fitness’ beverages) and also in the food business. This trend was followed by all the major Japanese alcoholic beverages firms – Kirin, Asahi, Suntory and Sapporo – who not only sought the growth potential of the soft drinks industry, but also to the high economies of scale and scope in distribution, as it used the same channels as alcoholic beverages. Apart from that many firms started investing in industries, such as pharmaceuticals, related with health in Japan.

Following Pernod-Ricard’s and the Japanese firms strategies of diversification into soft drinks, Seagram acquired Tropicana, a fruit juices company, in 1988. Despite the potential linkages in marketing knowledge and distribution between the alcoholic and non-alcoholic drinks businesses, Seagram never took advantage of these linkages, and ended up divesting from soft drinks in 1993.

Other firms followed a different rational for diversification during this period. Moët-Hennessy for example merged with Louis Vuitton (forming LVMH), a producer of luxury luggage and leather goods and accessories in 1987. This merger brought together two French firms, producers of high-prestige premium-priced brands, where there was clearly a high potential for sharing marketing knowledge in the management of brands (given the image of French sophistication and luxury) and in international distribution.

The US spirits firm Brown Forman, the owner of the successful bourbon brands Jack Daniels and Southern Comfort, diversified into the consumer durables industry, by acquiring Lenox china, crystal and giftware and Hartmann luggage in 1983, and Dansk table and giftware and Gohram silver in 1991. Unlike LVMH this strategic move did not turn out to be cost efficient, and profitable in the overall performance of the firm over time.[11] The linkages between the management of brands in bourbon and tableware and luggage products were weak, as well as the distribution channels.

[11] Hoovers Directory of World Business, ‘Brown Forman’ (Austin, Tex: Reference Press, 2002).

Grand Metropolitan remained highly diversified until it merged with Guinness in 1996 when it shed its hotel and real estate interests. During the 1980s this MNE became the world's largest firm in alcoholic beverages as a result of its mergers and acquisitions of firms such as Liggett & Myers in 1980 and Heublein in 1987. In its growth strategy Grand Metropolitan combined geographical and product diversification, focusing not only on the drinks sector but also on food, taking advantage of the physical and knowledge linkages that exist between the two businesses.

During the 1990s there was a trend for firms to re-focus on related activities. There were however some exceptions of leading firms which either focused more on alcoholic beverages or abandoned definitely the alcoholic beverages business and concentrated on their operations in other industries. In other cases alcoholic beverages became just part of their wide portfolio of businesses. Examples of firms that became more focused are, as already illustrated, Allied Domecq, Pernod Ricard, Anheuser-Busch and South African Breweries. The high level of competition and stagnation of consumption in many product categories influenced this trend. But most important of all, this was a way for firms to eliminate costs associated with these investments where both the physical and knowledge linkages were weak or non existent. This concern for taking advantage of physical and knowledge linkages even led Allied to focus essentially in the wines and spirits businesses. In 1996 it sold virtually all its food manufacturing activities and it also divested from the beer business selling in 1996 its stake of Carlsberg-Tetley brewing joint venture in the UK to Bass, which in 1997 had to sell it to Carlsberg upon orders from regulators. This joint venture had been set up in 1992 to implement large-scale distribution operations in the country. Carlsberg owned 50 per cent of the company, named Carlsberg-Tetley, and provided Allied pubs with beer, through a prearranged contract.

Examples of firms that during the 1990s increased their investments in other businesses are Louis Vuitton Moët Hennessy, Seagram Whitbread and Bass. From all these firms, LVMH was the only which by the beginning of the twenty first century still operated in the alcoholic beverages industry independently. Since the late 1980s it intensified its investments in the perfumes industry, leather goods and fashion and in 1996 acquired DFS (Duty Free Stores), the US-based world leader in luxury goods sales to international travellers, which then became a major distributor of LVMH products. Here the linkage involves not only marketing knowledge in term of the general management of brands and distribution but also in terms of knowledge about specific markets such as of how to do business in the Far East. The strong linkages of the distribution of apparently such different products is related to the fact that the kind of alcoholic beverages produced by LVMH are premium priced and for that reason may use the same distribution channels and address the same kind of customers as those in their fashion businesses (for example, Duty Frees).

In the 1980s when the beer market was sluggish, many brewers diversified into other leisure and related activities. For example Bass traditionally a brewing and pubs retailing business, entered in the hotel and restaurants businesses with the acquisitions of Crest Hotels. Later in the 1980s they sold this business and acquired, instead Holiday Inns International. Bass also invested in the leisure business with the acquisition of Coral Social Clubs, British American Bingo Inc., biotechnology and bars developments, among other businesses. Whitbread traditionally a brewing and wholesaling business, in the 1980s diversified into the restaurant sector by building a chain of Beefeater Steak Houses and forming a joint venture with Pepsi-Co - Pizza Hut. It also had a small wines, spirits and soft drinks business which was sold to Allied (Hiram Walker) in 1992.

Seagram had made a major investment in the film and entertainment industry in the 1990s. Since then the alcoholic beverages business lost important in the overall activity of the firm. Although one of the CEOs had a personal interest in this business since 1967 (when Seagram acquired Sagittarious Productions, an investment which did not turn out to be very successful), it was only in the 1990s with the acquisition of MCA in 1995 and also the investment in the share capital of Time Warner, that the entertainment business became their major source of revenue (Bronfman, 1998). Seagram ended up being acquired by Vivendi, which in 2002 sold the alcoholic beverages business to Diageo and Pernod Ricard.

Geographical markets

Over time as firm size expanded and knowledge accumulated, there was an increasing involvement in foreign markets by the world's largest firms in alcoholic beverages (Pearce, 1987). Figure 3 provides a ratio of geographical diversification for some of those firms between 1960 and 2001. This ratio considers the percentage of sales generated outside the continent of origin of the firms. This figure considers the continent of origin rather than the country of origin due to lack of systematic data.

For that reason this figure does not illuminate the initial steps of internationalisation of firms, which usually tend to take place in closer markets both geographically and culturally.

Insert: Figure 3 - Percentage of sales generated outside the continent of origin of the firm, 1960-2000

Despite the fragmentation of the industry, many leading alcoholic beverages firms were already in advanced stages of internationalisation during the 1960s and 1970s, generating more than 30 per cent of their sales in foreign markets, as illustrated by Figure 3. Examples of that are the British firms Distillers Company, IDV and Guinness, each of which set up operations in other continents in colonies from their countries' empires. Apart from that many MNEs, despite producing their beverages in their domestic markets or continent of origin, had a high level of exports. For example Moët & Chandon and Hennessy, the predecessor companies of Moët-Hennessy, the world leaders in the production of champagne and cognac, were internationalised as early as the eighteenth century (Butel and Huetz de Lemps, 1999; Cullen, 1998; Debois-Thibault, 2000). However the foreign direct investment of the newly merged firm started essentially from the 1970s in response to tariff barriers imposed to trade in countries such as Argentina and Brazil.

