2000

An investigation into the drivers of mergers and acquisitions within the spirits and wine industry.

J. Terry. Shields

University of Windsor

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UMI
AN INVESTIGATION INTO THE DRIVERS OF MERGERS 
AND ACQUISITIONS WITHIN THE SPIRITS & WINE 
INDUSTRY

By

J. Terry Shields

A Thesis

Submitted to the Faculty of Graduate Studies and Research

Through the Faculty of Business Administration

In Partial Fulfillment of the Requirements for

the Degree of Master of Business Administration at the

University of Windsor

Windsor, Ontario, Canada

2000

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ABSTRACT

Driven by diminishing returns, the inability to increase the stock price, and the slow development of emerging markets, companies in the spirits and wine industry are seeking partners with whom to merge or acquire to improve their competitive position.

Philip Bowman, Allied Domecq Spirits and Wine CEO, commented to employees of Allied Domecq on December 15, 1999 with the following. “I am aware from meetings around the company over the past two months that the subject of industry consolidation is a very live issue for many of you. I also recognize that the constant press speculation (and speculation it is) can be very unsettling. Therefore, let me set out my position clearly. Given the fragmented and mature nature of the industry in most countries, I believe that it is inevitable that there will be further consolidation at some stage in the future. As the no.2 global spirits & wine company, we could and should play a pivotal role in such consolidation when it happens. It is however essential that we are able to negotiate from the position of greatest strength. My message to you today is therefore simple. Do not let speculation in the media divert you from the tasks at hand - increasing the strength of our brands, delivering enhanced earnings growth and building on the strengths of our existing asset base. We have great brands and a tremendous business. With hard work and focus we can develop Allied Domecq still further for the benefit of our employees and our shareholders. With your support we can make this happen.”

The literature on the drivers of merger and acquisition was reviewed. From this review the drivers identified were related to two merger cases within the industry to test the extendibility of the concepts to the spirits and wine industry. Subsequently, the importance of the variables, based upon the responses of company personnel, was ranked based on their mean scores. The respondents assessed the suitability of merger and acquisition partners based on the importance of drivers identified.

This study has enabled the continuance of research on merger and acquisition strategies for Allied Domecq within the spirits and wine industry. Also, given the poor results of mergers a process model for pursuing mergers and acquisitions is presented. This model
is based on this body of work. Future research within this area should test the model on subsequent mergers and acquisitions.
DEDICATION

This thesis is dedicated to my wife, Nancy. If not for her patience, I would not have been able to realize a personal and professional goal.
ACKNOWLEDGEMENTS

I would like to express my gratitude to the thesis committee for its assistance and patience with respect to the preparation of this thesis. I am deeply indebted to Dr. Prince for his advice and direction provided.
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1.1 Overview of the Spirits and Wine Industry

As the major spirits and wine companies are experiencing sales that have remained flat or have been decreasing, there is a need to find alternative strategic actions to create growth for companies and their shareholders. A company should perform a strategic assessment of its competitive position before a strategy is set of acquiring other industry participants. Empirical research has shown that the greatest likelihood of achieving positive results comes from horizontal mergers (Kay, 1995). However, this will not limit the path chosen by the industry participants examined. Many companies in the industry have extended their operations beyond spirits and wine.

Allied Domecq Plc. has grown by acquiring small companies that operated on a regional basis. As the company desires to grow on a global basis there is a need to review the company’s strategic position relative to the competitive set. Industry participants want to create sustained competitive advantage.

Major markets like the U.S. and U.K. are mature and are experiencing limited growth. In essence major spirits and wine companies are trading share within these markets. In emerging markets the growth that is expected is costly to acquire. Local cultural differences exist on a market by market basis. Socio-economic factors contribute to the acceptance of imported brands. Local consumers can not afford premium brands.

Since the merger of Grand Metropolitan Plc. and Guinness Plc to create Diageo Plc., there has been considerable pressure on all industry participants to seek partners to reduce costs
while increasing revenues. By strategically merging with the proper partner a company may be able to increase revenues and reduce costs simultaneously through economies of scale and scope.

Despite thirty years of evidence demonstrating that most acquisitions do not create value for the acquiring company’s shareholders, executives continue to make more deals, and bigger deals, every year (Ecces, Lanes, & Wilson, 1999). While companies are seeking a partner, discipline needs to play a role to ensure that the drivers identified become the parameters in which a deal is codified.
Chapter 2: Literature Review

2.1 Merger and Acquisition Review

The last year has seen merger mania sweep across the business world. More companies than ever before have joined together as existing industry structures have been swept away, creating the largest oil company, the biggest bank, and the biggest cross-European merger.

Table 1 highlights Merger and Acquisition activities for the last 30 years.

Table 1
Reported merger and acquisition activity on a global basis.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>TOTAL DEALS</th>
<th>TOTAL DEAL VALUE (BILLIONS)</th>
<th>YEAR</th>
<th>TOTAL DEALS</th>
<th>TOTAL DEAL VALUE (BILLIONS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1963</td>
<td>1,361</td>
<td>N/A</td>
<td>1982</td>
<td>2,346</td>
<td>$53.8</td>
</tr>
<tr>
<td>1964</td>
<td>1,950</td>
<td>N/A</td>
<td>1983</td>
<td>2,533</td>
<td>$73.1</td>
</tr>
<tr>
<td>1965</td>
<td>2,125</td>
<td>N/A</td>
<td>1984</td>
<td>2,543</td>
<td>$122.2</td>
</tr>
<tr>
<td>1966</td>
<td>2,377</td>
<td>N/A</td>
<td>1985</td>
<td>3,001</td>
<td>$179.8</td>
</tr>
<tr>
<td>1967</td>
<td>2,975</td>
<td>N/A</td>
<td>1986</td>
<td>3,336</td>
<td>$173.1</td>
</tr>
<tr>
<td>1968</td>
<td>4,462</td>
<td>N/A</td>
<td>1987</td>
<td>2,932</td>
<td>$163.7</td>
</tr>
<tr>
<td>1969</td>
<td>6,107</td>
<td>N/A</td>
<td>1988</td>
<td>2,258</td>
<td>$246.9</td>
</tr>
<tr>
<td>1970</td>
<td>5,152</td>
<td>$43.6</td>
<td>1989</td>
<td>2,366</td>
<td>$221.1</td>
</tr>
<tr>
<td>1971</td>
<td>4,608</td>
<td>$23.7</td>
<td>1990</td>
<td>2,074</td>
<td>$108.2</td>
</tr>
<tr>
<td>1972</td>
<td>4,801</td>
<td>$16.4</td>
<td>1991</td>
<td>1,877</td>
<td>$71.2</td>
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<tr>
<td>1973</td>
<td>4,040</td>
<td>$16.7</td>
<td>1992</td>
<td>2,574</td>
<td>$96.7</td>
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<tr>
<td>1974</td>
<td>2,861</td>
<td>$12.5</td>
<td>1993</td>
<td>2,663</td>
<td>$176.4</td>
</tr>
<tr>
<td>1975</td>
<td>2,297</td>
<td>$11.8</td>
<td>1994</td>
<td>2,997</td>
<td>$226.7</td>
</tr>
<tr>
<td>1976</td>
<td>2,276</td>
<td>$20.0</td>
<td>1995</td>
<td>3,510</td>
<td>$356.0</td>
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<tr>
<td>1977</td>
<td>2,224</td>
<td>$21.9</td>
<td>1996</td>
<td>5,848</td>
<td>$495.0</td>
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<tr>
<td>1978</td>
<td>2,106</td>
<td>$34.2</td>
<td>1997</td>
<td>7,800</td>
<td>$657.1</td>
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<tr>
<td>1979</td>
<td>2,128</td>
<td>$43.5</td>
<td>1998</td>
<td>7,809</td>
<td>$1,192.9</td>
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<td>1980</td>
<td>1,889</td>
<td>$44.3</td>
<td>1999</td>
<td>5,782</td>
<td>$865.9</td>
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<tr>
<td>1981</td>
<td>2,395</td>
<td>$82.6</td>
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Source: Mergerstat.com, 1999

The pace of change has been greatest in those areas exposed to most competition. The merger wave has occurred at a time when the stock market reached record highs after a six-year boom. But even the sharp falls in the summer of 1999 only temporarily dented the merger
mania. High stock market prices made it easier to acquire companies by using shares rather than cash and promised big gains for the executives holding stock options.

There is no guarantee that the mergers will be successful. History shows that few mergers meet expectations and often contribute to the acquiring firms experiencing disappointing stock price results, but this round of mega-mergers has been much more defensive - the object more self-preservation (company survival) from intensified competitive pressures - and thus driven by necessity (McKelvey, 1999).

A company needs to evaluate its current and desired competitive position before the goals of an acquisition can be determined. It should evaluate the external environment, analyze the company’s internal strengths and weaknesses to compete in the environment, and assess its short term and long term objectives and the company’s ability to reach them. The external environment includes the economic, competitive, political, legal, social, and institutional factors. The internal environment includes cooperate strengths and weaknesses, shareholder goals, management style, and corporate factors. Some of the key strategic questions, developed by Arthur D. Little (ADL), to ask during the evaluation include the following:

- What are the long-term financial and non-financial corporate objectives?
- How mature are the corporation’s present businesses, and what growth potential remains?
- What technological trends are taking place, and what threats or opportunities to they pose?
- What legal or regulatory changes are taking place, and how will they affect the corporation?
- What is the corporation’s competitive position? How is it changing?
- Should the corporation deepen its penetration in existing businesses, or expand into new business areas?

The result of this evaluation is typically a set of corporate objectives and an evaluation of the capability of the company’s present business to satisfy these goals.
The Life Cycle Portfolio Matrix can aid a company in performing a corporate evaluation.

The matrix, design by Arthur D Little (ADL), focuses on:

- Stage of industry maturity - from a young and fast growing market through to a mature and declining market.
- Competitive position - from a company that is dominant and able to control the industry through to one that is weak and barely able to survive.

Table 2 highlights the options that a firm can follow depending on the strategic situation in which it finds itself and the industry in which it participates.

**Table 2:**
The Life Cycle Portfolio Matrix

<table>
<thead>
<tr>
<th>COMPETITIVE POSITION</th>
<th>MATURITY</th>
<th>EMBRYONIC</th>
<th>GROWING</th>
<th>MATURE</th>
<th>AGING</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clear Leader</td>
<td>Hold Position</td>
<td>Hold position</td>
<td>Hold position</td>
<td>Hold position</td>
<td>Hold position</td>
</tr>
<tr>
<td></td>
<td>Attempt to improve market penetration</td>
<td>Defend market share</td>
<td>Grow with industry</td>
<td>Reinvest as necessary</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Invest slightly faster than market dictates</td>
<td>Invest to sustain growth rate (and pre-empt potential competitors)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strong</td>
<td>Attempt to improve market penetration</td>
<td>Attempt to improve market penetration</td>
<td>Hold Position</td>
<td>Hold Position</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Invest as fast as market dictates</td>
<td>Invest to increase growth rate (and improve position)</td>
<td>Grow with industry</td>
<td>Reinvest as necessary</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Favorable</td>
<td>Attempt to improve position selectively</td>
<td>Attempt to improve position</td>
<td>Maintain position</td>
<td>Harvest, withdraw in phases, or abandon</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Penetrate market generally or selectively</td>
<td>Penetrate market selectively</td>
<td>Find niche and attempt to protect it</td>
<td>Reinvest minim as necessary or divest</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Invest selectively</td>
<td>Selectively invest to improve position</td>
<td>Make minimum and / or selective reinvestment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Defensible</td>
<td>Attempt to improve position selectively</td>
<td>Find niche and protect it</td>
<td>Find Niche or withdraw in phases</td>
<td>Withdraw in phases or abandon</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Invest (very) selectively</td>
<td>Invest selectively</td>
<td>Reinvest minimum necessary or divest</td>
<td>Divest</td>
<td></td>
</tr>
<tr>
<td>Weak</td>
<td>Improve position or withdraw</td>
<td>Turn around or abandon</td>
<td>Turn around or withdrawal in phases</td>
<td>Abandon position</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Invest or divest</td>
<td>Invest or divest</td>
<td>Invest selectively or divest</td>
<td>Divest</td>
<td></td>
</tr>
</tbody>
</table>
2.2 The Value of Merger and Acquisition Strategies

A merger or acquisition that enables a firm to exploit opportunities or neutralize threats, will enable the firm to reduce costs or increase its revenues.

At the heart of merger and acquisitions as a corporate strategy is the value created for shareholders. The shareholder value metric emphasizes that a merger or acquisition should be measured over three years following the deal (Smith, 1999). The measure is taken over two to three years to give the acquiring company time to demonstrate action, not just promise. The metric is taken relative to industry total return so that management performance is measured against industry trends. In summary, if a company can pay the premium, successfully integrate the acquisition, and deliver better returns to shareholders than competitors do, that is success.

The value of mergers and acquisitions can be depicted by the shareholder value approach as developed by Rappaport, (1998). According to Rapport the three basic steps of competitive analysis are:

- To assess industry attractiveness
- To evaluate the business’s competitive position within the industry
- To identify sources of competitive advantage

He states that the value created by an acquisition can be evidenced by the following equation:

\[ \text{Value created by acquisition} = \text{Value of combined company} - (\text{Stand-alone value of buyer} + \text{seller}). \]
The above equation is the total value created by the merger and not the value created for the buyer. In most merger and acquisition activities a substantial premium over the stand-alone price will be required to persuade the target company to sell. As the premium increases more of the value created by the acquisition goes to the selling company shareholders and the more difficult it becomes for the acquirer (bidder) achieve a rate of return exceeding the minimum acceptable rate. If the economic potential of acquiring a particular target firm is widely known, and if several potential bidding firms can all obtain this value by acquiring a target, then shareholders of bidding firms will, at best, earn only normal economic profits from implementing an acquisition strategy. In this setting, a strategically related merger or acquisition will create economic value, but this value will be distributed in the form of above-normal economic profits to the shareholders of acquired target firms.

For example, Lucent Technologies recently paid a 34% premium to the shareholders of Excel in a $1.7B stock deal to acquire the equipment makers switches because they can be programmed quickly for services like pre-paid calling cards and combined voice and e-mail. These are popular offerings that Lucent valued as part of its long-term strategic plan (Brooks, 1999).

The following equation defines the maximum acceptable price to pay for the seller as the sum of the stand-alone value of the seller plus the value of acquisition synergies. If the acquirer pays the maximum price, the seller extracts all of the value of the merger or acquisition.

\[
\text{Maximum purchase price} = \text{Stand-alone value of seller} + \text{Value of acquisition synergies}.
\]
Mergers or acquisitions may form part of a larger strategy and as such the bidder may be willing to pay more than the maximum price to attain or maintain competitive advantage. What is important is that the overall strategy creates shareholder value and that the merger or acquisition forms part of the tactics to achieve the goal of the organization.

The third equation defines the value created for the buyer as the difference between the maximum acceptable price and the price paid for the seller.

\[ \text{Value created for buyer} = \text{Maximum acceptable purchase price} - \text{Price paid for seller}. \]

An acquisition is likely to create value for the acquirer (bidder) only if the buyer has a distinctive ability to generate significant economic benefits as a result of the combination. This additional value can reflect either cost savings or revenue enhancements that are created by merging these two firms.

Determining whether mergers and acquisitions create shareholder value is challenging. The greater the success of the post merger integration the more difficult it becomes to measure the value added by the merger. As a result most empirical studies conducted by financial economists focus on the stock market response a few days before and after the announcement date of the merger. While the window is short the effect on the stock price of the bidder and the target is based on long term expectations. The market’s routinely negative response to M&A activity reflects investors’ skepticism about the likelihood that the acquirer will be able to maintain the original values of the businesses in question and to achieve the synergies required to justify the premium.
Acquisitions turn sour because the benefits they bring are easily replicated by competitors. Competitors will not stand by while an acquirer (bidder) attempts to generate synergies at their expense. Acquisitions that do not confer a sustainable competitive advantage should not command any premiums. Acquisitions may increase a company's vulnerability to competitive attack because the demands of integration can divert attention away from competitors.

2.3 Evaluations of Mergers and Acquisitions

Mergers and acquisitions often form part of the long-term strategic options available to a company. The empirical evidence on their performance suggests that they are little value to the companies undertaking the activity. Various empirical research studies concluded that there was not a consistent result that can be drawn. Results varied from slight improvement to slight loss effects (Hunt, 1987). The evaluation methods and performance of mergers and acquisitions is contained in table 3. The inconsistent results of merger or acquisitions may explain the negative response of financial markets to merger and acquisition activities. The main reason for failure seems to be over-optimistic objectives (Eccles, Lanes, & Wilson 1999).

Three consulting firms, A.T. Kearney, Mercer Management Consultants, and PricewaterhouseCoopers concluded that a high proportion of acquirers (bidders) lost value or generated sub-par returns for shareholders ("Why Good Deals Miss the Bull’s Eye," 1999). The biggest contributor to this was the ill-conceived integration plans not the drivers identified when the merger was first sought. The acquirer (bidder) must continuously
communicate the key aspects of the deal and manage market expectation by explaining the benefits of the transaction in terms of increased shareholder value. The acquirer needs to define its strategy and be able to demonstrate the strategic imperative of the deal to both internal and external stakeholders ("Why Good Deals Miss the Bull’s Eye," 1999).

Table 3
Merger & Acquisition Evaluations

<table>
<thead>
<tr>
<th>METHOD OF EVALUATION</th>
<th>MAJOR STUDIES</th>
<th>CONCLUSIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subjective opinions of company personnel</td>
<td>Hunt (1987)</td>
<td>Around half were successful</td>
</tr>
<tr>
<td>Whether acquired business is retained in the long term</td>
<td>Ravenscraft and Scherer (1987)</td>
<td>More divested than retained</td>
</tr>
<tr>
<td>Comparison of overall profitability before and after the merger</td>
<td>Meeks (1977), Mueller (1980), Ravenscraft and Cosh (1990), Scherer (1987)</td>
<td>Nil to negative effect</td>
</tr>
<tr>
<td>Effect on stock market valuation</td>
<td>Harris and Mayer (1988)</td>
<td>Positive initial impact</td>
</tr>
</tbody>
</table>


While there are no hard and fast rules on these issues, a review of prior experience with strategic development in U.S. industry is enlightening. Since World War II, there has been a strong trend for large U.S. corporations to diversify away from single businesses. One of the more compelling points brought out in the research is that the financial performance of diversifying companies is closely correlated with the way in which firms relate new business venture to their old businesses, rather than with the magnitude or pace of diversification. The most important finding is that companies that exhibit the best financial performance (i.e., highest returns to capital and least variability in earnings relative to growth) are those that have tightly controlled and consistently focused their diversification efforts by building on a
single core of existing skills, knowledge, or experience. In contrast, companies that have either disregarded their existing core of skills and knowledge or tried to build in various different directions, each new direction drawing on a different skill, knowledge, or experience, have not performed as well. (Smolowitz, 1997).

One of the objectives of this paper is to assess a merger or acquisition partner(s) for Allied Domecq from within the industry. As such the focus is on horizontal merger or acquisition strategies.

2.3.1 Relatedness in mergers and acquisitions:
Several authors have attempted to develop more complete lists of possible sources of relatedness between bidding and target firms. Lubatkin (1983) included technical economies (in marketing, production, and similar forms of relatedness), pecuniary economies (market power), and diversification economies (in portfolio management and risk reduction) as possible bases of strategic relatedness between bidding and target firms. Marketing competencies as part of technical economies) cover a large category that includes brands, sales forces and general marketing excellence. The effect of marketing resource deployment has a significant positive impact on revenue enhancement capabilities. However, the effect on cost based synergies was negligible (Capron & Hulland, 1999). Marketing synergy has become a more relevant factor in determining the ultimate success of merger and acquisition activities (Weber & Dholakia, 2000). Table 4 contains an explanation of the categories.
Table 4
Lubatkin’s List of Potential Sources of Strategic Relatedness between Bidding and Target Firms.

<table>
<thead>
<tr>
<th>Technical Economies</th>
<th>Scale economies that occur when the physical processes inside a firm are altered so that the same amounts of input produce higher quantity of outputs. Sources of technical economies include marketing, Production, experience, scheduling, banking, and compensation.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Economies</td>
<td>Economies achieved by the ability of firms to dictate prices by exerting market power.</td>
</tr>
<tr>
<td>Diversification Economies</td>
<td>Economies achieved by improving a firm’s performance relative to its risk attributes or lowering its risk attributes relative to its performance. Sources of diversification economies include portfolio management and risk reduction.</td>
</tr>
</tbody>
</table>


Jensen and Ruback (1983) developed another important list of possible sources of strategic attractiveness between bidding and target firms. This list is summarized in table 5 and includes the following factors as possible sources of economic gains in mergers and acquisitions: potential reductions in production or distribution costs (from economies of scale, vertical integration, reduction in agency costs, and so forth), the realization of financial opportunities (such as gaining access to underutilized tax shields, avoiding bankruptcy costs, profit growth and the avoidance of profit slumps), the creation of market power, and the ability to eliminate inefficient management in the target firm.

2.4 Merger & Acquisition Arguments

2.4.1 Introduction

There are two prevalent theories of merger and acquisition activities as part of a corporation’s strategic initiatives. The two theories are Value creating theory and Managerial theory. Within the value creating theory are two sub segments which is the basis of this research review. Often thought of as polarized, the sub segments are:

- Market power view (Revenue based synergies)
- Efficiency and effectiveness (Cost based synergies)
### Table 5
**Jensen and Ruback’s List of Reasons Why Bidding Firms Might Want to Engage in Merger and Acquisition Strategies.**

| To reduce production or distribution costs | 1. Through economies of scale.  
2. Through vertical integration.  
3. Through the adoption of more efficient production or organizational technology.  
4. Through the increased utilization of the Bidder’s management team  
5. Through a reduction of agency costs by bringing organization-specific assets under common ownership |
| Financial motivations | 1. To gain access to underutilized tax shields  
2. To avoid bankruptcy cost  
3. To increase leverage opportunities  
4. To gain other tax advantages |
| To gain market power in product markets | 1. Competition removal  
2. Market share growth |
| To eliminate inefficient target management |


The sub segments and the relevant literature are reviewed and will be utilized along with the empirical research of Lubatkin and Jensen & Ruback to identify the relevant drivers, which were utilized in the primary research conducted. The focus of this research is on the *Value Creating theory*.

Sir Philip Bowman, Chief Executive of Allied Domecq PLC, has publicly explained the company’s position on being involved in any further industry consolidations. As such the search is for a partner within the industry (Horizontal merger). Horizontal mergers and acquisitions are the dominant mode of firm growth since the 1980’s to present (Capron & Hulland, 1999). While these activities have played an important role in firm strategy, their
contribution to firm performance still remains a controversial issue (Seth, 1990). As identified above, two prevalent theories as explained in strategy literature for horizontal mergers. The strategies are:

- Value creating theories
- Managerial theories

Value creating theories have to sub segments, which are:
- Efficiency and Effectiveness (Cost based synergies).
- Market power views (Revenue base synergies).

Efficiency and effectiveness views emphasize the role of cost – based synergies that arise when the divestiture of the assets of the merging firms leads to cost savings. The market power view emphasizes market power as a primary incentive underlying horizontal acquisitions.

2.4.2 Value Creating Theories

Horizontal acquisitions create value by exploiting cost-based and revenue based synergies. On one hand, the cost efficiency theory emphasizes the role of cost-based synergies that arise when the divestiture of the assets of the merging firms leads to cost savings. On the other hand, the resource-based theory of firms emphasizes the role of revenue-enhancement synergies arising when the redeployment of resources of merged firms leads to revenue-enhancing capabilities (Seth, 1990). Horizontal acquisitions have typically been seen as a straightforward mechanism for reducing costs through asset divestiture.

2.4.2.1 Efficiency and Effectiveness Synergies:

Literature has seen horizontal acquisitions and mergers as an opportunity to achieve cost reductions through the rationalization of economies of scale and scope. Several studies show
that asset divestiture (i.e. the elimination of redundant activities and inefficient management practices and competencies), improves the performance of horizontal acquisitions (Anand & Singh, 1997). Economies of scale and scope are especially useful to predict the performance of horizontal acquisitions or mergers, since they are more likely to exist in horizontal merger and acquisitions (O'Shaughnessy & Flanagan, 1998).

Economies of scale arise if the merged firm achieves low cost production as it increases the extent of a given activity. Production related economies of scale are commonly considered as the main driver of cost cutting, but economies of scale may also be realized in other areas of a business (e.g., R&D personnel and facilities, distribution, sales, or administrative activities) through the spreading of fixed costs over a higher total volume (Shepherd, 1979). In addition, sharing activities can also enable merging firms to obtain cost reduction based on learning curve experiences, since each merging business, when acting independently, might not have a sufficient high level of cumulative volume of production to exploit learning curve economies (Capron & Hulland, 1999).

Economies of scope arise when the merged firm achieves cost savings as it increases the extent of activities it performs. This is the case when the shared factor of production is imperfectly divisible. So that the manufacturer of a subset of goods leaves excess capacity in some stages of production (Teece, 1982). Horizontal acquisitions commonly increase the scope of the firm and allow absorption of the firm’s resources over a broader range of products (Lubatkin, 1998). Horizontal acquisitions provide opportunities for sharing assets characterized by some indivisibility and under-utilized before the acquisition, while rationalizing two sets of product lines and divesting the less efficient assets.
The exploitation of economies of scale and scope through acquisition is usually achieved through asset rationalization. In principle, this divestiture could take place without the use of an acquisition if the market were efficient enough to discipline firms into specializing their assets in a given activity according to their respective efficiency, and to stimulate efficient plant investment (Scherer & Ross, 1990).

The manufacturing (plant utilization), logistics (channels of distribution) and administrative functions (i.e./ finance functions and information systems) are the most affected by the post – acquisition asset divestiture. These divestiture measures can be undertaken with a lower risk of damaging the innovative capabilities of the firm, its commercial presence, or its image in the market (Capron & Hulland, 1999). Post – acquisition divestiture affects the acquiring and target firms in an asymmetric manner: the target’s assets are commonly three to five times more likely to be divested than the acquirer’s assets. Results show that rationalizing the target’s businesses does not lead to systematic cost savings, and can even hurt costs. They also suggest that the acquirer is more effective in rationalizing its own assets than those of the target (Capron & Hulland, 1999). Divestiture of the acquirer’s assets is an action rarely taken by the managers of the acquiring firms. When it does take place, it has positive results on cost savings, and no effects on capability enhancements. Target divestiture has negative effects on both cost savings and capabilities.

2.4.2.2 Market power views (Revenue base synergies)

The economic logic of capturing revenue-based synergies is often known as sharing complementary resources (or leveraging core competencies). The literature identifies two
ways of enhancing revenues: increased market coverage (size) and enhanced innovation capability. Horizontal acquisitions can increase market coverage through the foreign market expansion and through portfolio expansion (Aaker, 1996). Greater market coverage allows the merged firm to sell existing products (new to market) to a wider body of consumers, thus enhancing revenues. Shared product lines enable the merging firms to increase the variety of product lines, and eventually to cross-sell and bundle products to customers. Product line extensions (new to world) can also enhance revenues if the merged firm manages to exploit the strong reputation of a merging business brand, sales network or marketing activities (Capron & Hulland, 1999). The redeployment of brands with strong consumer equities can help expand the customer base and change consumer’s perceptions of existing products, differentiating them from competitive offering (Keller, 1993). Overall, superior marketing competencies can lead to increased customer value, which in turn can be translated into premium prices and / or increase volumes (Barney, 1991).

Innovations are an alternative source of customer value. Horizontal acquisitions can enhance innovation capability by using the superior innovation capability of one of the merged firms to enhance product features or to improve organizational and marketing effectiveness. Innovation capability can be converted into price premium and / or increased volume, leading to higher returns.

The exploitation of revenue based synergies (increased market coverage and innovation capability) through acquisition is usually achieved trough resource deployment. Resource deployment to targets and to acquirers is captured through five types of intangible resources: R&D capabilities manufacturing know-how, marketing resources, supplier relationships and
distribution expertise. Capron and Hulland (1999) showed that resources are transferred from the acquirer to the target 44% of the time and from the target to the acquirer 24% of the time. Such resource redeployment, i.e. the use by a target or acquiring business of the other business’ resources, could take place without the use of an acquisition if the market for resources was efficient enough to allow firms to exchange resources. The market failure argument plays a central role in explaining why firms redeploy resources through acquisitions. It takes its intellectual roots in transaction cost economics and holds that several imperfections may exist in markets for intangible resources, including immobility, information asymmetries and associated moral hazards, causal ambiguity, and monopoly (Chi, 1994). These market imperfections create complications in the pricing and transfer of resources and consequently increase the associated risks of undertaking arm’s length contracts with independent partners (Chi, 1994). In parallel with transaction cost logic as previously highlighted, evolutionary arguments view acquisitions as part of a knowledge – based process (management competencies), in which acquirers learn how to use their existing intangible resources in the target’s market, or acquire unfamiliar new resources from the target (Kogut & Zander, 1992).

Many horizontal acquisitions span international boundaries. This is referred to as the internalization theory in literature which argues that cross – border acquisitions are primarily driven by the willingness of the acquirer to redeploy its excess resources and to use the target’s location – specific resources which are necessary to make the redeployment of other resources viable (Morck & Yeung, 1992). More recently, cross – border acquisitions have been shown to be a means for the acquirer to tap foreign target firms’ resources (Eun, Kolodny, & Scherage, 1996).
In summary, for reasons either of control or knowledge, acquisitions are a vehicle for selling or acquiring bundles of resources in highly imperfect resource markets (Mitchell, 1994). Acquisitions enhance performance by allowing businesses to obtain preferential access to resources that cannot be purchased in a competitive market. As a result, acquisitions can create value and enhance revenues by redeploying resources from the acquirer to the target, and vice – versa.

2.4.2.3 Exploration of potential cross effects:

Recent work on mergers or acquisitions tends to see asset divestiture and resource deployment as parts of a common process of reconfiguration of the target and acquirer business (Burgelman, 1994). Asset divestiture commonly implies changes in organizational, technological or marketing resources to produce and sell greater volumes of goods more efficiently. At the same time, the process of redeploying resources tends to create redundancies and conflicts with existing resources.

The question of whether asset divestiture stimulates or hinders market development is controversial (McKinley, 1993). Jensen (1986) claims that downsizing cuts out excessive resources and therefore allows resources to be allocated more productively. Others, have claimed that downsizing conflicts with innovation and market development. Asset divestiture risks damaging capabilities as the firm reduces its organizational slack and its propensity to innovate and develop new markets (Hamel & Prahalad, 1994). Downsizing can also violate employee trust, inhibit risk taking (Staw, Sandelands & Dutton, 1981), break the network of
informal relationships used by innovators, and lead to reduced innovation (Dougherty & Bowman, 1995).

The question of whether resource redeployment hurts or saves costs is controversial. On one hand resource redeployment can hurt costs as the merging firms need additional resources to implement resource redeployment. Maintaining slack resources may be necessary to increase the "learning" capacity of the recipient firm and to increase the transferring firm's "teaching" effectiveness. On the other hand, some authors have suggested that resource redeployment can improve cost efficiency in horizontal acquisitions (Scherer, 1980). Acquisitions could provide access to certain factors of productions – such as proprietary process technology –, which can be used to increase production efficiency or reduce production of supply costs. Such cost savings arise from resource redeployment and are a dynamic source of efficiency, in contrast with more static economies of scale.

Capron and Hulland (1999) showed that resource redeployment does not hurt costs, and may even contribute to achieving higher cost efficiency. Also, if stand-alone target divestiture does not provide the expected cost savings, changes in the way the target operates its businesses through redeployment or resources to the target help reduce costs. This result is consistent with previous empirical work that shows that downsizing is more likely to create value when its scope extends beyond cutting cost through the elimination of slack to include related changes in organizational design and resource reconfiguration (Anand & Singh, 1997).
Both cost and revenue based synergies contribute to acquisition performance. Substantial benefits of horizontal benefits come from increased revenues through enhanced market coverage and innovation capability (Capron & Hulland, 1999).

2.5 Project Boston

2.5.1 Background:

The US spirits operations of Allied Domecq Plc. were a result of the consolidation of a number of acquisitions over the past 15 years. The acquisition of Domecq, which included Domecq Importers in the U.S. market, resulted in two spirit sales and marketing organizations in the US (Allied Domecq – Project Boston – Implementing Organization Change publication [ADPBIOC],1998). At the time of the Domecq acquisition it was concluded that the maintenance of two businesses in the US would support the focused redevelopment of Allied Domecq Plc. brands. While this proved successful, the circumstances changed. Continued consolidation of the retail and wholesale market tiers, the formation of Diageo and the implementation of Allied Domecq’s distributor strategy, led to increased co-ordination between the two US National Marketing and Sales Company (NMSC’s) and resulted in a reappraisal of the US structure.

2.5.2 Description:

The proposal, (ADPBIOC[1998]), led to the merger of Hiram Walker and Domecq Importers and enabled the simplification of Allied Domecq’s North American support structures. The two companies employed 325 staff and the merged company employed 246 as detailed in table 6.
Table 6
Staffing Reconfiguration Resulting from the Merger of Hiram Walker & Sons Inc. and Domecq Importers.