The careful analysis of Figure 3 shows that the spirits and beer firms internationalised earlier than the wine firms (for example Pernod Ricard which apart from spirits also has an important wine business). Although European wine firms had naturally been selling in the European market for a long time.

Two main reasons explain the earlier internationalisation of beer and spirits firms. On the one hand, they had products that were easily branded and which did not vary significantly when produced in different places and in different years. In contrast, wine producers (at least the European firms) had difficulties in branding their beverages as the vulnerability to the quality of the crops made it difficult to produce beverages with the same characteristics every year. Consequently, consumers could not only rely on the name on the bottle, but had to take into account the year in assessing quality. And on the other hand, spirits and beer firms had products that were drunk by consumers who tended to have a higher level of income and for that reason had more 'global' tastes. By internationalising very early, these firms had in fact an important role in creating habits of alcohol consumption and in educating consumers in markets such as the Far East, where alcohol consumption was traditionally negligible (Lopes, 1999).

From the 1980s there was a clear shift in the diversification strategies of firms. The percentage of sales generated in markets inside the continent of origin of the firm decreased even further. The internationalisation of firms during this period, not only included mergers and acquisitions of other firms, producers of alcoholic beverages, but also of former distributors. These investments were not only directed at the European market, but also at emerging markets such as Asia, South America and Central Europe where there existed a potential for further growth of consumption of alcoholic beverages. By making these investments in foreign markets firms were able to apply excess production capacity and marketing knowledge.

The only firm which as illustrated by Figure 3 increased it percentage of sales in the continent of origin is Heineken. While in 1990 the European market accounted for 76 per cent of the total sales of the firm, by 2000 it corresponded to around 90 per cent.[12] This reflects the traditionally high level of competition and fragmentation of the European market, and with the opportunities that had emerged since very early in unexploited markets in the Far East, Africa and also in the lager high premium beer market in the US. Although the firm had invested in different European countries since World War II, it was essentially from the 1990s that Heineken entered actively in this market, by acquiring large local firms. In 1996 it acquired two important brewers in France (Fischer and Saint-Arnault), thereby entering a foreign market which by the beginning of the twenty first century was Heineken's biggest market, and one in Italy, Birra Moretti, which made Heineken Italia a market leader.[13]

In contrast with the European firms, the largest US and Japanese beer and spirits firms remained very concentrated in their local markets.[14] For example the very low level of internationalisation of Brown Forman is partly related to the large size of the US market, and also to the firm's strategy of owning very few distribution channels outside the US.[15] Its mergers and acquisitions in foreign markets were in firms such as Bushmills Irish Whisky (acquired in 1967). Brown Forman relied instead on alliances with multiple partners, in particular with other leading MNEs in alcoholic beverages to distribute their beverages in different markets. For example it had distributions alliances with UDV and LVMH to

12 Heineken, *Annual Reports and Accounts* (1990, 2000).

13 Heineken, *Annual Report and Accounts* (1996).

14 For lack of systematic data these firms are not included in Figure 3.

15 Brown Forman is not included in Figure 3 due to lack of systematic data.

distribute is beverages in Italy, Denmark, Hong-Kong, Malaysia, Singapore and South Korea. It had a different alliance with Seagram to distribute in France and Singapore. In the UK it had an alliance with IDV, in Portugal with Martini and in Germany it used Bacardi's distribution channels.[16]

The role of marketing knowledge linkages

Apart from looking at products and geographical markets it is also possible to analyse firms as portfolios of resources such as marketing knowledge. Although all these approaches have many similarities (such as those related with the management of the firms' portfolios of products or resources) they may highlight different growth avenues (Wernerfelt, 1984). Marketing knowledge can be easily transferred across different activities within the firm even if the products involved are technically unrelated and have completely different requirements on the production side. For that reason, marketing knowledge linkages may provide a fundamental explanation in the analysis of relatedness between businesses which operate in distinct industries, and where there seems to be no apparent relatedness in terms of products, geographical markets or complementarity of activities (such as vertical integration).

In order to analyse the relatedness between the different activities of the world's largest firms in alcoholic beverages, Figure 4 provides detailed evidence of the businesses in which they operated. It highlights which is the country of origin of each firm, its size (measured in current US$ in 2000), the type of alcoholic beverages businesses it is involved as well as other non-alcoholic beverages businesses, and the relative importance of each of these businesses in the total sales of the firm in 2000. It also characterises each firm in terms of its product/business relatedness strategy (as defined in the first section of this paper), and highlights the country of operation of the non-alcoholic beverages businesses. For that purpose

[16] International Wine and Spirit Record, 'Mergers and Acquisitions 1992', (London, 3 December, 1992).

it distinguishes two major categories of geographical diversification strategies by these firms into non-alcoholic beverages businesses: the strategies mainly focused in domestic market and the strategies mainly focused on the global market.

Several different patterns emerge from the analysis of Figure 4. The first concerns the diversification strategies followed by firms within the alcoholic beverages business (beer, spirits and wines). The second is related to the types of non-alcoholic beverages businesses they were diversified into. And the third relates to the countries of origin and operation of these non-alcoholic beverages businesses.

Insert: Figure 4 - World's largest firms in alcoholic beverages 2000

Within alcoholic beverages, the strategies of the world's largest firms varied. Some only operated in one single business producing and distributing either beer, spirits or wine. Others produced some beverages like wines and spirits and distributed all the three categories of alcoholic beverages including beer. From all the possible combinations between these beverages and the production and distribution, the less common is the one that involves firms producing spirits and beer simultaneously. The exceptions are Diageo, which produces Guinness beer and in and also spirits such as brands such as Smirnoff vodka, and Johnnie Walker and J&B Scotch whiskies, and Suntory very famous for its Japanese whisky such as Hibiki and Yamasaki and also for its Suntory beer. This issue of the diversification within alcoholic beverages is analysed in more detail in the next section of this paper.

The second major pattern that emerges from the analysis of Figure 4 shows that the diversification strategies that predominated among the world's largest firms by 2000 were either strategies of no or low diversification and strategies of high diversification. Firms were either refocusing on alcoholic beverages and taking advantage of both product and knowledge linkages, or they were internalising essentially knowledge linkages (and in some cases also physical linkages in distribution, depending on the market of operation of the firm).