<table>
<thead>
<tr>
<th>Function</th>
<th>Current</th>
<th>Proposed</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>184</td>
<td>135</td>
<td>(49)</td>
</tr>
<tr>
<td>Marketing</td>
<td>74</td>
<td>54</td>
<td>(20)</td>
</tr>
<tr>
<td>Support</td>
<td>67</td>
<td>57</td>
<td>(10)</td>
</tr>
<tr>
<td>Total</td>
<td>325</td>
<td>246</td>
<td>(79)</td>
</tr>
</tbody>
</table>

Source: ADUSAPBF[1998])

The sales structure was reorganized into 4 divisions from the six divisions that existed in each entity as outlined in the Allied Domecq – USA – Project Boston Financial Projection document (ADUSAPBF[1998]). The four divisions focus on the sales management of Allied Domecq’s core brands while the sales management of non core brands was transferred to brokers and other third parties. The benefit of this arrangement is the maintenance of the contribution from the non core portfolio until other value creating options are considered and has ensured complete focus on the Allied Domecq core brand portfolio.

ADSUSA represents a significant proportion of Allied Domecq’s North American spirits and wines operations (75% of North American total Trading Profit) and the revised structure enabled a review of the deployment of corporate services. The original proposal included an estimate of once off costs of 6.0m pds and related benefits of headcount reductions of 2.5m pds in this area (ADUSAPBF[1998]).

The financial evaluation lead to the closure of the two NMSC head office locations in Southfield Michigan (Detroit) and Old Greenwich Connecticut. Also the International Brand
Group (Responsible for global marketing) relocated from Los Angeles to Connecticut. Further, office buildings in Walkerville are for sale as a result of the simplification of corporate support resources (ADUSAPBF[1998]).

The costs and benefits of the project have been evaluated based on “hard” benefits. No revenue implications were included in the base financial evaluation but were included as sensitivities as outlined in table 7.

2.5.3 Objectives:

The objectives of Project Boston were defined in the Allied Domecq PLC., Board Digest (ADPLCBD[1998]) as the following:

- Creating a business designed for the new millennium (soft measure).
- Reaching the consumer by the creation of marketing excellence.
- Building stronger relationships with distributor networks in the U.S. market.
- Consolidating and re-engineering operations.
- Re-defining the portfolio and managing separately:
  - Core brands
  - Non – Core brands
- Support marketing of agency brands only if they enhance ADSUSA.
- Prepare the organization for future mergers or alliances.
Table 7

<table>
<thead>
<tr>
<th>Analysis of Investment:</th>
<th>Sterling millions</th>
<th>Sterling millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Expenditure</td>
<td></td>
<td>0.7</td>
</tr>
<tr>
<td>Once off Costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NMSC Redundancy</td>
<td>5.2</td>
<td></td>
</tr>
<tr>
<td>NMSC Relocation</td>
<td>2.1</td>
<td></td>
</tr>
<tr>
<td>Double Running Costs</td>
<td>1.2</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>5.5</td>
<td></td>
</tr>
<tr>
<td>Corporate Redundancy</td>
<td>6.0</td>
<td></td>
</tr>
<tr>
<td>Sub total</td>
<td>20.0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>20.7</td>
</tr>
<tr>
<td>Net Present Value</td>
<td></td>
<td>12.5m</td>
</tr>
<tr>
<td>IRR</td>
<td></td>
<td>43%</td>
</tr>
<tr>
<td>Sensitivity to IRR of 1% volume disruption for 3 years</td>
<td>-11%</td>
<td></td>
</tr>
<tr>
<td>Sensitivity to IRR of 1% annual core brand growth</td>
<td>+12%</td>
<td></td>
</tr>
<tr>
<td>Sensitivity to no Interim Arrangements</td>
<td>+13%</td>
<td></td>
</tr>
<tr>
<td>Sensitivity of including residual value (L10.6m)</td>
<td>+5%</td>
<td></td>
</tr>
<tr>
<td>Year 2 Return on Investment</td>
<td></td>
<td>34%</td>
</tr>
<tr>
<td>Payback</td>
<td></td>
<td>In 3rd year</td>
</tr>
</tbody>
</table>

Source: ADUSAPBF[1998]
The savings generated from the alignment and the consolidated back office operations through the merger of the two U.S. National Marketing and Sales Companies (NMSC’s) may have resulted in savings that supported core brands. By creating one NMSC there would be a stronger effort behind core brands. The merger of two US NMSC’s was in response to the changing business climate in the U.S. Diageo (the merger of Grand Metropolitan PLC and Guinness PLC) and the consolidation of distributors and retailers reduced the power level of suppliers like Allied Domecq.

The supporting principles of the merger of Hiram Walker & Domecq Importers were defined as:

- Enhancing Shareholder Value. This was the intended theme of the merger.
- Organization for the new millennium. The creation of a distinct culture.
- Consumer Focus. Reach the consumer through greater marketing investment.
- Customer Partnership. Partner with fewer select distributors.
- Competitive positioning. Increase the brand equity of brands to reach consumers.
- Brand Focus / Equity. Actions to reinforce development of core brands
- Employees. Developing “best in class” work environment.

The merger of Hiram Walker and Domecq Importers was divided into five project components as outlined in the ADUSA – Project Boston Planning Phase docket (ADUSAPBPP[1998]).

- Consumer focus / Customer partnership

By focusing on core brands ADUSA may be able to build the brand equity of those brands and increase the ROI for the organization. Also, their reputation may be enhanced as a company of marketing excellence.
• Investment behind consumer oriented marketing

By redistributing resources from non-core brands to core brands ADUSA may be able to increase consumer pull for their brands.

• Enhancing marketing skill sets

Based on the five principles of marketing; Market evaluation (audit), Planning, Implementing, Evaluating, People development.

• Organizational structure to support consumer focus / customer partnership:

By removing non-core brand from internal management ADUSA will be able to focus on the core brands. Also, the consolidation into four field offices will support a close link to corporate HQ.

• Manage distributor network to maximize and influence consumer pull:

By consolidating its portfolio with a few distributors ADUSA will be able to increase its market power to align the operations of the distributor to enhance consumer pull by extracting investment from the distributors.

2.6 Case Study: Diageo

The formation of Diageo highlighted many of the strategic themes outlined above.

Grand Metropolitan PLC (IDV) and Guinness PLC (United Distillers) merged in 1998, creating the world’s largest spirits and wine group. Combined, the new group Diageo, is twice as large as its nearest rival.

Diageo has four divisions:

• United Distillers and Vintners (UDV)
• Pillsbury
• Burger King
• Guinness Brewing Worldwide.
2.6.1 Strategic Aims

The main strategic aims behind the merger were:

- To increase scale and efficiencies in mature markets (i.e. attain critical mass in the global drinks business). The merger involves potential savings of £175 million a year in the spirits and wine business, and some industry figures believe the savings could top £200 million a year.

- The geographic fit and brand fit is good between the two companies so as to drive aggressively into emerging markets. The UDV group brought together Guinness’s strong distribution network in Asia and important Latin American countries, while GM was strong in central Europe, other parts of Latin America. Guinness also had strong joint-distribution companies in Asia.

Distribution is the key benefit of the merger for both companies. The enlarged UDV has:

- Gained cheaper and more widespread product distribution

- A far broader portfolio of brands and thus a major competitive edge over its main rivals

Diageo is in a better position than either Grand Metropolitan Plc. or Guinness Plc. were to grow its volumes and squeeze better prices. The enlarged group has:

- Offered wholesalers and retailers a full range of drinks - white and brown spirits, liqueurs and cocktails

- Invested more in advertising, marketing and promotion in order to establish strong brand loyalty

Diageo is in a position to develop local spirits brands to help fund the promotion of its global brands, at a price which will appeal to the mass of consumers rather than the affluent sections of society who are the main consumers of international spirits brands.

2.6.2 Competitor Reaction

The reaction of Diageo’s main rivals indicated how seriously they took its formation.

Immediately after the merger was announced, rivals like Seagram and Allied Domecq
pressed for investigations by the relevant competition authorities in Europe and North America.

LVMH, which had a cross-shareholding relationship and joint-venture distribution operations with Guinness Plc., was not happy with the merger. It preferred an agreement merging Moët Hennessy with Diageo and splitting out the food, fast food and brewing operations. LVMH has terminated joint-distribution agreements between LVMH and Guinness in France, the US and Asia and bought back Guinness’s 34% stake in Moët Hennessy.

Diageo’s other main rivals have been undertaking some serious strategic thinking on how to react to the new group. Remy Cointreau, Pernod Ricard, Bacardi and Brown-Forman are essentially all family businesses and so are less likely to consider a merger with a rival until they feel the financial squeeze, at which point it could be too late to react.

There has been speculation that Allied Domecq and Suntory, or Allied Domecq and Seagram, may seek a merger. Given that both Allied Domecq and Seagram are public companies and that Seagram continues to move strongly into entertainment, the prospects of a newly formed spirits operation is relatively good.

2.7 Identification of Merger & Acquisition drivers

Table 8 contains the drivers identified through the review of literature, the examination of Project Boston, which was the merger of two Allied Domecq Spirits organization in the United States, and the review of the Diageo case which was the merger of Grand Metropolitan Plc. and Guinness Plc.
<table>
<thead>
<tr>
<th>Drivers</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Avoid Profit Slumps</td>
<td>Jensen &amp; Ruback, 1983</td>
</tr>
<tr>
<td>Channels of Distribution</td>
<td>Shepherd, 1979</td>
</tr>
<tr>
<td>Company Survival</td>
<td>Chal'dhuri &amp; Tabrizi, 1999</td>
</tr>
<tr>
<td>Competition Removal</td>
<td>Jensen &amp; Ruback, 1983</td>
</tr>
<tr>
<td>Cost Reductions</td>
<td>Shepherd, 1979</td>
</tr>
<tr>
<td>Customer Expansion</td>
<td>Capron &amp; Hulland, 1998</td>
</tr>
<tr>
<td>Financial Leverage</td>
<td>Jensen &amp; Ruback, 1983</td>
</tr>
<tr>
<td>Foreign market expansion</td>
<td>Aaker, 1996</td>
</tr>
<tr>
<td>Government Regulation</td>
<td>McKelvey, 1999</td>
</tr>
<tr>
<td>Information Systems</td>
<td>Capron &amp; Hulland, 1998</td>
</tr>
<tr>
<td>Low Cost Producer</td>
<td>Capron &amp; Hulland, 1998</td>
</tr>
<tr>
<td>Management Hubris</td>
<td>Project Boston 1998, Albo, 1987</td>
</tr>
<tr>
<td>Market Dominance</td>
<td>Jensen &amp; Ruback, 1983</td>
</tr>
<tr>
<td>Market Share</td>
<td>Keller, 1993</td>
</tr>
<tr>
<td>Marketing Competencies</td>
<td>Barney, 1991</td>
</tr>
<tr>
<td>New to Market brands</td>
<td>Capron &amp; Hulland, 1998</td>
</tr>
<tr>
<td>New to World brands</td>
<td>Capron &amp; Hulland, 1998</td>
</tr>
<tr>
<td>Obtaining Ideas</td>
<td>Aaker, 1996, Capron, 1999</td>
</tr>
<tr>
<td>Plant Utilization</td>
<td>Capron &amp; Hulland, 1998</td>
</tr>
<tr>
<td>Political reasons</td>
<td>Project Boston, 1998, Diageo Case Study, 1997</td>
</tr>
<tr>
<td>Portfolio Expansion</td>
<td>Aaker, 1996</td>
</tr>
<tr>
<td>Profit Growth</td>
<td>Diageo Case Study</td>
</tr>
<tr>
<td>R&amp;D personnel &amp; facilities</td>
<td>Capron, 1999</td>
</tr>
<tr>
<td>Shareholder Pressure</td>
<td>Project Boston, 1998</td>
</tr>
<tr>
<td>Social Pressures</td>
<td>McKelvey, 1999</td>
</tr>
<tr>
<td>Strategic Synergy</td>
<td>Anand &amp; Singh, 1997</td>
</tr>
</tbody>
</table>
2.7.1 Literature review summary and conclusions:

Three bases of information were utilized to construct the literature review. First, literature was reviewed from traditional sources like journals and book references. Second, the information on Project Boston was presented. Third, a brief synopsis of the Diageo merger was included to provide additional examples of drivers of mergers and acquisitions.

Within the Review of Literature arguments were established between the classifications of merger actions between cost based synergies and revenue based synergies. Also, it has been noted that some of the drivers identified have cross effects between the two categories. These classifications will be tested chapter five.

The drivers identified in the three sources of information were summarized in table 8. The application of the identified drivers to both cases will be revisited in chapter five. The drivers identified will be utilized to construct the primary research and to provide the foundation for the assessment of suitable horizontal merger partners for Allied Domecq Plc based on the subjective opinions of company personnel.

30
Chapter 3: Conceptual Overview

3.1 Study Rationale for Allied Domecq Plc.

The global Spirits & Wine industry has been undergoing radical changes in response to increased competition and the inability of the industry to generate organic growth. This coupled with the inability to increase prices has led to the need for companies to seek growth through mergers or acquisitions.

In response to the changing environment, industry participants are seeking partners to complete their brand portfolios and provide the leverage to realize growth in emerging markets. While emerging markets are perceived to provide the necessary growth opportunities the returns have not yet materialized. While companies pursue merger and acquisition initiatives as a corporate strategy the rational for such activities can be classified into various factors. Two main factors are the revenue enhancement theory and the cost based theory.

Cost based savings are often referred to as *hard synergies* and the degree of certainty that they will be achieved is generally very high (Eccles, Lanes & Wilson, 1999). Usually they come from eliminating jobs, facilities, and related expenses that are no longer needed when functions are consolidated or they come from economies of scale in purchasing. Cost savings may be large when one company acquires another from within the industry. Even though cost savings are the easiest synergy to calculate, overly optimistic projections certainly do occur, so a company needs to be aware of the numbers presented. These cost savings could be easily offset as the benefits of the merger are extracted by the shareholders of the target company.
when a premium is paid to the target company. Also, if acquirers underestimate how long it will take to realize the savings the synergistic effect of such actions may be lost.

It is possible for an acquirer and its target to achieve a higher level of sales growth together than either company could on its own. Revenue enhancements are notoriously hard to estimate, however, because they involve external variables beyond management’s control. Revenue enhancements are so difficult to predict that they are considered soft synergies (Eccles et al, 1999). Despite their dangers, revenue enhancements can create real value. In addition cross effects can occur when best practice is transferred from one company to another. This may result in both cost savings and revenue enhancements (Eccles et al, 1999).

Drivers (variables) identified through the Review of Literature and the examination of two separate and distinct cases were utilized to determined their suitability to the spirits and wine industry and to assess the most relevant drivers in the assessment of suitable merger or acquisition partners.

3.2 Aims and Objectives

The aim of this investigation is to identify, and provide examples drivers (variables) of mergers and acquisitions that are relative to Allied Domecq Spirits & Wine operations. Also, to measure the perception of Allied Domecq personnel with respect to those drivers identified above. Further, to assess the suitability of merger and acquisition partners as determined by the research respondents based on the importance of drivers identified.
In alignment with the hypotheses, the aim of the research will be achieved through meeting
the following three objectives:

1. Identify drivers (variables) of mergers and acquisitions that are relative to the spirits and
wine industry.

2. Quantify the perception of Allied Domecq Personnel and industry professionals to the
drivers of mergers and acquisitions.

3. Assess the suitability of merger and acquisition partners as determined by the research
respondents based on the importance of the drivers identified.

Due to the broad scope that this subject offers, research will be primarily based on those
areas of mergers and acquisitions that are prevalent in all industries. Activities such as
valuation and legal structures are not considered in detail. It should be noted that objectives 1
and 2 serve as a basis to evaluate the assessment of suitable merger partners for Allied
Domecq.

3.3 Research Questions

Three research questions addressed in this thesis are as follows:

1. What are the drivers of mergers or acquisitions activities that can be identified from the
literature that may be relevant to the spirits and wine industry?

2. Of the drivers identified, which are the most important drivers for mergers or acquisitions
as perceived by personnel within Allied Domecq spirits & wine?

3. How can the drivers identified as ranked by the respondents be used to assess potential
merger or acquisition candidates?
3.4 Research Approach

3.4.1 Introduction

The purpose of this chapter is to describe the methodology and approaches used throughout the primary research period from which findings, conclusions and recommendations have emanated. Understandably, some of the initial findings during the early part of research proved to be the catalyst for further approaches requiring more information. These findings are seen as part of the normal iterative process by which further understanding is gained, and are therefore discussed as part of the research methodology rather than as a basis for conclusions.

3.4.2 Choice of Approach:

There are different ways to approach research, each depends on the type of research, the type and level of information accessible, the ability of the researcher to analyze and interpret the data, and the time available. Bremen (1989), in his book Research methodology, says that research design should be thought of as the overall structure of framework for collecting and analyzing data, whereas the methodology is the techniques used for the collection of that data. The following subsections briefly describe the options that were considered at the outset of the research for its design and the methodologies for the data collection, the choice made and reasons why.

3.4.3 Research Designs

Bryman describes 5 major research designs while Yin (1989) discusses the relevant situations for each design, suggesting that choice of design depends on the type of questions to be asked, and also whether the design will require control over the behavioral events and if that
design focuses on the contemporary events. A review of each design based on Bryman and Yin’s question overlay is shown in table 9.

3.4.4 Choice of Research Design

The experimental design on its own was discounted because it required hard data that could be quantitatively researched and analyzed. Due to the subject under review, only part of the equation relied on quantitative facts - merger and acquisition drivers. However, a selection of suitable partners may result in many qualitative aspects.

The action research approach was discounted because it required ‘living’ with the research area for a significant part of its life-cycle, making suggestions for improvement during that time and observing the results. While the learning experience would have been extremely useful, time was not available for this approach and independence could surely be questioned.

Bryman says “It is often difficult to distinguish qualitative from case study research...” While case studies on mergers and acquisitions are available there is limited data of such activities in the Spirits and Wine industries. The most recent merger of Grand Metropolitan Plc and Guinness Plc is presented due to the applicable information that can be utilized in the preparation of the thesis questionnaire. Also, the rationale for Project “Boston” has been presented to aid in communicating company information and to aid in Questionnaire design.

The chosen method was the utilization of the survey (questionnaire) approach as the primary theme. This was augmented by qualitative research (one on one interview).
Table 9
Research Design and Relevant Questions, Control requirements and focus

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Research Design</td>
<td>Type of Research Question</td>
</tr>
<tr>
<td>Experimental Research, which is a framework that enables strong, claims about</td>
<td>How, Why</td>
</tr>
<tr>
<td>cause and effect. It is frequently perceived as a model research design and</td>
<td></td>
</tr>
<tr>
<td>has a strong orientation to natural science and the study of social phenomenon.</td>
<td></td>
</tr>
<tr>
<td>Survey Research is a framework by which data is collected usually by interview</td>
<td>Who, what* where, how many, how much</td>
</tr>
<tr>
<td>or by questionnaire on a number of variables. Patterns between the variables</td>
<td></td>
</tr>
<tr>
<td>are then examined. Causality is inferred not observed.</td>
<td></td>
</tr>
<tr>
<td>Qualitative Research is where the research interprets behavior within their</td>
<td>Who, what* where, how much</td>
</tr>
<tr>
<td>environment, making cognitive reasoning between what people say and do.</td>
<td></td>
</tr>
<tr>
<td>Case Study Research is a framework where one or a small number of cases are</td>
<td>How, why</td>
</tr>
<tr>
<td>examined in detail. It often comprises of a whole spectrum of methods of</td>
<td></td>
</tr>
<tr>
<td>data collection.</td>
<td></td>
</tr>
<tr>
<td>Action Research is where the researcher and the research (organization) are</td>
<td>who, what* where, how many, how much</td>
</tr>
<tr>
<td>often trying to identify and solve a common problem. The researcher feeds</td>
<td></td>
</tr>
<tr>
<td>advice to the organization, they act and the researcher observes the outcome,</td>
<td></td>
</tr>
<tr>
<td>and so on.</td>
<td></td>
</tr>
</tbody>
</table>


* What questions can apply to all designs in part of an exploratory study
Note: Some of Yin’s 5 designs differed / overlapped Bryman’s but the same relevance theory is maintained

3.4.5 Data collection:

Within the various research designs are a large number of research methods available to collect the data. Bryman discusses 7 major methods, which are outlined below:

1. Self-administered questionnaires - which the respondents complete on their own.

2. Structured interviews - where specific and precisely formulated questions are asked during interview.
3. Participant observation - a time-consuming technique, often called ethnographies, where the researcher observes an organization intimately.

4. Unstructured interviewing - where the researcher has informal interviews allowing respondents more leeway in their answers. This method may not have any pre-formulated questions.

5. Structured Observations - where the researcher records observations on a predefined schedule.

6. Simulation - where real-life is imitated often in controlled environments, and their reactions are observed (method 5 can be used for this purpose).

7. Archival Information – where pre-existing data, (often called secondary data), is sourced and analyzed.

To decide upon the method of data collection, the objectives posed at the outset had to be considered in an attempt to meet the aim of the research and test the hypotheses. The objective are tabulated below with the corresponding data collection methods that were envisaged:

**Table 10**

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>DATA COLLECTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Identify drivers (variables) of mergers and acquisitions that</td>
<td>1. Case Studies</td>
</tr>
<tr>
<td>are relative to the spirits and wine industry.</td>
<td></td>
</tr>
<tr>
<td>2. Quantify the perception of Allied Domecq Personnel and industry</td>
<td>1. Questionnaire</td>
</tr>
<tr>
<td>professionals to the drivers of mergers and acquisitions.</td>
<td>2. Interviews</td>
</tr>
<tr>
<td>3. Assess the suitability of merger and acquisition partners as determined by the research respondents based on the importance of the drivers identified.</td>
<td>1. Interviews</td>
</tr>
</tbody>
</table>
3.5 Data Collection and Analysis Methodology

3.5.1 Initial Questionnaire

The first step was to identify individuals that were suitable to act as respondents for the questionnaire. The selection of the individuals and the departments they represent was made in conjunction with the President and General Manager of the NPD center and the Vice President of Marketing Research, who were the sponsors of the research.

The departments represented were:

- Strategy
- Marketing
- Finance
- Sales
- Logistics
- Supply Management

Geographical locations represented were:

- North America
- South America
- U.K.
- Europe
- Far East

Initial contact was made by a letter of introduction signed by the sponsors to the individuals identified. The letter asked for their corporation given the possible application to the business of Allied Domecq Plc.

3.5.2 Interviews:

From the questionnaire, a list was drawn up of those people that would aid the research from direct interviews. In order to assure the respondents of confidentiality the names of the respondents quoted have in some instances been changed. This approach would also assist in testing research questions 2 and 3. It was decided that the interviews should take place on the
interviewees ‘home ground’ where possible as some of the information could be regarded as sensitive or political. It was felt that only direct assurances from the interviewer would gain honest responses. Also, it was felt that the interviews should not be recorded, instead notes would be taken and if any of the discussion was to be quoted, then the interviewee would be asked for permission to quote them while being assured anonymity.

The questions would be open-ended and of the semi-structured type, thus in preparation, discussion guides were drafted for each of the study groups. Initial telephone conversations served to set the scene and eliminate any fears as to the purpose of the interviews. Confirmation to the respondents was then made by letter.

Prior and during the interview phase, some of the interviews had to be cancelled. However, by using the discussion guides, limited research was effected by e-mailing the guide to the interviewee and conducting the interview over the telephone. Where this was not possible, the interviewee was asked to respond to the question in writing, thus forming closed rather the open questions.

3.5.3 Case Study Design

The two case studies presented here, Project Boston for Allied Domecq Plc and the merger of Guinness Plc and Grand Metropolitan Plc serve as supporting documentation to enhance the other forms of research presented and as such is not viewed as the core methodology utilized.

1) Project Boston: Presented rationale for the merger. An evaluation of the merger relative to the objectives has not been performed. At this point no opinion will be stated, as enough time has not expired to draw definitive conclusions.
2) Merger of Grand Metropolitan and Guinness into Diageo. Rationale for merger and post merger evaluation has been presented.

The case study design allows a greater opportunity to use any of the previously presented data collection methods, unlike other designs, which traditionally had a limited number of methods for each design. However, for this reason, case study research has in the past been regarded as the weakest of all designs, deviating from academic disciplines and having insufficient precision, objectivity and rigor (Yin, 1989). Yet within his book, Yin says that this design is remarkably hard to do.

Within case study design are two main options; (1) Single case design or (2) Multiple Case Studies. Yin points out that a single case is analogous to a single experiment and is acceptable when it represents a critical case to test a well-formulated theory; or an extreme or unique case where documentation and analysis is worthwhile; or as an exploratory devise conducted as a prelude to further study.

It is not intended to explore either the Project Boston case or the Diageo case from a primary research perspective. The cases are included as part of the Review of Literature and will be utilized to fulfill objective 1 of the investigation.
Chapter 4: Company & Industry Background

4.1 Introduction

The company and industry review was constructed from documents and from internal presentations or working papers that the author either has prepared or has had the opportunity to review as part of the author’s position responsibilities within Allied Domecq and as part of the process in developing this thesis. The company review was primarily constructed from the Allied Domecq Corporate Information presentation. The industry review was constructed from Allied Domecq presentations of major competitors. References to the presentations used to construct the company industry review are contained in the bibliography section.

4.1.1 History and Development

Allied Domecq began life as a UK brewer. In 1961 the foundations of the company were laid when two UK brewers - Ind Coope, Tetley Walker and Ansells - merged to form Ind Coope Tetley Ansell, which was subsequently renamed Allied Breweries in 1963.

In the late 1960s and early 1970s, Allied Breweries expanded into related areas, such as wines and ciders, and in 1978 acquired three UK-based tea and food companies J Lyons, Hale Trent Cakes (Lyons Cakes) and Baskin Robbins. Following these acquisitions, the company changed its name to Allied-Lyons plc in 1981.

In 1986 the company formed a distinct wine and spirits division, called Allied Vintners, and split the company into three distinct operations:

- Allied Breweries
- Allied Vintners
- J Lyons
A year later the company greatly expanded its interest in the spirits market by acquiring a majority stake in Hiram Walker & Sons Ltd., which owned brands such as Courvoisier, Ballantine’s, Tia Maria, Kahlua and Canadian Club.

In 1989, further acquisitions were made in the spirits sector. The company bought out the minority interests in Hiram Walker and also acquired James Burrough (Beefeater Gin and Laphroaig Malt Whisky). It also moved the company further into the franchising market by buying Dunkin’ Donuts.

1993 saw a major realignment of the company’s drinks interests. It formed a joint brewing venture with Carlsberg - called Carlsberg-Tetley. In 1994 the company acquired Pedro Domecq, the Spanish international wine and spirits operation with brands such as Tequila Sauza, Presidente, Fundador and Centenario. As a result, the company changed its name to Allied Domecq Plc. In the same year, the company disposed of its food ingredients businesses.

Between 1995 and 1997, Allied Domecq withdrew from the brewing (Allied Breweries) and the tea and coffee business (J. Lyons). In 1995 its tea and coffee interests were sold to Karand Ltd; in 1996 it sold Lyons Irish tea business to Unilever and it also sold its 50% interest in Carlsberg-Tetley, together with its beer brands, breweries and network of depots to Bass plc. The sale of its breweries marked the company’s strategic shift towards spirits and wine and retailing (Dunkin’ Donuts, Firkin restaurants, etc.) at that time. On September 6th, 1999 the sale of the retailing operations (with the exception of the U.S. operations) were
finalized. Table 13 summarizes the major mergers, acquisitions, and disposals between 1994 and 1999. The rationale for disposing of its retail operations was due to the lack of synergies that existed between the two operations. In essence, before the disposal, AD operated in much the same way as a conglomerate. This strategic shift will allow AD to focus on its spirits and wine operations.

4.1.2 Organizational Structure

The acquisition of Domecq expanded the group internationally. A regional structure has been developed, establishing three market-led operations:

- Europe (U.K., France, Germany, Spain, etc)
- Americas (Latin America, Mexico, U.S., Canada)
- Asia-Pacific (Japan, China, Australia, etc.)

A president heads each of these regions.

Overlaying this regional structure is a business structure, relating to Allied Domecq’s two core operations - spirits and wines, and retailing. In addition to the above lines of business, each regional group has a number of investments/companies (Companies which Allied Domecq Plc does not control) in other countries including:

- Americas - Argentina, Brazil, Chile, Colombia, Jamaica, Venezuela;
- Europe - Austria, Croatia, Czech Republic, Denmark, Finland, Greece, Hungary, Iceland, Italy, the Netherlands, Norway, Poland, Portugal, Russia, Slovenia, Sweden, Switzerland;
- Asia-Pacific - Australia, China, Hong Kong, India, Malaysia, New Zealand, the Philippines, Singapore, Taiwan, Thailand, Vietnam.
4.1.2.1 Geographical Coverage

Allied Domecq’s two core business sectors - spirits and wines, and retailing - have very distinct geographical coverage. While the wine and spirits operation is truly international, the retailing operation is focused on U.S. operations (Dunkin’ Donuts, Baskin Robbins, and Togos), where the company is the largest U.S. franchised Quick Service Restaurant (QSR) in the morning sector.

Allied Domecq Spirits & Wine operations are in the major markets of Europe and North America. However, it is experiencing strong business growth in developing markets, especially those of Eastern Europe and Mexico. It is trying to leverage its strong position in Mexico and the high profile of Domecq brands in Latin America to extend its sales in the region.

In Asia-Pacific, Allied Domecq has traditionally been weak. Allied Domecq is now aiming to move from small, wholly owned companies to partnership with powerful local operators, and will focus on its Ballantine and Courvoisier brands.

In line with the increased importance given to the Asia-Pacific region, in early 1997 Allied Domecq announced a major joint venture with Lucio Tan Group in the Philippines, called Domecq Asia Brands Inc. This will combine Allied Domecq’s marketing skills with the bottling, sales and distribution abilities of Tanduay Distillers.
**Table 11:**
**Allied Domecq PLC: Percentage of Sales by Region 1995-1998**

Year ending August 31, 1998

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>49.2</td>
<td>51.1</td>
<td>49.6</td>
<td>48.7</td>
</tr>
<tr>
<td>Rest of Europe</td>
<td>21.4</td>
<td>21.2</td>
<td>21.8</td>
<td>21.6</td>
</tr>
<tr>
<td>US</td>
<td>16.8</td>
<td>14.5</td>
<td>15.0</td>
<td>17.1</td>
</tr>
<tr>
<td>Canada</td>
<td>2.1</td>
<td>1.7</td>
<td>1.9</td>
<td>2.2</td>
</tr>
<tr>
<td>Mexico</td>
<td>5.5</td>
<td>5.1</td>
<td>4.8</td>
<td>4.6</td>
</tr>
<tr>
<td>Rest of World</td>
<td>5.0</td>
<td>6.4</td>
<td>6.9</td>
<td>5.8</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


Table 12 below shows the major markets in which the company has important operations.

**Table 12:**
**Allied Domecq PLC: Major Market Presence 1998**

<table>
<thead>
<tr>
<th>REGION</th>
<th>MARKET</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>US, Canada</td>
</tr>
<tr>
<td>Western Europe</td>
<td>UK, Spain, France, Portugal, Germany, Sweden, Italy</td>
</tr>
<tr>
<td>Latin America</td>
<td>Mexico, Brazil</td>
</tr>
<tr>
<td>Asia-Pacific</td>
<td>Japan</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>Russia, Poland</td>
</tr>
</tbody>
</table>


**4.1.3 Corporate Strategy**

Allied Domecq is now strategically focused on international spirits and wine, and U.S. retailing. The company has chosen to focus on its core competencies. As a result, its recent
strategic changes have involved the sale of businesses, not acquisitions as outlined in the Allied Domecq PLC Corporate Strategy Bulletin, 1998 (ADPCSB[1998]).

4.1.3.1 Mergers, Acquisition and Disposals
In line with Allied-Domecq’s strategic focus on spirits and wine, and U.S. retailing, it has undertaken major business disposals and acquisitions. Its major acquisitions took place in the early 1990s. The acquisitions are outlined in table 13.

Table 13
Allied Domecq PLC: Major Mergers, Acquisitions and Disposals 1994-1999

<table>
<thead>
<tr>
<th></th>
<th>COMPANY ACQUIRED</th>
<th>DATE OF DISPOSAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisitions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spirits</td>
<td>Pedro Domecq</td>
<td>1994</td>
</tr>
<tr>
<td>Retailing</td>
<td>Togo's</td>
<td>1998</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disposals</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tea and Coffee</td>
<td>Most of its interests in Tetley tea</td>
<td>1995</td>
</tr>
<tr>
<td>Tea</td>
<td>Lyons Irish Tea</td>
<td>1995</td>
</tr>
<tr>
<td>Beer</td>
<td>50% stake in Carlsberg-Tetley</td>
<td>1996</td>
</tr>
<tr>
<td>Spirits</td>
<td>Cantral &amp; Cochrane</td>
<td>1999</td>
</tr>
</tbody>
</table>

Source: (ADPCSB[1998])

4.1.3.2 Strategic Orientation

Allied Domecq now operates in two business sectors:

- Spirits and Wines
- U.S. Retailing
It has moved out of other alcoholic drinks markets and out of the food business, so as to focus on these markets. This is allowing the company to sharpen its marketing focus on a range of core brands and improve its operational efficiency by integrating its production, distribution and marketing efforts in strategically important markets and for strategically important brands (ADPCSB[1998]). Table 14 highlights the breakdown of business by product sector and Table 15 summarizes the brands by product sector.