While product and knowledge linkages of firms with no diversification or low diversification are easy to trace, as they tend to occur at all levels of the value added chain of different businesses, in highly diversified firms the efficiency rationale is much less easy to see. Sometimes linkages do not even exist, highlighting the presence of conglomerates rather than diversified firms.

Figure 5 provides a summarised analysis of the linkages between alcoholic beverages and the other businesses to where the world's largest firms in alcoholic beverages had diversified by 2000. In order to avoid bogus quantification this figure identifies four types of linkages: strong linkages (+++), medium linkages (++), weak linkages (+) or non existent linkages (0). When the strength of the linkages created between firms through internalisation is not clear, depending on the situation of the firm, that appears illustrated on the figure as a succession of alternative signs (+++/++), (++/+) or (+/0).

The classification of the linkages between businesses into four categories draws on the analysis of various activities that form the value added chains of different industries. Basically these value added chains are compared in terms of possible physical or knowledge linkages in research and development, production, marketing/branding and logistics of distribution. For example if two businesses share the same principles and methods of advertising, benefit from the same market research, rely on the same marketing department, and use the same warehouses and trucks to transport products, as well as sales force, and also target the same kind of customers, then businesses are considered to have strong linkages (+++). On the other hand if two businesses share none of these kinds of physical or knowledge linkages, then they are considered to have non-existent linkages (0). It is the nature and incidence of the linkages that may exist between firms that explains the internalisation of intermediate product markets and consequently the boundaries of alcoholic beverages firms (Kay, 1997).

Insert: Figure 5 - Valued added chain relatedness between the businesses of the world's largest MNEs in alcoholic beverages

From the analysis of Figure 5 it is clear that most of the businesses, despite being apparently unrelated and belonging to different industries tend to have linkages with the alcoholic beverages industry, even if they are weak (+) or uncertain (+/0). Those linkages tend however to be stronger between businesses within the same SIC (Standard Industrial Classification)[17] class as alcoholic beverages. This numerical system developed by the federal government for classifying all types of activity within the US economy is very useful for illustrating product relatedness as it relies essentially on the outputs produced by firms. However it does not account for those situations where they may exist linkages at other levels of the value added chain of industries such as in marketing or distribution. The characteristics of these other businesses into which alcoholic beverages firms diversified – essentially related to lifestyle and leisure – point to one common linkage with the alcoholic beverages industry which is marketing knowledge, as the particular competencies of firms are roughly the same as those required in alcoholic beverages (Nayar, 1992). This is why these businesses to which alcoholic beverages firms diversified offer potential economies of scale and scope in marketing such as those in the branding of products or the distribution costs of the final products to customers.

While marketing knowledge may explain most of the diversification of firms, production knowledge and common inputs may explain diversification into businesses such as pharmaceuticals and biotechnology, as it is possible to apply the expertise used in the brewing

[17] Office of Management and Budget, *Standard Industrial Classification Manual* (Washington: US Government Printing Office, 1972).

and distilling applications in those industries. There are still some other cases of firms where neither physical nor knowledge linkages seem to exist between alcoholic beverages and the business to which the firm diversified. An example is Fortune Brands diversification into home and office products in 1970, which include respectively kitchen and bath cabinets, and binders, report covers, labels, and storage boxes among other items. Despite the claim by the firm that there exist marketing linkages between all these businesses as they are all branded products,[18] the image transmitted by those brands is completely different. The lack of linkages between the businesses in part explain the low value the non-alcoholic beverages businesses add to the total profitability of the firm.[19]

Another business to which several alcoholic beverages firms diversified, but where the level of physical and knowledge relatedness is very low is tableware and glassware. The two leading Danish brewers Carlsberg's and Tuborg (acquired by Carlsberg in 1970), always had interests in this industry since the beginning of their operations in the nineteenth century. In 1985 this investment is however increased with the merger of Royal Copenhagen with Kastrup-Holmegaard Glasvaerker A/S, where Carlsberg interest in this new firm increased to 73 per cent.

In those cases where firms strategies lack coherence or where there are no linkages, it is more cost efficient for firms to dispose these businesses (Dosi *et al*, 1992).

Some studies argue however that such investments may be financially oriented (either because the management of the firm though they had the necessary knowledge to turn the business around and sell it subsequently obtaining a profit, or because they envisaged stock market acceptance of the firm) (Ditrichsen, 1972). In other cases conglomerate diversification may also be connected with managerial incentives for diversification (such as managerial risk

18 Fortune Brands, *Annual Report and Accounts* (2000)

19 Ibid.

reduction, and desire for increased compensation), and the lack of adequate corporate governance mechanisms to minimise agency costs where managers are the agents and shareholders the owners (Jensen and Meckling, 1976). However, evidence suggests that governance structure mechanisms such as board of directors, ownership monitoring, executive compensation, and the market for corporate control may limit managerial tendencies to over diversify (Hoskisson and Hitt, 1990).

The kind of businesses into which firms diversified and the strength of the linkages formed with the alcoholic beverages businesses are also related with the country of origin and operation of those non-alcoholic beverages businesses. As illustrated by Figure 5, while diversification into food and beverages (in the same SIC class as alcoholic beverages) may have a global scope, in the other SIC classes the scope of diversification of alcoholic beverages firms into these businesses tends to be essentially domestic. Food and drinks are among the most highly branded sectors in the consumer goods industry. While food is often a regional business many spirits, beer and also wine brands have a built-in capacity for international sales. However food may also have a global scope. Fast food chains such as Diageo's Burger King are an example of that. This firm was a conglomerate (as alcoholic beverages only accounted for around 43 per cent of the total business of its activity in 2000). Apart from its wines and spirits business (UDV), Diageo also had Pillsbury, the US food manufacturer sold in 2001 to General Mills; Guinness brewing, an international brewer, and Burger King, a fast food chain.

The evidence provided about the diversification strategies of the world's largest firms in alcoholic beverages in 2000 points to the fact that the weaker the linkages between the firm and the businesses they chose to diversify, the more domestic these investments tend to be. The presence of high transfer and communication costs associated with risk and uncertainty certainly help explain such pattern of diversification into the non-alcoholic beverages business.

4 Cycles of diversification within alcoholic beverages

Despite the vast array of paths followed by the world's largest firms in alcoholic beverages between 1960 and 2000 it is possible to find common patterns of evolution, indicating the presence of cycles of diversification within this industry. The origins of firms in wines, spirits or beer, and their distinct cost structures and path dependent processes in the accumulation of marketing knowledge, provide an important base for understanding these cycles. Figure 6 identifies the paths of diversification. In this figure firms were categorised in four groups according to their overall diversification strategies by the end of the century. For those cases of leading firms which did not survive until 2000 this categorisation was based on diversification strategies they had by the time they were merged or acquired. The four categories introduced in the beginning of this paper are: no diversification/low diversification, medium diversification, high diversification and conglomerate or unrelated diversification.