Table 14
Allied Domecq PLC: Breakdown of Turnover by Business Activity 1993-1998
% of turnover

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Spirits &amp; Wines</td>
<td>35.1</td>
<td>32.7</td>
<td>60.5</td>
<td>58.7</td>
<td>60.2</td>
<td>62.1</td>
</tr>
<tr>
<td>Retailing</td>
<td>28.3</td>
<td>29.1</td>
<td>39.3</td>
<td>40.9</td>
<td>39.8</td>
<td>37.9</td>
</tr>
<tr>
<td>Brewing &amp; Wholesaling</td>
<td>19.5</td>
<td>20.1</td>
<td>0.2</td>
<td>0.3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Food Manufacturing</td>
<td>17.1</td>
<td>18.1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


Table 15
Allied Domecq PLC: Main Operations by Product Sector 1998

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>SUB-SECTOR</th>
<th>MAIN BRANDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spirits</td>
<td>Gin</td>
<td>Beefeater, Nicolson’s, Plymouth</td>
</tr>
<tr>
<td></td>
<td>Whisky Blended</td>
<td>Canadian Club, Ballantines, Teachers</td>
</tr>
<tr>
<td></td>
<td>Whisky Malt</td>
<td>Laphroaig, Milton Duff, The Glendronach, The Tormore</td>
</tr>
<tr>
<td></td>
<td>Bourbon</td>
<td>Maker’s mark</td>
</tr>
<tr>
<td></td>
<td>Vodka</td>
<td>Borzoii, Hiram Walker, Polar Ice</td>
</tr>
<tr>
<td></td>
<td>Rum</td>
<td>Lamb’s, Lemon Hart</td>
</tr>
<tr>
<td></td>
<td>Cognac</td>
<td>Courvoisier</td>
</tr>
<tr>
<td></td>
<td>Brandy</td>
<td>Don Pedro, Presidente, Centenario, Fundador</td>
</tr>
<tr>
<td></td>
<td>Liqueurs</td>
<td>Tia Maria, Kahlua</td>
</tr>
<tr>
<td></td>
<td>Tequila</td>
<td>Sauza</td>
</tr>
<tr>
<td>Wines</td>
<td>Sherry</td>
<td>Harvey’s, Cockburn’s</td>
</tr>
<tr>
<td></td>
<td>Wine</td>
<td>Callaway, Clos du Bois, Atlas Peak</td>
</tr>
<tr>
<td>Retail</td>
<td>Franchising</td>
<td>Baskin Robbins, Dunkin’ Donuts, Togo</td>
</tr>
</tbody>
</table>

Source: (ADPCSB[1998])
4.1.4 Spirits Market Activity

4.1.4.1 Mission Statement

The stated mission of Allied Domecq Spirits and Wine is to be the leading international company marketing premium brands of spirits and other related adult beverages (ADPCSB[1998]). In striving to achieve their objectives AD will create value for its shareholders by continuing to build a business which will be attractive to investors for its profitability, returns, and development prospects (ADPCSB[1998]).

4.1.4.1.1 North America

Trading in North America (principally the US) was difficult for Allied Domecq from 1996 through 1999. Stock reductions led to significant volume sales declines for its main brands such as Kahlua, Canadian Club, Courvoisier and Beefeater, with Kahlua being especially hard hit as outlined in the ADSW Consolidation Team, Allied Domecq Corporate Strategy, 1999, (ADSWCTADCS[1998]). Retail sales proved more buoyant, with Kahlua and other major brands experiencing sales at the retail level exceeding shipments to the distributor level.

4.1.4.1.2 Latin America

Allied Domecq is well placed to develop markets in Latin America. The ownership of the Spanish Domecq brands gives it a firm foothold in Brazil, Mexico, Argentina and Colombia. In these markets, the Domecq brandies, with their strong local franchise, gives the company a platform on which to build sales of its whisky (mainly Ballantine’s) and tequila (Sauza) brands (ADPCSB[1998]).
4.1.4.1.3 Europe

European market fortunes were mixed for Allied Domecq in 1998. Destocking of its Ballantine’s Whisky brand resulted in overall volumes being down. Spain is Allied Domecq’s key continental European market, especially for Ballantine’s and Beefeater. In Spain, Ballantine’s continued to increase its share of the bar trade but lost share in the off-trade to low-priced whiskies. Beefeater gin, in contrast, gained share generally despite its premium price (ADPCSB[1998]).

In Europe as a whole, Domecq brands proved very strong, with DYC whiskies, for example, moving ahead strongly in Spain.

Allied Domecq faces two key problems in Europe:

- Continued increase in spirits duties, especially in Spain, Greece and Belgium
- The ending of European duty free

4.1.4.1.4 Asia-Pacific

Although traditionally a weak region for Allied Domecq, sales in Japan have been increasing marginally over the last three years, helped by Allied Domecq’s strategic relationship with Suntory. Ballantine’s sales in Japan rose by 25% (ADPCSB[1998]). Allied has not experienced the poor results of its competitors due to its limited exposure in the region compared to Seagram or Diageo.
Table 16
ADSW World Market Share by Product Line 1998

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tequila</td>
<td>20.0</td>
</tr>
<tr>
<td>Brandy</td>
<td>19.1</td>
</tr>
<tr>
<td>Liqueurs</td>
<td>10.8</td>
</tr>
<tr>
<td>Whisky</td>
<td>9.2</td>
</tr>
<tr>
<td>Gin</td>
<td>4.7</td>
</tr>
<tr>
<td><strong>WORLD MARKET</strong></td>
<td><strong>8.4</strong></td>
</tr>
</tbody>
</table>

Source: Data Impact, M. Shanken Communications Inc. New York, N.Y., 1999

In 1998, Allied Domecq accounted for 8.4% of the world's branded spirits sales. Its main strength is in the tequila and brandy market, reflecting the importance of the company in the Latin American markets.

### 4.1.5 Production Strategies

Allied Domecq is moving towards the development of a fully integrated supply chain, which will see suppliers (including packaging suppliers) integrated with production, which in turn will be fully integrated with distribution, and then with marketing. They are also attempting to create a marketing led organization that is pulled by consumer demand, rather than pushed by manufacturing. Such an organization, it is believed, will cut response times and facilitate greater efficiency in production and supply chain management (ADPCSB[1998]).

This implies production systems will have to be both efficient and flexible. Changes in market demand will require rapid adjustments to production volumes. In sectors such as whisky this, of course, is not possible, given the need to lay down stocks to mature. In these
markets, it is distribution systems rather than production systems that will need to respond quickly to demand.

4.1.6 Distribution Strategies
Allied Domecq’s key strategy with regard to distribution has been to improve its internal efficiencies. The aim is to release cash for the group through more effective supply chain management.

In particular the group has sought to eliminate overstocking of spirits brands, which has resulted in a reduction of 580,000 cases in the US distribution network alone and 2 million cases worldwide, during the late 1990’s. Also, another estimated million cases were eliminated during the last fiscal year due to the financial gain realized on the sale of the retailing operations. Worldwide the company has reduced its stock keeping units (SKU’s). In Europe alone they were cut by 23%, a figure helped by the integration of the Harvey’s and Domecq businesses in Spain (ADPCSB[1998]).

As part of its efforts to improve its supply chain management, Allied Domecq is attempting to improve its customer service to the retail trade. This implies effort to integrate more closely its key trade customers with its own production and distribution system, thereby reducing ordering times and lowering stock levels for its own and its clients’ operations.

Allied Domecq now controls the distribution of 90% of its sales volume, compared with only 70% in 1991, which makes total integration easier and more practical to undertake.
4.1.7 Marketing Strategies

The focus on Spirits and Wines, and U.S. Retailing has resulted in major structural and strategic marketing changes within the company. The company is customer-focused, with decision making having been shifted away from the production companies towards front-line managers (ADPCSB[1998]).

As a result, marketing is organized under a two-tier system:

- International brand groups - offering global support, including consistency of message and quality control;
- Local management - taking day-to-day marketing decisions for brands in each particular market or product sector.

Allied Domecq’s marketing strategy is now focused on three core objectives (ADPCSB[1998]):

- A substantial and consistent level of spending on brand promotion, across markets and brands
- Investment to be targeted to major profit earning brands
- Marketing targeted at core consumers - especially younger consumers.

Marketing effort is now being targeted at 15 priority combinations of brands and markets, which Allied Domecq has identified as the most likely to deliver increased profits (ADPCSB[1998]). This is creating a core of global brands, which centre on:

- Ballantine’s (whisky),
- Kahlua (liqueur),
- Beefeater (gin),
- Sauza (tequila).

Non-core brands will be sold or harvested. The core brands will be stretched in certain markets and areas - e.g. Kahluaaccino - and core brands will be used to sponsor high profile international events (e.g. Ballantine’s World Professional Snowboarding Championship).

Aligned to the company’s new marketing focus has been increased attention to customer service.
Outside Europe and North America, the key marketing objective is to grow market share through focused, creative and innovative marketing, especially in Asia-Pacific, central and Eastern Europe and Latin America. Allied Domecq will seek control over the destiny of its brands in key markets. It is understood that in certain circumstances control may be exerted through influence rather than total ownership, as is the case of ADSW's joint venture with Suntory in Japan. Individual Market situations will be assessed against a variety of parameters. ADSW's aim is to control the following (ADPCSB[1998]):

- Brand Positioning
- Marketing Mix
- Pricing
- Trade Influence
- Company Structure
- Selling Resources
- Brand priorities
- Margins

4.1.8 Retailing

The Board of Allied Domecq announced on July 20, 1999 that Allied Domecq and Punch Newco have entered into an agreement for the purchase of Allied's UK retail operations. Agreement was reached with Punch following Whitbread's announcement on July 15, 1999 that it did not intend to proceed with acquisition of the UK Retail Business as outlined in a bulletin sent to shareholders (Proxy For The Extraordinary General Meeting [PFTEGM], 1999).

Under the Punch Transfer Agreement Allied Domecq has conditionally agreed to dispose of the UK Retail Business to Punch Newco in consideration for the issue of Punch Newco Shares directly to new Allied Domecq Shareholders. An offer will then be made for those
Punch Newco Shares to be acquired from the new Allied Domecq Shareholders for an aggregate consideration currently valued at 2,709 million sterling. The UK Retail business consists of Allied Domecq’s managed and leased pub estates together with Allied Domecq’s 50% share in First Quench, its off-license joint venture with Whitbread. It also consists of its 25% interest in Britannia Soft Drinks, a soft drinks manufacturer, wholesaler and distributor, which is a joint venture between Allied Domecq, Whitbread and Bass (PFTEGM[1999]).

4.1.8.1 Mission Statement

The mission of Allied Domecq Retailing is to be the fastest growing premium retailing operation in defined geographic markets. In striving to achieve their goal, Allied Domecq Retailing will concentrate on brands that exceed the growth rates of competitors and provides a proven return for Allied Domecq's business partners and retailers (ADPCSB[1998]).

Allied Domecq Retailing objective is to control the retail experience of consumers through:

- Consistent store presentation (Brand Positioning)
- Superior product offerings
- Superior company structure
- Low cost production
- Superior franchisee community and business partners.

Table 17

<table>
<thead>
<tr>
<th>Franchised Stores</th>
<th>8,795</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>8,795</td>
</tr>
</tbody>
</table>

Allied Domecq Retailing (U.S.) operates primarily in North America. Operations in the United States are integrated with regards to operations (Site selection, Franchisee selection,
and production) and support functions (Information technology, finance, legal, taxation). In the U.S.A., where the goal of the brands (Baskin-Robbins, Dunkin' Donuts, and Togo's) are to offer multiple concepts within the same establishment, the level of integration is high. All operations are integrated. Brand champions, (marketing function) are geographically dispersed. However, their business plans are fully integrated within Allied Domecq Retailing U.S.A. Financial analyst have commented that the new Allied Domecq is in a position to move on merging its Spirits & Wine operations as the remaining retail operations can be easily spun off (ADPCSB[1998]).

The U.S. brands offer consumers different usage and occasion opportunities. They are:

- Dunkin' Donuts - Mornings, Basics
- Togo's - Lunch, Basics
- Baskin-Robbins - Evening, Indulgence.

Due to a lack of international brands, there are no central strategic groups, as contained in ADSW. Objectives, strategies, and tactics are set on a market by market basis.

4.1.8.2 Franchising

Allied Domecq's franchising operations, is comprised principally of Baskin - Robbins ice cream parlours and Dunkin' Donuts stores. There are more than 5,500 outlets in the USA, with international stores outside the US now numbering 3,000. Profits for fiscal 1998 were 6 percent lower reflecting the impact of severe winter weather in the USA and also higher milk prices adversely affecting Baskin-Robbins (ADPCSB[1998]). Operations in the USA have now been merged to form a single management structure to drive both brands.
The two brands continued to grow in the USA and internationally. By the end of the period under review there were 4,348 Baskin-Robbins outlets worldwide, and increase of 262, and 4,447 Dunkin' Donuts, and increase of 347.

The Information provided in the Allied Domecq PLC, Annual Reports and Accounts (ADPCSB[1998]) indicates that sales in existing stores moved ahead in both chains in the USA, aided by new product introductions. Dunkin' Donuts is now the leading retailer of bagels in the USA and plan to extend distribution to over 2,000 additional outlets in the course of the year. International expansion continues - most markedly in Russia and Korea for Baskin-Robbins and through first time openings for Dunkin' Donuts in Russia, China, the Czech Republic and Greece.

On July 18, 1997 Allied Domecq announced an agreement to purchase Togo's restaurants of California, which have over 200 outlets in California, for 54 million dollars. This is in line with AD's strategy of extending food offerings to consumers.

4.1.9 Allied Domecq PLC: Strategic Intent

AD hopes to achieve its mission through a strategy of (ADPCSB[1998]):

- Focusing on the development of brands in the selected international spirit and wine product categories.
- Growing their business from the aggressive development of international brands in selected key markets.
- Gaining a strong position in relevant domestic or regional products in key markets.
- Developing quickly and effectively is designated markets outside core markets.
- Increasing profitability and returns from the business.
- Cultivating a culture that embraces quality management, best practice and the best standards of service.
4.1.9.1 SWOT Analysis

Strengths

- World’s No 2 spirits company in terms of volume sales
- Well balanced mix of brands and markets
- Retail experiencing double digit growth
- Not dependent on one brand or channel of distribution

Weaknesses

- Relatively weak in emerging markets such as Asia-Pacific and Latin America
- Is still having to adjust to the acquisition of Pedro Domecq and re-focus its operations to become more customer-led
- Has continuously under performed UK trade index
- Outspent in terms of measured media in mature and developing Spirits & Wine markets

Opportunities

- To expand strongly into Latin America, especially Brazil and Argentina
- To expand strongly into eastern Europe, where the company has a strong position in the whisky market
- To streamline its production, distribution and marketing operations to gain share in established markets
- Reducing cost through consolidation of retailing support functions
- Purchase White spirit brands or seek strategic alliances to fulfill portfolio gaps

Threats

- The ending of duty-free shopping in Europe
- Continuing rises in spirits taxes and excise duties in Europe (but not the UK)
- Pressure from financial communities & shareholders for a merger of its Spirit and Wine operations and a divestment of the remaining retailing interests
- Diageo’s market power, brand depth and width will enable it to expand exponentially into emerging markets to the harm of its competitors
4.1.10 Future Strategy

Allied Domecq has undertaken a large amount of internal restructuring, to strategically focus the operations on spirits and wine, and to a lesser extent U.S. retailing. Now that the company has completed much of this activity, its core strategy in the future is to turn around the performance of the group. The focus of future attention will be to exploit past reorganizations and to improve operating performance. This has led to three key future strategies (ADPCSB[1998]):

- Make its core businesses leaders in their respective fields (i.e. increase market share)
- Manage the group strongly (i.e. improve operating efficiencies and market focus)
- Demonstrate good performance (i.e. improve profitability)

This strategy is being led by focusing on core brands, targeted national markets and targeted consumer groups. Focused marketing will be backed up with an integrated marketing, distribution and production system.

4.1.11 Financial Review

The 1998 results showed continuing progress towards financial targets, with improvements in earnings, dividend cover, interest cover and return on capital. Turnover at 4.3 billion sterling was broadly flat at constant exchange rates. Normalized profit before tax at constant exchange rates rose by 34 million sterling to 61.5 million sterling, although taking account of exchange rates the increase was 8 million sterling. Trading profits at constant exchange rates from continuing businesses in Spirits & Wine rose by 9 percent and within retailing they were maintained. Both sectors’ trading profits performances were achieved despite being adversely affected by the economic crisis across south-east Asia where Spirits & Wine
profits declined by 9 million sterling and Retailing profits declined by 7 million sterling (ADPLCARA [1998]).

“Fiscal 1999 has been a year of significant achievement for Allied Domecq. Through extensive restructuring AD returned 2.7 million sterling of value to shareholders and have emerged as a tightly focused international brand-led business,” commented Sir Christopher Hogg, Chairman of Allied Domecq. “The opportunities to improve the performance of the business are significant. We are committed to delivering these improvements which will markedly strengthen our position in any future industry consolidation, thereby further enhancing the return to shareholders” (ADPLCARA [1998]).

Table 18
Earnings per Share
(Normalized - Pence)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EPS</td>
<td>38</td>
<td>38</td>
<td>33</td>
<td>39</td>
<td>41</td>
</tr>
</tbody>
</table>

Source: (ADPLCARA [1998]).

Table 19
Dividends Paid
Pence

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>22.75</td>
<td>23.50</td>
<td>23.50</td>
<td>24.25</td>
<td>25.33</td>
</tr>
</tbody>
</table>

Source: (ADPLCARA [1998]).

Table 20
Geographical Analysis - Turnover
millions sterling

<table>
<thead>
<tr>
<th>AREA</th>
<th>U.K.</th>
<th>REST OF EUROPE</th>
<th>USA</th>
<th>CANADA</th>
<th>MEXICO</th>
<th>REST OF WORLD</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>1,937</td>
<td>931</td>
<td>804</td>
<td>88</td>
<td>300</td>
<td>248</td>
<td>4,308</td>
</tr>
<tr>
<td>1997</td>
<td>2,026</td>
<td>978</td>
<td>797</td>
<td>90</td>
<td>266</td>
<td>292</td>
<td>4,449</td>
</tr>
</tbody>
</table>

Source: (ADPLCARA [1998]).

59
In fiscal 1999 turnover increased to 2.4 million sterling on continuing operations a gain of 2% from the previous year on a like basis.

**Table 21**

<table>
<thead>
<tr>
<th>AREA</th>
<th>U.K.</th>
<th>REST OF EUROPE</th>
<th>USA</th>
<th>CANADA</th>
<th>MEXICO</th>
<th>REST OF WORLD</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>233</td>
<td>141</td>
<td>157</td>
<td>18</td>
<td>42</td>
<td>43</td>
<td>634</td>
</tr>
<tr>
<td>1997</td>
<td>293</td>
<td>158</td>
<td>147</td>
<td>19</td>
<td>42</td>
<td>56</td>
<td>715</td>
</tr>
</tbody>
</table>

*Source: (ADPLCARA [1998]).*

Trading profit for Spirits and Wine increased 4% before exceptional items (7 million sterling destocking in the US and the profit shortfall realized from the sale of bulk spirits of 8 million sterling) to 369 million sterling. The inclusion of the above items would have lowered profits to 354 million sterling, which is consistent with 1998 results for spirits & Wine operations (ADPLCARA [1998]).

Trading profit before exceptional business conditions and at constant exchange rates rose 3% to 443 million sterling. With the inclusion of the above, trading profit dropped by 1% compared with 1998 results on a continuing operations basis (ADPLCARA [1998]).

Sir Christopher Hogg goes on to state, “Allied Domecq in its new form has considerable operating strengths. We can see clear scope to add value by further improving business performance and we are determined to do so. The share price was adjusted at the beginning of September to 3.25 sterling (January 21, price of 3.02 sterling) to reflect the demerger and
we are experiencing the considerable benefits of being a more focused group” (ADPLCARA [1998]).

Philip Bowman, the new Chief Executive comments “The businesses that now comprise the new Allied Domecq made good progress during the year despite the inevitable distraction of the protracted disposal process referred to above. We have a clear strategy to improve the performance of these operations and have taken steps to accelerate the implementation of this strategy. In Spirits & Wine, the continued focus of direct brand marketing behind core brand market combinations has sustained the expansion of volumes, underlying profits and cash flow growth in the major regions of Europe and the Americas. Greater marketing emphasis and sophisticated customer management techniques are key drivers of this growth which will be reinforced by cost cutting and tighter management of the supply chain” (ADPLCARA [1998]).

He goes on to state, “We are actively seeking opportunities to improve the return on our existing assets and to enhance our position as the number two global spirits and wine company. These may include improving our geographic distribution (as highlighted by the recent agreement with Jinro in Korea), building on the strengths of our existing distribution infrastructure and developing our international wine business. There are significant opportunities for improving the performance of the business and management is focused on delivering these improvements. Achieving these objectives will strengthen the company’s position and therefore the return to shareholders in any future industry consolidation” (ADPLCARA [1998]).
Spirits and Wines

4.2 Industry Analysis

Since the merger of Guinness and Grand Metropolitan consolidation is the paramount issue in the global drinks business. Regardless of regulatory complications, the trend toward further consolidation appears likely. The global drinks business remains largely a zero-sum game, with major brands fighting for market share in all key markets. The difficulties involved in achieving more rapid growth rates are reflected in the world's top 10 leader's average growth rates in operating income and revenue for their respective 1998 financial years. The 10 averaged a 3% growth rate in operating income and a 0.3% increase in revenues. To achieve better growth, all the major companies are pursuing strategies of cost base reductions, increased marketing expenditures, strengthened focus on new products and heavier investment in underdeveloped markets.

While the underdeveloped markets still hold huge potential, their anticipated emergence has been slow to occur. The key new targets of India, China, the former soviet bloc countries and Latin America have all experienced uneven progress.

The continuing financial turmoil in the Far East, fueled by the erosion of the Thai baht and Thailand's US $17 billion bailout by the IMF, may well inhibit efforts to pry open markets in that part of the world. Guinness Plc, whose Johnnie Walker Black brand accounts for 32% of the Thai Scotch whisky market with a volume in 1998 of 655,000 cases, reported that its losses from the baht's collapse were 7 million sterling in 1997 and 5 million sterling in 1998 with continued anticipated losses for 1999 and 2000. This trend and the jittery atmosphere in the region's financial markets, has led to fears over future Asian expansion.
For the longer term, the emerging markets still hold a large opportunity. The traditional spirits market totals 576 million nine-litre cases annually, but the inclusion of local spirits from non-traditional markets brings the total spirits universe to 2.09 billion cases, according to Impact databank (1998). In markets like India, Scotch whisky accounts for around 100,000 cases in a local whisky market of 30 million cases and a total spirits market of 225 million cases. The China market is similar, with spirits imports comprising around 865,000 cases of a 574 million case spirits market. Gaining share from local spirits is also a priority in the more traditional markets like Japan, where recent tax reforms should level the playing field between imported whisky and sôchu. With a sôchu market of 76 million cases, drinks marketers see hope of gaining some share of that market.

Despite stubborn volume growth, the emerging markets are accounting for a growing part of the major multinational's business. Diageo reported that emerging markets represented 25% of its total volume and generated 10% of its operating profit in 1998. Although big sums are being spent to bolster their presence in these new markets, it will be some time before there is an improvement in the volume/profit ratio.

Among the mature markets, Western Europe continues to be a problem, with the key countries still progressing slowly from the recent economic recession. That, along with retail consolidation, continues to hold down pricing. Spain is showing some signs of improvement, but not in pricing terms. France is still being hindered by a 5% spirits duty increase that went into effect at the start of 1998. The German recession, meanwhile, continues to inhibit
volume and value growth. In general, Western Europe has probably the most difficult pricing environment of the mature markets.

In the U.S., while last year's upturn in the spirits market was undoubtedly significant, estimates at mid-year show spirits to be down slightly from the previous year. Still, the good news in the US is that the premium and super-premium brands are generally doing well.

Globally, spirits pricing continues to struggle. Price increases in recent years have averaged around half the low inflation rates of the developed markets - in other words between 0% - 2%. Drinks companies have significantly increased marketing expenditure to create better conditions for value growth. Diageo has increased its marketing expenditure by 17%, with additional increases expected in the future.

4.2.1 Corporate Strategies

The world spirits market is highly competitive. The bulk of the market is mature with manufacturers fighting to establish new products and gain share in stable market sectors. As a result, the major producers face intense competition. Margins in mature markets are under pressure - in part from increased retail buying power - and yet manufacturers need to find the resources to develop and exploit new products and increased marketing resources. This is resulting in the following strategies, to:

- Attain critical mass in the global drinks business, i.e. increased scale and efficiencies in mature markets
- Drive aggressively into emerging markets to generate volume sales
Competitive pricing requires the best practice in terms of manufacturing and distribution efficiency, while customer service requires leading-edge technology and flexible systems. Cost control and research and development will be central for future operations.

The need to maintain brand equity and define brands clearly in the customer’s mind also requires efficient operations in order to generate the resources needed for increased marketing spend. The need to maintain brand equity and improve manufacturing also implies closer co-operation between manufacturers and packaging suppliers, so as to reduce production costs, aid efficiency and improve or maintain the visual impact of packaging on customers.

In emerging markets, consumers are not brand-loyal and will switch brands if brands are not available. Therefore, distribution is central to developing customer loyalty.

Although manufacturing is not global in the spirits industry, distribution and marketing increasingly is. Many spirits producers are undertaking global marketing and distribution strategies. That is, they are:

- Contesting particular national markets, which they see as offering the best potential for growth
- Bringing their worldwide resources to bear on their operations in a given sector or sub-sector

**4.2.1.1 Global Brands**

To be truly global operators, companies must have consistent marketing and brand values across its national markets. A global manufacturer which offers different brands in different
markets and a diverse range of product specifications is operating like a series of national producers, not a global operator.

Most of the world’s leading producers have a variety of brands. However, marketing resources and distribution resources are increasingly being focused on a core of global brands.

**Table 22**

*Core Global Strategic Brands of the Major Spirits*

<table>
<thead>
<tr>
<th>COMPANY</th>
<th>STRATEGIC BRANDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allied Domecq</td>
<td>Ballantine's (whisky), Beefeater (gin), Sauza (tequila), Kahlua (liqueur)</td>
</tr>
<tr>
<td>Diageo</td>
<td>Smirnoff (vodka), J &amp; B Rare (whisky), Gilbey's (gin), Bailey's (liqueurs)</td>
</tr>
<tr>
<td></td>
<td>Johnnie Walker (whisky), Bell's (whisky), Gordon's (gin), Tanqueray (gin)</td>
</tr>
<tr>
<td>Seagram</td>
<td>Royal Chivas (whisky), Seagram's (gin), Captain Morgan (rum), Martell (cognac)</td>
</tr>
<tr>
<td>Brown-Forman</td>
<td>Jack Daniel's (whisky), Southern Comfort (liqueur)</td>
</tr>
<tr>
<td>American Brands</td>
<td>Jim Beam (whisky)</td>
</tr>
<tr>
<td>LVMH</td>
<td>Hennessy (cognac) Remy Martin (cognac), Cointreau (liqueur)</td>
</tr>
<tr>
<td>Pernod Ricard</td>
<td>Ricard (anis), Clan Campbell (Scotch whisky), Jameson (Irish whiskey)</td>
</tr>
<tr>
<td>Bacardi-Martini</td>
<td>Bacardi (rum). Dewar's (Scotch), Bombay Sapphire (gin)</td>
</tr>
<tr>
<td>Suntory</td>
<td>whisky, (brandy)</td>
</tr>
</tbody>
</table>


To deal with the size of the global economy, companies are:

- Consolidating through mergers and acquisitions to reach the scale required to compete in the global arena
- Globally rationalizing operations and seeking world standards for efficiency and productivity
- Selling off incompatible businesses and seeking global leadership in global segments and niches
Global operations does not mean creating a single global market. Local differences will always persist, with trade barriers and cultural differences resulting in distinct local markets. This means all companies will in some degree be under- or over-invested in certain assets, mainly distribution and marketing. They will need to spend more on both compared with the situation where a truly global marketplace exists. Moreover, there will remain a degree of inconsistency in a company’s marketing strategies. Companies as a result must build these factors into their strategy, without losing sight of the overall objective of global operations.

4.2.3 Vertical Integration

The costs of developing new products are high. Despite leading-edge technology and high-profile marketing, volume sales are often held back by a lack of suitable distribution, especially in emerging markets. More importantly, as distribution becomes increasingly tied in with marketing, so distribution must fit into a company’s marketing message.

For this reason, some manufacturers have sought to gain increasing control over the distribution of their products. Such vertical integration is taking place via three key methods:

- Setting up joint ventures with existing national distributors
- Setting up joint ventures with mutually compatible spirits companies
- Taking over existing distributors (e.g. Diageo’s take over of Cinzano and the subsequent ownership of its joint-venture distribution companies with Cinzano and Cointreau).

It is becoming increasingly important for manufacturers to control or have a strong influence over all aspects of the spirits industry, from production through to distribution. If a manufacturer does not own such expertise or control it in its own right, it has to seek strategic
alliances to make such resources available to it. Most major strategic acquisitions or joint ventures set up in the past few years have had improved distribution as their key motivation.

4.2.4 Broad Product Portfolios

In most of the spirits markets, new products, often spin-offs from existing products (such as ready-mixed products like gin & tonic) are showing above-average growth, although it is still true that established products form the bulk of the industry. The changing internal dynamics of the spirits markets means that manufacturers are having to adopt a broad market approach in terms of product portfolios. Manufacturers must offer a complete range of products. This has the following advantages:

- It covers the whole customer base (especially the younger market and women), thereby reducing the possibility of being locked into an narrow customer base
- It allows manufacturers to draw in sales from a younger target population, without abandoning sales from existing users who are already committed spirits drinkers
- It makes product migration easier - i.e. new, younger consumers start off with mixers and progress to standard spirits lines
- It allows manufacturers to capture the strategic high ground in the distribution chain by offering wholesalers and retailers a full range of drinks - white and brown spirits, liqueurs and cocktails

It includes manufacturers developing local spirits brands, at a price that will appeal to the mass of consumers in emerging markets rather than the affluent sections of society who are the main consumers of international spirits brands.

4.2.5 Diageo PLC

Diageo’s main strategy appears to be the following:

- Developing new brands
- Focusing its resources, financial and managerial on its core businesses
• Continuing to develop its portfolio of premium brands and building value added brand equity

• Continuing to expand internationally

• Getting closer to local national markets in order to be the best placed to anticipate and serve consumer demands

In the spirits market, UDV’s key priority is to improve its global distribution, a key driver to the merger, so as to continue to move and strengthen its position against its rivals in emerging markets. At the same time production, distribution, and marketing resources are being focused on those brands and markets seen as offering the best potential for profitable sales. The company has highlighted the Far East, Latin America, and the former Soviet Bloc for foreign market expansion.

4.2.5.1 Distribution Strategies

The merger has allowed UDV to globalize its distribution network. It has greatly expanded its distribution strength covering much of central and eastern Europe, Latin America, Africa, and Asia. As highlighted in the case study, distribution was a key benefit of the deal between Grand Metropolitan and Guinness. Diageo has gained and will continue to gain cheaper product distribution, has a far broader portfolio of brands and thus as major competitive edge over its main rivals. It will be able to both grow its volumes and squeeze better prices.

4.2.5.2 Marketing Strategies

The strategy of UDV is seen within the context of the strategy of its parent company, Diageo. The Diageo group strategy appears to be:

• Develop and build its existing portfolio of brands, (build volume, share, and brand equity)
- Consistently increase investment in highly targeted marketing support for its brands, (increased marketing spend and focus on a core of profitable and high profile brands)

This essentially implies:
- Growing the brand volumes (increased volume in mature markets and greater penetration in emerging markets)
- Protect or improve profit margins (remove costs from the system)

UDV’s perceived strategy appears to be designed to enhance the brand equity of its brands, that is:
- Continually to refresh the impact of its existing brands, (generate sales growth of its core brands)
- To build new brands, (broaden the brand franchise by bringing in new consumers to spirits consumption)
- To develop new markets, (new national, regional, and targeted consumer group markets)

Refreshing existing brands essentially means introducing established brands such as Johnnie Walker to a younger generation of drinkers. To ensure this, UDV makes extensive use of main-media advertising, plus heavy investment in sponsorship. Sponsorship is seen by UDV as especially attractive as it can target a brand’s appeal to a specific audience. UDV’s marketing is lead by extensive marketing research studies that analyze not only consumer tastes but also where and when consumers buy UDV products.

Spending on main-media advertising and other above-the-line activities has been given a high priority for the new organization compared to its predecessor organizations (Grand Metropolitan and Guinness).
Marketing investment is allocated to brands according to Diageo’s strategic resource allocation process, which ensures money is targeted appropriately. Within UDV there are brand market units (BMU’s), which handle the marketing of a particular brand with a particular market. BMU’s are categorized according to their potential to generate value in the future, with marketing investment allocated to those BMU’s with the greatest potential to provide a profitable return. Once money is allocated, its effectiveness is increased.