For each firm, Figure 6 highlights which were the types of alcoholic beverages (beer, spirits and wines) they operated during the period of analysis. When new types of beverages were added to the portfolio of products, that appears highlighted on a time line. Investments in production and distribution are also distinguished from investments in distribution only. While production and distribution activities appear symbolised as (wines, spirits or beer), investments exclusively in distribution appear symbolised in the same way with an added (d) for 'distribution' after the type of beverage.

As illustrated by Figure 6 there is a relatively high number of brewers which by the end of the twentieth century were not diversified or had a low level of diversification. The firms which originally operated in the spirits business, over time tended to invest in wines (see Rémy Cointreau and Bacardi). The ones that did not, were not able to survive independently. A similar trend occurred with wines firms. Over time they invested in spirits with the wines business remaining the dominant activity.

Insert: Figure 6 - Patterns of diversification within the alcoholic beverages industry

While spirits firms only tended to diversify into wines, and wines firms essentially diversified into spirits, the brewers remained concentrated, yet invested in wines and or in spirits. Two of the world's largest brewers that remained concentrated in the beer business – Anheuser-Busch, and Adolph Coors - are of US origin. This is related to the high level of vertical integration and to the government regulations concerning the different activities of the value added chain of firms including, regulations restricting what beverages can be distributed in what channels of distribution (McGowan, 1997). The increasing government regulations on alcoholic beverages in the 1980s and 1990s led the large brewers to make the decisive commitment to stay in the beer industry and divest themselves from other non-beer related businesses. For example in the early 1990s Anheuser-Busch divested from businesses such as the St. Louis Cardinals Baseball Team Inc. Eagle Snacks and Campbell Taggart.

The trend towards globalisation of the industry enabled firms to grow through internationalisation either by setting up greenfield investments, forming alliances or merging and acquiring other firms. Heineken for example moved from beer production and distribution to include also wines and spirits distribution in the 1970s when it acquired Bokma distillery, producer of one of Holland's most popular gins.[20] Other examples are the other Japanese firms Kirin and Asahi Brewery which were traditionally brewers and diversified to spirits and wines. Kirin for example first entered the hard liquor business through its joint venture with Seagram for the production of Japanese whisky and also distribution of Seagram's spirits. In 1989 Kirin invested in the wine business with the acquisition of Napa Valley Raymond Vineyards in California and in the 1990s it intensified these interests in the wine business with other acquisitions, such as that of Lion Nathan in 1998, an Australian brewer which also had large

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[20] Heineken, *Annual Report and Accounts* (1970, 1988).

interests in the wines business.

Allied is a particular case of a firm which between 1960 and 2000 operated in the full range of alcoholic beverages businesses. When it was formed in 1961 it was a British vertically integrated brewer. During the 1960s, anticipating changes in incomes and in life styles and habits (where for example women started drinking more alcoholic beverages) Allied moved into processed wines. It acquired Showerings in 1968 (which owned Babycham and Harvey's Bristol Cream). In 1976 Allied entered in the spirits business with the acquisition of Teacher's a Scotch whisky producer. By the 1980s the spirits business had achieved such high importance in the total activity of the firm that Allied started to divest itself from the brewing business, the last brewing interest sold being the Carlsberg-Tetley joint venture in the UK which they disposed of in 1996.

Firms with medium diversification include brewers like Kirin which diversified either into the production and distribution of wines and spirits, or into distribution only. The Brazilian firm Ambev, formed in 2000 as a result of the merger between two long established and leading domestic firms - Companhia Cervejeira Brahma and Companhia Antarctica Paulista, concentrated on the beer business.

Brown Forman, another medium diversified firm, moved from spirits production and distribution, to wines distribution in the late 1960s with the acquisition of the distribution rights for the California sparkling wines Korbel and Bolla & Cella during the 1960s. It is only in 1991 with the acquisition of premium California wine maker Jekel Vineyards and the alliance with Fontanafredda, a producer of Italian wines, that licensed the rights to market and distribute their wines that Brown Forman became a major player in the wine industry.

The firms classified as being highly diversified also tended to be those that during the period of analysis most diversified within the alcoholic beverages industry. In some cases they kept their original business as their core activity. In other cases the original alcoholic beverages business lost importance, being substituted by another alcoholic beverages business (for example, in the case of Grand Metropolitan the beer business was discontinued in favour of wines and spirits)

The only firm which by the end of the century was part of a conglomerate was Miller Brewing acquired in 1970. However, and as already mentioned, that situation changed in May 2002, when South African Breweries acquired Miller from Phillip Morris. Over time it remained essentially concentrated in the beer business, although in the 1980s Phillip Morris also made investments in the Australian wine Lindemann. This strategy of concentrating in beer as the only alcoholic beverages business is actually very similar to that followed by the other leading US brewers Anheuser-Busch and Coors. Figure 7 summarizes the alternative cycles of diversification within alcoholic beverages followed by firms originally producers of beer, wines and spirits, between 1960 and 2000.

Insert : Figure 7 - Cycles of diversification in alcoholic beverages

Two main patterns come out from the analysis of this figure. One is that while beer firms expanded into wines and spirits (in some cases even divesting from beer), spirits firms only invested in wines and wines firms only invested in spirits. The exceptions are Diageo and Suntory, which were operating in simultaneous in wines, spirits and beer. While for Diageo this exceptional cycle may be explained by the characteristics of its beer business, which always relied essentially on marketing links rather than physical links (a strategy quite distinct from other brands), in Suntory the linkages between the three businesses are also based on the economies of scope in distribution (as in Japan, wines, beer and spirits share the same channels of distribution). However, having been a late entrant in the industry, this business was never profitable. The rationale for keeping the business is related with the need of firms in Japan for having a wide portfolio of brands not only in order to obtain economies of scale and scope in distribution but also not to create holes in the market that would be filled by competitors.[21]

Other cases of spirits firms which invested in the brewing business and did not succeed are Schenley and Heublein. Schenley for example acquired Blatz Brewing Company in 1944 and sold it in 1958 to Pabst, as the brewing industry was started to consolidate and firms were starting to distribute nationally, and Schenley was not able to achieve economies of the scale and scope that allowed the firm to achieve national distribution in the beer business.[22]

Another interesting feature in the cycle of firms illustrated by Figure 7 concerns the sequence of diversification they followed within the alcoholic beverages industry. The first firms to diversify were the brewers. They first went into processed wines (such as port and champagne), then they invested in spirits and finally in wines. By the end of the century still wines, especially those from the New World, were easily branded. One explanation behind this cycle resides on the knowledge of beer, spirits and wines firms about the branding of beverages. Although there exist branded wine beverages since the mid nineteenth century (Duguid, 2000), beer was the first alcoholic beverage to be branded in a standardised form. That is illustrated for example with the case of the England where Bass was the first firm to make use of the Trade Mark Registration Act of 1875 to protect its red pyramid trademark (Jorgensen, 1994). Spirits are also easily branded beverages, as in most cases it is possible to obtain a standard product. That is why it is easier to go from beer or spirits into wines.