4.2.5.3 SWOT Analysis

Strengths:

- Wide-ranging portfolio of brands
- Not dependent on a single market of product sector (It has global and market brands in most sectors)
- Distribution Network
- Perceived as global leader
- Wide geographic spread of business
- It’s marketing ability and control over distribution allows it to tailor its marketing message to local conditions.

Weaknesses:

- Part of large conglomerate corporation
- Expected increases are expensive to achieve in Asia and other emerging markets which may hinder stock performance in the short term.

Opportunities:

- Clear leader in expanding into emerging markets.
- Size can lead to dominance in countries which require distribution networks (U.S.)
Threats:

- Expected savings and market expansion are slow to realize relative to the targets set at the time of the merger
- The continuing slow recovery in the Asian market where it has large market exposures
- Stock price that does not outperform the index.

4.2.5.4 Future Strategy

UDV’s future strategy appears to be based around its core international brands. UDV believes that brands are the focus for future growth. In mature markets like the US and the UK UDV’s brands maintain high brand equity ratings. It will continue to invest heavily in its core brands and continue to focus on the premium end of the market, where the opportunities are the highest. UDV will continue to focus on building its brand image and market share so as to build its brand equity. This is designed to build volume sales and protect or build profit margins.

In emerging markets UDV may be able to capitalize on its marketing philosophy, its brand width and depth, and its distribution network to lead and dominate the emerging markets of Asia, Latin America, and the former Soviet Bloc.

UDV’s strategy appears to imply heavy but targeted investment put into production, distribution, and marketing so as to concentrate the company’s resources on those brands and markets seen as offering the best potential for profitable sales growth in both the short and long term.
4.2.6 LVMH (Louis Vuitton Moët Hennessy)

LVMH had a complex inter-relationship with Guinness. The companies had a series of joint marketing and distribution operations and until early 1994 had a 24% stake in each other’s companies. In early 1994, Guinness sold for £1.3 billion its 24% in LVMH to Arnault Group, the ultimate owner of LVMH, and took a direct 34% stake for £902 million in Moët Hennessy, the wines and spirits subsidiary of LVMH. At the same time, LVMH has agreed to reduce its stake in Guinness to 20%.

LVMH was not happy with the Diageo merger deal. It preferred a deal merging Moët Hennessy with Diageo and splitting out the food, fast food and brewing operations. LVMH has terminated joint-distribution deals between LVMH and Guinness in France, the US and Asia and bought back Guinness’s 34% stake in Moët Hennessy.

4.2.6.1 Corporate Strategy

On a general level, LVMH appears to have a long-standing four-point corporate strategy, which can be summarized as:

- Focus on quality premium products
- Tight control over production to ensure quality
- Building brand equity, i.e. the value of the brand name
- Development of a multi-cultural organization able to react quickly to new opportunities. LVMH is strategically focused on luxury goods. As such, its key strategy is to maintain the premium image and price positioning of its brands. In order to achieve its goals, LVMH has laid out a two-point plan of action:
• Strengthen its position in mature markets (i.e. Europe and US) - i.e. increase its market share

• Establish major footholds in emerging markets, particularly in the Far East and Latin America

Increasing market share in mature markets is being led by introducing new products. In line with these strategic goals, Moët Hennessy has had a new structure developed to boost its wines and spirits brands. The reorganization was designed to:

• Encourage operating synergies among all the group’s wine and spirits companies - i.e. cut operating costs, aid new product development and speed time to market

• Protect the share interests of the wine and spirits company - i.e. protect brand equity

• Co-ordinate distribution strategies - i.e. save distribution costs and increased the effectiveness of distribution.

4.2.6.2 Distribution Strategies

In order to uphold its quality image and yet push sales in mature markets, LVMH has to ensure its key distributors are tied in with the company’s production and marketing operations. To ensure a high degree of support for and from wholesalers, LVMH (i.e. Moët Hennessy - MH) makes extensive use of joint ventures. It has 17 such ventures, throughout North and South America, Asia and Europe.

Because LVMH focuses on premium brands, the marketing operations tend to offer high wholesale margins, which ensures a high level of commitment to the companies brands from their key wholesalers.

Overall, MH has a worldwide distribution network, which provides sales and marketing support for its brands in every country important to it.
4.2.6.3 Marketing Strategies

LVMH marketing, with regard to spirits and cognac, appears to have been designed to achieve two goals:

- Increase brand share in mature markets
- Help penetrate newly emerging markets

These goals have involved new product launches, which have been seen as the best way to enliven mature markets. New launches have included Hennessy Extra (duty free), Hennessy Choice (aimed at Chinese consumers) and Hennessy Privé, targeted at take-home Japanese consumers. In 1998, the company launched Richard Hennessy, a blend of several cognacs.

Marketing for Hennessy, LVMH’s leading cognac, appears to be focused on trying to promote new forms of consumption aimed at rejuvenating the image of cognac and attracting new categories of consumers. Marketing in this respect has included:

- Promoting cognac-based cocktails in the US
- Developing authentic local advertising and promotional campaigns for Japan and South East Asian markets
- Linking the Hennessy name with major cultural or sporting events
- Opening a second visitor centre in Cognac
- Focusing on the premium market (Thomas Hine brand) and linking sales with the growth of cigar smoking, especially in the US.

While the customer base is being broadened, Hennessy’s central position as a quality brand is being supported.
4.2.6.4 SWOT Analysis

**Strengths**

- Strong premium brands that are winning market share
- High margin consumer goods

**Weaknesses**

- LVMH operates in small niche sectors of the spirits market (i.e. brandy and cognac)
- Volume sales increases are only being won at the expense of value sales declines
- Week or nonexistent foreign distribution network
- Dependence on third party distributors

**Opportunities**

- To expand its sales in the Far East, where Japanese and Asian consumers are showing a preference for brandies

**Threats**

- The ending of duty free in Europe
- A possible undermining of its premium positioning if it cut prices too far or moves its brand too aggressively into new markets, e.g. cocktails
- Inability to capitalize on emerging markets

4.2.6.5 Future Strategy

LVMH will maintain its premium market status with regard to its premium cognac brands. It will, however, be seeking to market these very aggressively in the future and may have to sacrifice some price points in order to main its stated goal of increasing market share in its mature markets and expanding rapidly into emerging markets.

4.2.7 Seagram:

Since the merger of Guinness Plc and Grand Metropolitan Plc, special attention has been paid to Seagram as it reassesses its position within the drinks business. The company's
options are varied, but two main choices are acquisition of a major company like Allied Domecq or the purchase of brands. Seagram can certainly afford further acquisitions, thanks in part to strong cash flow from its spirits and wine business.

Seagram has a considerable war chest, but the clear priority is the development of the entertainment business. The company has shown no sign of putting those plans on hold because of the Guinness and Grand Metropolitan deal. Its recent purchase of the remaining 50% of cable programming service USA Network for US$1.7 billion, the purchase of Polygram N.V. for $18.4 billion, and the disposal of Seagram’s remaining stake in Time Warner for $1.5 billion has strengthened the entertainment side. Seagram has said publicly that it plans further acquisitions in the entertainment area. Like other large entertainment production companies, Seagram is now seeking to acquire television stations, in a vertical integration move to gain distribution.

The Seagram Annual Report (1998) outlined that in August 1998, Seagram sold its shares in Tropicana for $3.3 billion U.S. Following the sale of Tropicana, Seagram now has major positions in two clear and distinct lines of business; Spirits & Wine; & Entertainment. Upon the completion of Universal’s acquisition of Polygram, 70% of its revenues come from entertainment and 30% come from Spirits & Wine operations. With the purchase of Polygram, Seagram is the world’s largest music company when combined with Universal’s holdings. The company (division) is known as the Universal Music Group.

Subsequent to the purchase of USA networks Inc. (full ownership), Seagram combined the operations with Universal Television. This group was combined with HSN, the parent
company of the Home Shopping Network, which owned a variety of television stations. Universal holds 45% interest in the above with the option over the next three years to increase its majority equity interest. Seagram has further developments in the U.K., Europe, Spain, and China to develop theme parks (SAR, [1998]).

4.2.7.1 Corporate Strategy

Seagram appears to be undergoing business re-engineering. This is part of a new strategy designed to improve management effectiveness with regard to:

- Controlling the significant changes in its core assets
- Senior management control of all operations
- Operating procedures

The newly re-engineered Seagram appears to be designed to become operationally more flexible and more nimble than it was in the past. In particular, Seagram is aiming to become more customer-driven, which implies upgrading its management techniques, its information systems and its objectives. Seagram has been a sleeping giant for many years, with financial performance not matching its strength in terms of volume sales and geographic coverage.

More specifically, Seagram appears to have four key strategic goals:

- To increase its market share and expand geographically - i.e. to grow its business and adapt to changing markets
- To improve customer service - i.e. improve response times, price competitiveness and the general service to key retail customers
- To protect brand equity - i.e. retain the premium status of its most important bands
- To use strategic partnerships and alliances where necessary - i.e. seize entrepreneurial business opportunities
In order to adjust to expected market changes and new business opportunities, Seagram’s strategy appears to require that it invest opportunistically in new businesses that will strengthen its current operations and offer attractive longer-term growth.

Most of the company’s initiatives during the past few years were in entertainment, a business Seagram has identified as one that clearly meets its growth objectives. Seagram is now investing heavily in films and entertainment, including theme parks.

4.2.7.2 Distribution Strategies

Outside the US and Canada, Seagram’s spirits and wines are marketed through affiliates, joint ventures or independent distributors. Such affiliates and joint ventures are located in Argentina, Australia, Austria, Belgium, Brazil, Chile, China, Colombia, Costa Rica, the Czech Republic, the Dominican Republic, France, Germany, Greece, Hungary, Hong Kong, India, Israel, Italy, Jamaica, Japan, Mexico, the Netherlands, New Zealand, the Philippines, Poland, Portugal, Singapore, Slovakia, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, Ukraine, the UK and Venezuela.

Much of Seagram’s re-engineering activities have been the result of increased retail concentration. This has meant the company is increasingly selling large volumes but at relatively low prices. The growing importance of a smaller group of key retail customers and the growing importance of duty free to the company has meant that improving retail (and wholesale) customer service is a core strategic goal for Seagram.
To earn more shelf space, Seagram is adopting key account management and working to simplify processes such as invoicing and delivery. Tailored services for each retailer are being put together to match Seagram’s offerings to each retail client’s service, sales and value propositions. As such, Seagram is employing supply-chain techniques to link its own computer systems with that of major accounts. In addition the company is streamlining the physical logistics of delivery, so it can deliver more frequently, on shorter notice, thus minimizing store inventories.

4.2.7.3 Marketing Strategies

Seagram’s marketing appears to be undertaken on three key levels: global, regional and national:

- Global Brands division - this handles strategic planning, marketing, general management, sales and administration for Seagram’s key global brands

- Global Duty Free - this handles strategic planning, marketing general management, sales and administration for Seagram’s key global brands sold in duty-free shops

- Regional Marketing Operations - these control marketing within specific region based on global objectives

- National Marketing - this handles the day-to-day marketing operations

Seagram’s top 15 wine and spirits brands, which represent over 65% of total annualized attributed revenues, are and will continue to be the primary focus for future growth. The Seagram Spirits and Wine Group has developed a much-improved customer fulfillment program and a stronger marketing focus on consumer brand awareness.

The Seagram Spirits and Wine Group, as part of its planning process, has completed a rigorous review of its 150 brands across all regions. The division has clearly delineated
growth initiatives in each of the markets in which it competes. For the more mature markets such as North America and Europe, the Group has streamlined its operations and realigned its sales force in response to changes in distribution.

Most importantly, it has segmented the market to focus on premium brands, which are expected to outperform the overall industry in these markets. In the emerging markets, Seagram's strong distribution and brand portfolios provide a competitive advantage. The premium brand strategy has strengthened profit margins and led to divestment of low-margin brands. In markets that are not mature, Seagram is aggressively expanding.

Seagram is investing in its key brand franchises to build image and grow distribution in all markets. To maintain or improve its market position, the company makes extensive use of magazine, newspaper and outdoor advertising. Seagram also utilizes radio and television advertising, although the use of such advertising in connection with the sale of spirits is restricted in certain countries.

Despite difficult operating results for wine and spirits, Seagram has continued to invest in marketing, with marketing spending increasing. This included increased investment in new and developing markets such as India and greater China. Advertising is focused behind core strategic brands and in key markets, including Germany, South Korea and greater China.

In the US, Seagram broke the voluntary ban on TV advertising of spirits by running local campaigns for its key brands on local cable channels. This was Seagram America’s most
extensive TV campaign ever for spirits and ran in more than 25 markets. The ads featured a
dog carrying a bottle of Crown Royal Canadian whisky.

These ads have drawn criticism from the President of the United States, health bodies and
other manufacturers. However, Seagram contends that the media landscape has changed
dramatically since the 1940s, when the ban was agreed, and that a company such as Seagram
should be as free as the beer and wine marketers are to buy commercial time.

4.2.7.4 SWOT Analysis

Strengths

- Extensive portfolio of spirits, including global brands such as Chivas, Martell
- Already has major strength in emerging markets such as Latin America and Asia

Weaknesses

- A traditional, bureaucratic and inward-looking management philosophy which is only
  now changing
- Still undergoing major restructuring to correct its traditional and bureaucratic method of
  operating

Opportunities

- To expand into Eastern Europe, Africa and Asia
- To exploit fully the strong sales potential of its premium brands
- To seek strategic alliance partners

Threats

- The ending of duty free in Europe
- Possible restrictions on alcohol in North America
- The strength of Diageo in mature and emerging markets
- Downward pressure on price to combat Diageo
4.2.7.5 Future Strategy

Seagram has a number of key strengths, specifically its extensive portfolio of brands. The company's future strategy appears to revolve around exploiting these brands financially, in terms of generating and maintaining higher profit margins, while exploiting volume sales to key retail accounts.

Seagram’s appears to have, therefore, a premium, profit-led strategy for the future, which is dependent on the company improving its operational and organizational structure to ensure high levels of service to its core retail and duty-free accounts.

4.2.8 Pernod Ricard

4.2.8.1 Corporate Strategy

PR appears to have a three-point business strategy:

- To maintain its leadership in the French spirits market
- To develop its overseas spirits sales by entering new markets
- To diversify its activities and increase its operations in the non-alcoholic drinks sector

This implies expanding its activities into major emerging markets such as Latin America (e.g. Chile, Venezuela), Africa (South Africa) and Asia (e.g. India and Sri Lanka). Between 1990 and 1998, PR had already expanded its operations into other parts of Asia, including Hong Kong, Singapore, Thailand, South Korea, China, Japan and Vietnam. This followed its strategic push from 1985 to the early 1990s into the rest of Europe, including Eastern Europe.

At the same time, the company is seeking to improve its distribution in the major developed markets, such as those of Greece, Belgium and Canada. It has begun to take greater control of its distribution by taking over local distributors in key markets.
The three core strategic aims also imply important operational activities, including:

- Moves to increase market share in France in two key markets - aniseed-based spirits and whiskies
- Accelerated development and focus on strategically important international brands, including increased promotional and advertising backing for these brands
- Increased attention to operational efficiencies by exploiting operational synergies between group companies, leading to savings on operational running costs

4.2.8.2 Distribution Strategies

PR appears to be moving to strengthen its international distribution network, especially in emerging markets. The concentration of activities in the international arena has led PR to reorganize its network, placing all of its distribution subsidiaries under the control of three new companies:

- PR Europe
- PR Americas
- PR Asia

This is designed to give its distribution operations greater focus and regional co-ordination. It has also taken greater control over its own distribution network, allowing it to achieve greater co-ordination between its marketing, bottling, warehousing and distribution operations.

4.2.8.3 Marketing Strategies

PR’s key marketing strategies appear to be as follows:

- To invigorate its brand franchise for its established brands in the developed markets
- To build sales of its brands in the emerging markets
- To focus on its core international brands and especially fast growing brands such as Jameson.
PR has tried to invigorate its key aniseed-based brands and make them more appealing to a new generation of consumers. In France, for example, using the slogan "Un Ricard Sinon Rien" (A Ricard or nothing), PR tried to build on the confident, non-conformist attitudes of French youth to make Ricard an attractive option. Promoting its brands in emerging markets has including taking control over distribution so as to co-ordinate marketing with product availability.