It was the accumulated knowledge in marketing that allowed brewers to develop into other beverages businesses which they believed could share the same marketing knowledge. That is why firms originally producing wines tended to remain focused due to their lack of marketing knowledge to manage brands. Those that diversified from wines into other alcoholic beverages

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21 Interview with Yoshi Kunimoto, Executive Vice President of Suntory Allied and Kunimasa Himeno, Manager of International Division of Suntory; both in Tokyo, 16 September 1999; and interview with Kozo Chiji, Manager of the Corporate Planning Department, Tokyo, 16 September 1999.

22 Schenley, *Annual Reports and Accounts* (1963).

entered in spirits production or beer distribution, but wines remaining their core business.

By the end of the century as the practice of branding wines became increasingly more frequent, especially in wines from the New World (where brands are not connected with a particular crop), many large MNEs started making significant investments in the wines business. This trend occurred not only among brewers but also among large spirits firms with excess resources to be applied in new ventures. Examples are the acquisition by Foster's Group, the Australian leader in brewing, of the Australian wine firms Mildara Blass and Rothbury Wines in, respectively, 1995 and 1996. In spirits Allied acquired Montana Wines in New Zealand in 2001.

The cycles of diversification in alcoholic beverages are, to a certain extent, also visible in he globalisation and concentration of the three drinks sectors. While the spirits industry became global since the 1980s, the wine industry was starting to concentrate and globalise in the beginning of the twenty first century. The beer industry, despite producing and trading the most easily branded alcoholic beverage, due to the high level of distribution costs that characterise the industry, remained until recently concentrated only at a regional level. As in wines, it is only recently that the industry started to globalise and concentrate on a international scale,

Another explanation behind the cycles of diversification resides in the requirements of firms to obtain economies of scale and scope in production and distribution. Economies of scale and scope in the production of wines and spirits are not so relevant as in beer due to the lower value added generated in the production process in the beer industry. That is why it is only cost efficient for firms to be in the beer business if the firm is able to obtain economies of scale and scope in production as well as marketing.

Despite the difficulties that exist in obtaining comparable information about the cost structures for wine, spirits and beer it is possible to identify the major differences that characterise the value added chains of these three drinks sectors.[23] They help explain not only the cycles of diversification in this industry, but also the timing in which they took place. From the 1960s, despite the major transformations in production and in R&D, it was in marketing (in particular in the management of brands) and in distribution that those changes were most significant (Lopes, 2002; Espey, 1985; Craig, 1995).

Historically, on average beer travelled less than spirits or wines because its transport costs as a percentage of its unit value (due to its high level of water content of over 90 per cent) were higher, and also because it was easily perishable.[24] Over time, as technologies developed, transportation costs of beer decreased, as firms were able to achieve economies of scale and scope associated with the logistics of transportation. Distribution costs in spirits and wines also decreased, but that also varied depending of the kind of beverage.[25] For example in spirits such as gin which can be produced anywhere as it is not dependent on any asset specific assets such as soil or climate, it was possible for firms to lower their distribution costs by investing in production facilities in foreign markets.

By the 1990s the distribution systems for beer, wines and spirits had converged. The revolution in distribution that had taken place since the late 1970s and the globalisation of markets explain to a great extent such changes. As a result, many large MNEs created central warehouses, from where they managed the logistics of distribution of their products. They also had incentives to enter in other alcoholic beverages in order to widen their portfolios of

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23 Even within the same sector there exist high differences in the cost structure of beverages. For example the production costs of a Bordeaux wine such as Chateau d'Yquem (one of the world's most expensive wines in the world owned by Bernard Arnault, also the major shareholder of LVMH) are certainly much higher than those of a standard wine like Ernest & Julio Gallo. Even within the same firm it is possible to find great differences in terms of the cost structure of the different beverages.

24 Federal Trade Commission: Bureau of Economics, *The Brewing Industry* (USA, Dec. 1978).

25 For examples of cost structures per bottle in spirits and wines see: for spirits, ABN AMRO(1999), p.23; for wines, Harper Trade Journals (1997); Conseil Interprofessionnel des Vins du Languedoc et Syndicat des Vins de Pays d'Oc, (2001).

beverages. In sophisticated markets such as those in Western Europe frequently stockholding and distribution appeared together as the same function, as firms were able to send the beer to the outlets straight away without any stockholding. Apart from the cost advantages for the firm, these changes made it possible to get the beer to the final consumer in fresher and better conditions. In some countries like the US in many States regulations did not allow beer to be distributed through the same channels as spirits and wine, and for that reason there were no incentives for brewers to diversify into the wines and spirits business.[26]

5 Conclusion

This paper on multinational related and unrelated diversification in alcoholic beverages showed that a combination of physical linkages and knowledge linkages explains the diversification strategies of the leading multinational firms in the alcoholic beverages industry. First, it defined the concept of related diversification used in this study. This includes not only investments made by firms in products similar to those where it is already operating, but also investments into new geographical markets, in complementary activities (through vertical integration) and in businesses which despite not sharing the same physical resources share the same knowledge. Subsequently it discussed the applicability of the 'Systems View' in this study on the diversification strategies of MNEs in the global alcoholic beverages industry, and relevance of processes of transfer as well as accumulation of marketing knowledge.

After a detailed analysis was provided about the shifts in the diversification strategies of firms over time, it was shown that in the 1960s most firms had little or no diversification, being that diversification most frequently related with linkages in physical assets. As firms accumulated marketing knowledge, diversification into non-alcoholic beverages businesses tended to increase, because firms were able to take advantage of the efficiencies provided by

26 Interview with John the Lucca, President of the California Wine Institute, San Francisco, 20 March 2001.

knowledge linkages. However, by the end of the century the high number of low diversified alcoholic beverages firms reflected the importance that product as well as knowledge linkages had on the efficient operation of firms and their long-term survival.

Another trend relates to geographical diversification. Internationalisation tended to take place essentially within the alcoholic beverages business. In contrast, diversification into other businesses essentially took place in the domestic markets of the investing firms. The lack of very strong physical and knowledge linkages, and the higher risk involved in international investment, explain why firms did not combine strategies of unrelated diversification with geographical diversification. The exceptions were the investments in the foods and soft drinks industry, which in some cases were globalised.

Within the alcoholic beverages industry, there were cycles of diversification followed by firms. While beer firms expanded into wines and spirits, spirits firms only invested in wines, and wines firms invested in spirits but modestly. Another interesting feature of these cycles concerns the sequences of diversification followed by firms, where it is shown that the last beverage to become the target of multinational investment was wine. The origins of firms in wines, spirits and beer, and their distinct cost structures and path dependent processes in the accumulation of marketing knowledge provided an important base for understanding these cycles. Again this demonstrates the importance that the flows of knowledge accumulated in the marketing and management of brands have in the growth and survival of multinational firms in alcoholic beverages.

Figure 1 - Explaining diversification in alcoholic beverages using a Systems View

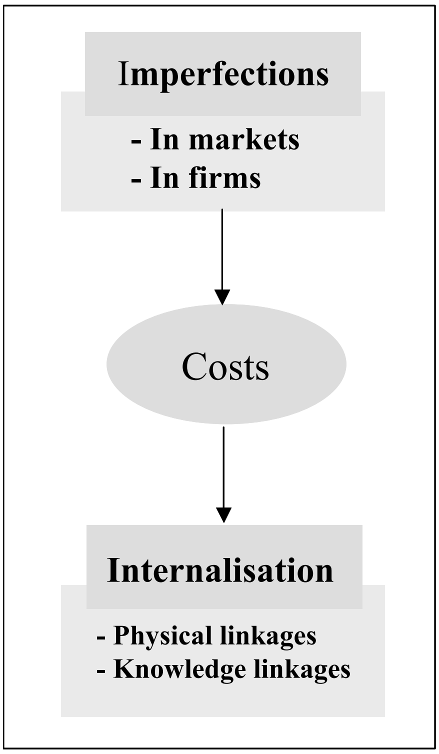


Figure 2 - Percentage of sales in alcoholic beverages to total sales, 1960-2000

Year	Distillers	IDV	Grand Metropolitan	Diageo	Guinness	Allied	Hiram Walker	Seagram	Pernod Ricard	Heineken	LVMH	Anheuser Busch
Origin	**UK**	**UK**	**UK**	**UK**	**UK**	**UK**	**CAN**	**CAN**	**FRA**	**NL**	**FRA**	**US**
1960	80	100	0	-	n/a	n/a	n/a	100	n/a	n/a	-	n/a
1961	82	100	0	-	91	n/a	n/a	100	n/a	n/a	-	n/a
1962	88	100	0	-	94	n/a	n/a	100	n/a	n/a	-	n/a
1963	86	100	0	-	96	n/a	n/a	100	n/a	n/a	-	n/a
1964	83	100	0	-	98	n/a	n/a	100	n/a	97	-	n/a
1965	81	100	0	-	92	n/a	n/a	100	n/a	96	-	n/a
1966	n/a	100	0	-	92	n/a	n/a	100	n/a	94	-	n/a
1967	n/a	100	0	-	89	n/a	n/a	100	n/a	95	-	n/a
1968	91	100	0	-	87	n/a	n/a	100	n/a	96	-	n/a
1969	91	100	0	-	84	n/a	n/a	100	n/a	78	-	n/a
1970	90	100	0	-	84	n/a	n/a	100	n/a	80	-	n/a
1971	89	100	5	-	85	n/a	n/a	98	n/a	84	-	n/a
1972	89	100	33	-	85	n/a	n/a	98	n/a	86	-	n/a
1973	88	100	34	-	81	n/a	n/a	98	n/a	84	-	n/a
1974	88	100	29	-	81	n/a	n/a	97	n/a	86	-	n/a
1975	86	-	32	-	79	n/a	n/a	94	75	86	-	n/a
1976	86	-	n/a	-	77	n/a	n/a	92	n/a	87	-	n/a
1977	86	-	n/a	-	74	n/a	58	92	n/a	89	-	n/a
1978	84	-	n/a	-	61	58	60	93	n/a	88	-	n/a
1979	84	-	49	-	62	64	62	93	n/a	87	-	n/a
1980	84	-	50	-	64	66	57	88	n/a	88	-	n/a
1981	84	-	57	-	69	70	50	100	n/a	89	-	n/a
1982	83	-	35	-	73	69	43	100	n/a	90	-	98
1983	83	-	43	-	84	67	41	100	n/a	n/a	-	81
1984	67	-	31	-	85	64	-	100	n/a	88	-	83
1985	60	-	30	-	69	64	-	100	n/a	87	-	77
1986	-	-	33	-	73	66	-	100	n/a	87	-	77
1987	-	-	38	-	79	67	-	100	64	87	56	77
1988	-	-	43	-	95	72	-	100	60	87	54	77
1989	-	-	30	-	98	71	-	85	n/a	87	52	78
1990	-	-	24	-	98	75	-	78	64	87	52	76
1991	-	-	28	-	99	77	-	79	n/a	86	53	76
1992	-	-	36	-	100	60	-	78	n/a	n/a	50	76
1993	-	-	42	-	100	59	-	77	53	87	47	n/a
1994	-	-	43	-	100	56	-	76	49	n/a	42	n/a
1995	-	-	41	-	100	63	-	76	48	86	38	n/a
1996	-	-	40	-	100	62	-	72	n/a	n/a	37	n/a
1997	-	-	-	44	-	57	-	74	67	n/a	26	82
1998	-	-	-	44	-	56	-	48	68	n/a	27	82
1999	-	-	-	42	-	51	-	39	70	87	26	83
2000	-	-	-	60	-	88	-	39	69	85	20	82

Figure 3 - Percentage of sales generated outside the continent of origin of the firm, 1960-2000

Year	Distillers	IDV	Grand Metropolitan	Diageo	Guinness	Allied	Hiram Walker	Seagram	Pernod Ricard	Heineken	LVMH	Anheuser Busch
Origin	**UK**	**UK**	**UK**	**UK**	**UK**	**UK**	**CAN**	**CAN**	**FRA**	**NL**	**FRA**	**US**
1960	n/a	n/a	n/a	-	n/a	n/a	n/a	n/a	0	n/a	-	n/a
1961	n/a	n/a	n/a	-	n/a	n/a	n/a	n/a	0	n/a	-	n/a
1962	n/a	n/a	n/a	-	n/a	n/a	n/a	n/a	0	n/a	-	n/a
1963	n/a	n/a	n/a	-	n/a	n/a	n/a	n/a	0	n/a	-	n/a
1964	n/a	n/a	n/a	-	n/a	n/a	n/a	n/a	0	n/a	-	n/a
1965	n/a	n/a	n/a	-	9	n/a	n/a	n/a	0	n/a	-	n/a
1966	n/a	29	n/a	-	n/a	n/a	n/a	n/a	0	n/a	-	n/a
1967	36	30	n/a	-	16	n/a	n/a	n/a	0	n/a	-	n/a
1968	44	30	0	-	19	n/a	n/a	n/a	0	n/a	-	n/a
1969	48	30	4	-	28	n/a	n/a	n/a	0	n/a	-	n/a
1970	47	30	1	-	31	n/a	n/a	n/a	0	n/a	-	n/a
1971	46	30	1	-	21	n/a	n/a	n/a	0	n/a	-	n/a
1972	46	20	3	-	19	n/a	n/a	n/a	0	n/a	-	n/a
1973	46	25	4	-	17	n/a	n/a	n/a	0	n/a	-	n/a
1974	44	28	6	-	20	n/a	n/a	n/a	0	n/a	-	n/a
1975	42	-	5	-	26	n/a	n/a	n/a	0	n/a	-	n/a
1976	39	-	n/a	-	n/a	n/a	n/a	n/a	n/a	n/a	-	n/a
1977	37	-	n/a	-	21	n/a	n/a	n/a	n/a	n/a	-	n/a
1978	40	-	n/a	-	20	4	n/a	23	n/a	n/a	-	n/a
1979	38	-	6	-	22	11	n/a	26	n/a	n/a	-	n/a
1980	39	-	11	-	18	11	n/a	30	n/a	n/a	-	n/a
1981	40	-	23	-	24	11	15	32	n/a	n/a	-	n/a
1982	44	-	27	-	21	12	14	31	n/a	n/a	-	n/a
1983	45	-	31	-	20	14	12	32	n/a	n/a	-	n/a
1984	45	-	36	-	20	17	12	29	n/a	n/a	-	n/a
1985	52	-	38	-	19	18	11	32	n/a	n/a	-	n/a
1986	-	-	34	-	27	16	-	36	n/a	n/a	-	n/a
1987	-	-	34	-	30	18	-	43	n/a	n/a	52	n/a
1988	-	-	32	-	41	26	-	51	n/a	n/a	56	n/a
1989	-	-	45	-	40	25	-	47	n/a	27	60	n/a
1990	-	-	54	-	39	27	-	47	n/a	24	56	n/a
1991	-	-	56	-	38	24	-	52	n/a	25	51	n/a
1992	-	-	60	-	41	23	-	52	n/a	25	60	n/a
1993	-	-	65	-	44	24	-	55	n/a	27	63	n/a
1994	-	-	69	-	45	26	-	55	20	30	62	5
1995	-	-	67	-	43	28	-	54	19	30	62	6
1996	-	-	69	-	44	24	-	44	n/a	29	61	6
1997	-	-	-	66	-	19	-	41	n/a	31	70	7
1998	-	-	-	65	-	21	-	43	19	29	63	6
1999	-	-	-	64	-	23	-	49	19	10	63	6
2000	-	-	-	65	-	43	-	51	19	10	66	6

Figure 4 - World's largest firms in alcoholic beverages 2000

Multinational Enterprise	**Country of origin**	**Total Net Sales 2000** (millions of current US$)	**Company diversification**	**Alcoholic Beverages (%)**	**Other Businesses (% of sales)**	**Other businesses (country of operation)**
Allied Domecq	UK	3,945	Low diversification	- wines and spirits (88%)	- quick service restaurants (12%)	global market
Ambev	BRA	2,706	Medium diversification	- beer (79%)	- soft drinks (21%)	domestic market
Anheuser-Busch	US	12,262.8	No diversification	- beer (82%)	- packaging (10%) - other (8%)	domestic market
Asahi Breweries	JAP	12,982	Low diversification	- wines, spirits, beer (81%)	- soft drinks and food (16%) - others (3%)	domestic market
Bacardi	CB/BER	2,800	No diversification	- spirits and wines (100%)		
Brown Forman	US	2,134	Medium diversification	- wines and spirits (72%)	- luggage and chinaware (28%)	domestic market
Carlsberg	DEN	4,272	Low diversification	- beer (99%)	- other businesses (1%)	domestic market
Adolph Coors	US	2,414	No diversification	- beer (100%)		
Constellation Brands / Canadaigua	US	2,340	No diversification	- wines and spirits (73%) - beer (distribution) (27%)		
Diageo	UK	17,996	High diversification	- wines, spirits, beer (60%)	- quick service restaurants (8%) - packaged foods (32%)	global market
E & J Gallo	US	1,650	No diversification	- wines (100%)		
Edrington Group	UK		No diversification	- spirits (100%)		
Fortune Brands/ American Brands	US	5,845	High diversification	- wines and spirits (21%)	- home products (38%) - office products (25%) - golf products (16%)	domestic market
Foster's Group	AUS	5,728	High diversification	- beer (48%) - wines and spirits (20%)	- leisure and hospitality (27%) - other (5%)	Domestic market

Figure 4 (Cont.) - World's largest firms in alcoholic beverages 2000

Multinational Enterprise	**Country of origin**	**Total Net Sales 2000** (millions of current US$)	**Company diversification**	**Alcoholic Beverages (%)**	**Other Businesses (% of sales)**	**Other businesses (country of operation)**
Heineken	NL	8,776	Low diversification	- beer (80%) - wines and spirits (5%)	- soft drinks (11%) - other (4%)	domestic market
Interbrew	BEL	8,659	Low diversification	- beer (98%)	- other (2%)	domestic market
Kirin	JAP	14,669	Medium diversification	- beer (71%)	- soft drinks (20%) - other (9%)	domestic market
LVMH (Moët-Hennessy)	FRA	10,670	High diversification	- wines and spirits (20%)	- fashion and leather goods (28%) - perfumes and cosmetics (18%) - selective retailing (28%) - watches and jewellery (5%) - other (1%)	global market
Phillip Morris (Miller)	US	80,356	Unrelated diversification	- beer (5%)	- tobacco (61%) - food (33%) - financial services (1%)	domestic market
Molson	CAN	1,754	No diversification	- beer and related (100%)		
Pernod Ricard	FRA	4,074	High diversification	- wines and spirits (69%)	- processed fruits (31%)	domestic market
Remy Cointreau	FRA	792	No diversification	- wines and spirits (100%)		
Scottish Newcastle	UK	5,431	Low diversification	- beer (58%) - retail (pub restaurant) (31%)	- leisure (11%)	domestic market
Seagram	CAN	15,686	High diversification	- wines and spirits (39%)	- music (54%) - entertainment and recreation (7%)	global market
South African Breweries	SA	5,424	Medium diversification	- beer (72%)	- other beverages (22%) - hotels and gaming (6%)	domestic market
Suntory	JAP	7,879	High diversification	- wines and spirits (24%) - beer (17%)	- food (44%) - other (15%)	domestic market

Figure 5 - Valued added chain relatedness between the businesses of the world's largest MNEs in alcoholic beverages

(SIC) Other businesses	Beer	Spirits	Wine
SIC 20 Food and Beverages			
Beer	+++	++	+++/++
Spirits	++	+++	+++/++
Wines	+++/++	+++/++	+++
Quick service restaurants	+	+	+/0
Packaged foods	++	+	+
Soft drinks	+++	++	+
Other SIC codes			
Fashion and leather goods	+/0	++/+	++/+
Home and office products	0	0	0
Leisure – music, films	+/0	+/0	+/0
Perfumes	+	++/+	++/+
Watches	+/0	+	+
Tableware and glassware	0	0	0
Pharmaceuticals and biochemicals	++/+	+/0	+/0
Golf products	+	+	+
Tobacco	+/0	+/0	+/0

Legend: +++ - strong linkage; ++ - medium linkage; + -weak linkage;

0 – no linkage; +++/++, ++/+, +/0 – depends.

Figure 6 - Patterns of diversification within the alcoholic beverages industry

	1960-69	1970-79	1980-89	1990-99	2000
No diversification / Low diversification					
Beer:					
- Anheuser-Busch	beer				beer
- Adolph Coors	beer				beer
- Interbrew			beer		beer
- Molson	beer				beer
Spirits:					
- Teacher (acquired in 1975)	spirits	●			
- Arthur Bells (acquired in 1984)	spirits		●		
- Distillers (acquired in 1985)	spirits		●		
Beer => spirits					
- Guinness (merged in 1996)	beer		spirits	●	
Beer => spirits ad wines					
- Heineken	beer	spirits		wines (d)	beer, spirits, wines (d)
- Carlsberg	beer				beer
- Asahi Breweries	beer	spirits, wines (d)	wines		beer, spirits, wines (d)
Beer => processed wines => spirits => (beer) => wines					
- Allied Domecq	beer, processed wines	spirits		(beer), wines	spirits, wines
Wines => spirits					
- R & J Gallo	wines			spirits	wines, spirits
- Constellation Brands	wines			spirits, beer (d)	wines, spirits
Spirits => wines					
- Remy Cointreau	spirits		wines		spirits, wines
- Bacardi	spirits			wines	spirits, wines
- Highland Distillers	spirits			wines (d)	spirits, wines (d)

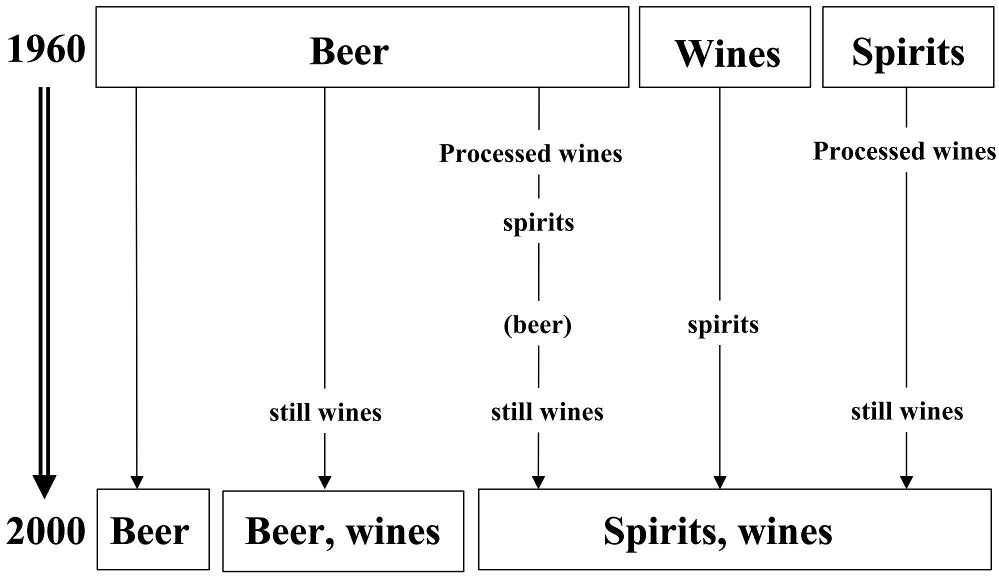
Notes: ● – firm merged or acquired; (d) – distribution; (beer) – divestment from the beer business

Figure 6 (Cont.) - Patterns of diversification within the alcoholic beverages industry

	1960-69	1970-79	1980-89	1990-99	2000
Medium diversification					
Beer:					
- Ambev (formed in 2000)					beer
Beer => spirits and wines					
- Kirin Breweries	beer	spirits, wines (d)	wines		beer, spirits, wines
- South African Breweries	beer			wines	beer, wines
Spirits => processed wines => wines					
- Brown Forman	spirits, processed wines (d)			wines	spirits, wines
High diversification					
Spirits and wines:					
- Pernod Ricard (formed in 1975)		processed wines, spirits			wines, spirits
- Moët-Hennessy (formed in 1971)		processed wines, spirits			wines, spirits
Spirits => wines					
- Seagram	spirits, wines				spirits, wines
- Fortune Brands	spirits			wines	spirits, wines
Beer => processed wines, wines and spirits => (beer)	beer	spirits, wines	(beer)	●	
- Grand Metropolitan (merged in 1996)					
Beer => wines					
- Foster's	beer			wines	beer, wines
Beer , wines and spirits:					
- Diageo (formed in 1996)				beer, spirits, wines	beer, spirits, wines
- Suntory	sprits, wines, beer				spirits, wines, beer
Unrelated diversification					
Beer:					
- Miller (Phillip Morris) (acquired in 1970)		beer			beer

Notes: ● – firm merged or acquired; (d) – distribution; (beer) – divestment from the beer business

Figure 7 - Cycles of diversification in alcoholic beverages



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