4.2.8.4 SWOT Analysis

**Strengths**

- World leader in aniseed-based spirits
- Owns fast-growing international brands such as Jameson

**Weaknesses**

- Requires further structural changes to improve its operational efficiency and co-ordination
- Overly dependent on aniseed-based spirits for its sales
- Low awareness levels amongst LDA to 29 consumer segment

**Opportunities**

- To expand its international sales in emerging markets
- To grow brands such as Jameson into significant world brands
- Seek a partner to merge with or strategic alliances

**Threats**

- Any shift away from aniseed-based spirits (especially in France)
- The market power of Diageo
- Lacks mass to make any foreign expansion profitable in the short or medium term
4.2.8.5 Future Strategy

PR’s future strategy appears to be based on two core aims of the group:

• To consolidate its position in France and increase its leadership in the spirits sector;

To reinforce its overseas position and focus on its strategically important brands (i.e. Pernod, Jameson, Clan Campbell).

4.2.9 Bacardi-Martini

4.2.9.1 Corporate Strategy

The company’s key strategies appear to be:

• Maintain its leadership in the world rum and world spirits markets

• Increase global penetration of markets, i.e. achieve global distribution of its brands

The first strategy resulted in a series of line and brand extensions, such as Bacardi Breezers, designed to allow the company to compete against newly established international rums and to compete against other fast-growing white spirits categories, such as vodka and tequila. The second strategy led to the merger with Martini & Rossi. Starting with a series of joint ventures and wholly owned subsidiaries, Bacardi began to improve its performance and achieve greater control over its distribution in Europe and North America. A number of these joint ventures involved Martini & Rossi. The synergies between the two companies soon became apparent, and a merger resulted. The acquisition of Dewar’s and Bombay Sapphire from Diageo has given Bacardi and expanded portfolio in segments that it previously did not have a large presence in.

4.2.9.2 Distribution Strategies

Bacardi-Martini has active distribution in more than 100 countries. In all of its major markets, Bacardi-Martini owns its own distribution. This gives Bacardi-Martini control of
98% of its global distribution. The formation of Bacardi-Martini is an indication of the priority put on distribution by Bacardi: the 1992 merger meant Bacardi acquired 35 distribution networks, almost all in areas complementary to its own.

Bacardi-Martini’s distribution strategy appears to be to globalize its distribution network, either by buying into existing operators or setting up joint ventures. Bacardi-Martini provides major backing to the on-trade, which its sees as the prime channel for introducing new drinks.

4.2.9.3 Marketing Strategies

With regards to its marketing message, Bacardi appears to have four key principles:

- Keep it simple
- Keep it direct
- Keep it positive
- Stay consistent

Bacardi’s fundamental marketing strategy has not changed since the 1930s/1940s. The message can be summed up as "mixability". The central core of Bacardi’s marketing message has remained "Bacardi Rum - the mixable one".

This strategy carved out a niche for Bacardi in the rum and total spirits market. Bacardi does not compete against whisky, gin or vodka and created an appeal that went across and broad spectrum of consumers. Mixability also allowed Bacardi to benefit from the growing popularity of Coca-Cola worldwide: the Bacardi and Coke drink (Cuba Libre) remains important to Bacardi’s global marketing strategy.
The mixability of Bacardi and its ability to become a variety of drinks (when mixed with different soft drinks or flavours) created the party image for Bacardi. A 1995 US ad, featuring segments of orange and party colours, had the main message, "Just Add Bacardi" was very successful. The campaign has since been augmented by the message, “Bacardi by Day, Bacardi by Night” emphasizing the life style of young, professional, and successful individuals.

Today, Bacardi is focused on premium line extensions for its main brand. In 1996, extensions such as Bacardi Spice, Bacardi Limon and Bacardi Breezers proved very successful. At the same time, the company is seeking to emphasize the heritage and roots of its Bacardi products in order to give the brand more integrity with its target audience. As populations in traditional markets age and as Bacardi wishes its younger audience to take the Bacardi drinking habit into older age, so the brand must become more relevant to 25+ year-old consumers. At the same time, the packaging on its standard rums have been changed to create a more premium image.

4.2.9.4 SWOT Analysis

Strengths

- Bacardi is the most valuable spirits brand in the world

- The merger with Martini has given Bacardi-Martini one of the strongest distribution networks in the spirits market

- The acquisition of Dewar’s and Bombay Sapphire have added high profile brands

- Bacardi has had a tradition of local management and a flat, lean organizations structure. This has tended to result in the company being quick-footed and capable of responding quickly to changing market conditions
Weaknesses

- Relies mainly on a single brand and a single market segment
- Being family-owned, it could lack the resources of its corporate competitors
- The price paid for Dewar’s and Bombay Sapphire will create internal pressure to recoup the investment on a timely basis

Opportunities

- To extend the Bacardi brand family to tap new and niche market segments
- Expansion in Latin America, Eastern Europe and South-East Asia
- To exploit its other brands
- Leverage its strength in emerging markets to capitalize on its purchase of Dewar’s and Bombay Sapphire
- To go Public to acquire funds to grow the company and the brands

Threats

- The growth of rival international rums, such as Havana Club
- The market strength of Diageo

4.2.9.5 Future Strategy

Bacardi-Martini will continue its push to achieve global distribution of its products. With this in mind, its future strategy appears to revolve around:

- Building its main brands
- Creating new products, especially line extensions
- Moving into strategic collaboration with producers and distributors around the world

There is clear potential for the brand in South America, where major markets such as Brazil have not been fully developed. Its American/Caribbean roots should give it a major marketing weapon in the region. Sales into Eastern Europe should also grow strongly, given
the region's liking for white spirits and Bacardi’s close association with Coca-Cola. Bacardi-Martini also has a well-developed distribution system in Russia through the Roust trading company. Sales into Southeast Asia will prove more difficult for its white rums, but its dark rums offer the company a major potential for growth. However, Bacardi will initially target Japan only.

In a restructuring from its previous five operating companies in Mexico, Puerto Rico, Florida, The Bahamas and Bermuda, Bacardi was regrouped regionally in 1995 into Bacardi-Martini of North America, Latin America, Asia Pacific and Europe, as well as Bacardi International and a central marketing unit based in Florida. This has focused the company's regional strategy and laid the groundwork for a more defined marketing approach. In 1998, family-held Bacardi also broke with tradition in naming a non-family member, Chip Reid, as its president and CEO. However, in early calendar year 2000 Mr. Reid was severed from the company and replaced with a family member.

4.2.10 Brown-Forman:

4.2.10.1 Corporate Strategy

Brown-Forman's strategy with respect to the wines and spirits segment appears to be to:

- Accelerate its expansion into international markets
- Add new beverage products, by either internal development or acquisition

Around 25% of beverage sales, excluding excise taxes, were generated from new products introduced or brands added within the past five years.
4.2.10.2 Distribution Strategies

The wine and spirits segment distributes its spirits products domestically either through state agencies or through wholesale distributors. Sales managers and representatives handle Brown-Forman products or brokers in all states of the US.

The contracts, which Brown-Forman has with many of its distributors, have formulas that determine reimbursement to distributors if Brown-Forman terminates them; the amount of reimbursement is based primarily on the distributor's length of service and a percentage of its purchases over time. Some states have statutes that limit Brown-Forman's ability to terminate distributor contracts.

Overseas, Jack Daniel's Tennessee Whisky and Southern Comfort are the principal products exported, and these brands are sold through contracts with brokers and distributors in most countries. Brown-Forman has important agency contracts for its Jack Daniel's whisky and Southern Comfort liqueurs with Bacardi-Martini GmbH (Austria) Diageo in the U.K.

4.2.10.3 Marketing Strategies

Brown-Forman appears to have two key marketing strategic objectives:

- To focus on premium, high-quality brands (e.g. Jack Daniel’s and Southern Comfort)
- To protect and promote brand equity with extensive international, national and regional marketing programs, these being intended to extend consumer brand recognition and brand loyalty

As such Brown-Forman is not aiming for mass volume sales, but rather targeted, high value and profitable sales.
4.2.10.4 SWOT Analysis

Strengths

- Two strong, internationally famous brands - Jack Daniel’s and Southern Comfort
- Both its international brands appeal to both a young and older audience, while retaining an authentic quality image

Weaknesses

- Outside of the US the company has little international brand strength, despite rapidly growing sales
- Apart from Jack Daniel’s and Southern Comfort, its spirits brands are not showing strong sales in the US

Opportunities

- To expand its internationals sales in both mature and emerging markets
- To align itself with another major industry participant through merger or joint ventures

Threats

- If the US Congress goes forward with efforts to return responsibility for expensive social programs to individual states, many more states are likely to consider imposing regressive taxes on alcoholic drinks
- The Diageo merger and its influence on distributors in BF's core markets U.S. & U.K.

4.2.10.5 Future Strategy

Brown-Forman appears to be focusing on its core spirits brands of Jack Daniel’s and Southern Comfort. The cornerstone of its future strategy is to turn these brands into global market leaders, while protecting their premium market image and positioning.

4.2.11 American Brands: (Jim Beam Brands) (JBB)

4.2.11.1 Corporate Strategy

In recent years, American Brands appears to have been engaged in a strategy seeking to enhance the operations of its subsidiaries in certain major businesses. This has involved the
company refocusing its business away from tobacco and non-core activities such as optical
goods towards more growth-orientated consumer-branded activities.

American Brands spun off its UK-based Gallaher tobacco business. Following completion of
the transaction American Brands became two publicly traded companies:

- American Brands (renamed Fortune Brands, Inc)
- Gallaher

Fortune Brands appears to continue to pursue its strategy of enhancing the operations of its
subsidiaries in certain major businesses and therefore is exploring other possible acquisitions
in fields related to its major businesses.

4.2.11.2 Distribution Strategies

Products of JBB Worldwide subsidiaries are sold through various distributors and, in the 18
"controlled" states in the US. JBB (Greater Europe’s) products are sold in the UK through its
own sales force, in the US and Australia through the affiliated company distribution
networks, and through independent distributors in other areas of the world.

4.2.11.3 Marketing Strategies

Fortune Brands seems to be a marketing-orientated company. Its strength is in its brand
names. As such, it appears to adopt a strategy of high-profile backing for its brands; brand
image and brand equity are the core of the company’s strengths.
Its core marketing strategy appears to be to build its brand equity, especially for its central international brands such as Jim Beam. In this regard, it uses all marketing methods available and spends heavily on main media and below-the-line marketing.

Total marketing expenses in 1998 increased 11%, reflecting higher support of new products in the North American market and Whyte & Mackay branded products in the UK.

During 1996, certain competitors of JBB Worldwide began television and radio broadcast advertising of distilled spirits products in the US market, and the national distilled spirits industry association retracted a previous voluntary ban on such activities. To date, JBB Worldwide, through its Beam subsidiary, has not begun any such advertising but may yet do so in response to competitive conditions: other operating units outside the US have already begun such broadcast advertising in markets where it is legal and not in violation of voluntary restrictions by industry groups.

4.2.11.4 SWOT Analysis

Strengths

- It owns some of the world most famous spirits brands
- It owns high profile consumer goods

Weaknesses

- The company is very diverse, which could dilute its attention on a specific product or brand
- Reliance on third party distribution network
Opportunities

- The move to exploit the worldwide appeal of its main global brand such as Jim Beam
- Full integration of Jim Beam and Whyte & Mackay, allowing leverage of the combined brand portfolio

Threats

- Potential lawsuits against the company related to its past ownership of tobacco companies
- Diageo market power
- Lack of resources, financial and managerial, to gain share in emerging markets

4.2.11.5 Future Strategy

Fortune Brands' core future strategy appears to be to improve its profitability. In the spirits market, this would imply:

- Enhancing brand equity - i.e. supporting or enforcing price points for key brand
- Substantial marketing support for key brands - i.e. so as to maintain profit margins and premium price-points
- Growing volumes by penetrating emerging markets and winning market share in established markets - i.e. a focus on brands with international appeal, such as Jim Beam, with a proven ability to grow sales faster than industry averages

The JBB Worldwide group is now comprised of divisions JBB Greater Europe, JBB Asia-Pacific, JBB Americas and JBB North America. JBB Worldwide is part of Fortune brands, which also owns Cobra, Titleist, and Foot-Joy golf equipment, Master Lock, Moen appliances and Swingline office products. There seems to be few synergies between the drinks side and the other businesses.
4.2.12 Other Companies

Japan's drinks giant Suntory Ltd ranks in the top 10 in terms of spirit cases sold. Suntory's total spirits volume grew by 1.1% to 16.9 million cases. The recent tax changes in the Japanese market should actually be a positive development, despite the fact that the changes are designed to help imported brands. Like the importers, Suntory is looking to trade consumers up from lesser price shochu category to its whiskies. Allied-Domecq has the distribution rights to Suntory products in Eastern Europe and the United States.

As the leader in Japan's domestic whisky category, Suntory has presided over a period of extreme difficulty for the sector. Since 1990, Japanese whisky volume has fallen from 18 million cases to 11.4 million cases in 1998. During that same period, shochu volume rose from 66 million cases to 76 million cases. Much of the domestic whisky decline is attributable to the 1989 tax changes that raised the rate on second-grade whiskies and effectively priced them out of the markets. Annual spirits growth, which was at 4% - 5% prior to 1990, has been stagnant since the start of the decade. The long-running weakness in Japanese consumer spending has hurt sales, and the proliferation of discount stores has severely eroded margins. From being virtually non-existent in 1990, the discount stores now account for around 25% of all Japanese domestic whisky sales and 40% of total whisky sales.

Suntory has moved to diversify its portfolio, with the introduction of shochu brands, premixed products and other new brands. The company has also sought to broaden its presence in other far Eastern markets, particularly those where whisky consumption is strong,
or has strong potential, In Thailand, for example, Suntory has linked with domestic giant Boonrawd to try and develop a presence there. It has also been active in the Chinese market.

India's slow progress of imported whisky brands in India has undoubtedly been good for business, as UB is India's leading domestic spirits company. UB groups' total spirit volume, which is predominantly in the Indian whisky, rose by 6% last year to 16 million cases. In total, the UB Group holds over a 30% share of the Indian Made Foreign Liquor (IMFL) market.

India's still difficult import policies, coupled with ongoing advertising restrictions, have meant that UB Group and its domestic counterparts still have the market largely to themselves, despite some successes for locally-bottled whisky admix products for foreign companies such as UDV's Gilbeys whisky line. Nearly every international drinks company has now linked with a partner in India. UDV is in fact partnered with the UB Group. But although the groundwork has been laid, the domestic players are still in control.

4.3 Company and Industry Conclusions

The third objective of this investigation it to assess the suitability of merger and acquisition partners as determined by the research respondents based on the importance of the drivers identified. In order to be able to complete this objective a review of the company and industry was required. Chapter 4 laid the framework for the development of Appendix C, the competitor assessment. This tool was utilized in the interviews to aid the respondents in assessing merger candidates.
Chapter 5: Research Findings and Synthesis: Merger and Acquisition perceptions and the effects on Allied Domecq Spirits & Wine.

Table 23 highlights the surveys that were received and classified as complete. A total of 195 surveys were mailed out on May 1, 1999. Of those surveys 88 were returned. Due to incomplete data or other missing information 17 of the surveys were excluded. Six departments were represented in the survey. They included finance, human resources, marketing, strategy, sales and supply management (purchasing). Only information technology failed to be represented. The geographical areas covered included North America, South America, U.K., Europe, Australia - Asia (referred to as Aust/Asia), and other.

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<tr>
<th>DEPARTMENT</th>
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</thead>
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<td>Finance</td>
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<tr>
<td>Human Resources</td>
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<td>Supply Management</td>
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<td>Sales</td>
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</table>

5.1 Objective 1:

Identify drivers of mergers and acquisitions that are relative to the spirits and wine industry.

While a definable list cannot be established for merger and acquisition strategies, a review of prior experience with strategic development in the U.S. industry is enlightening. The latest surge in M&A activity has only two quantitative equals in the United States Industrial history; First, the largely horizontal merger wave of 1898 to 1902, when the great industrial
monopolies were formed; Second, the conglomerate wave of the 1960’s, when large companies diversified by purchasing unrelated businesses (Jensen & Ruback, 1983). In the 1960’s, many companies pursued a corporate strategy attempting to increase earnings per share and spread risk through investment in diverse enterprises. While this strategy worked for a time the longer-term performance of the resulting conglomerates led the stock market to accord them below-average price earnings (P/EP) ratios. By contrast the current M&A movement seems to be focused around producing synergy between the companies (Jensen et al, 1983). Critics of the merger movement, however, cite concerns over the high premiums paid and the significant debt incurred to finance the deals, and they question whether the claimed synergies will materialize (Ecces et al, 1999).

Table 24 compares the drivers identified through the Review of Literature and cross-references the drivers identified in Project Boston, Diageo or both if applicable. Through this exercise the extendibility of the drivers identified in the Review of Literature to the spirits and wine industry is confirmed. 82 percent of the drivers identified in the secondary research are applicable to either the merger of Hiram Walker & Sons Inc. with Domecq Importers or the formation of Diageo, which was the merger of Grand Metropolitan Plc and Guinness Plc.

5.2 Objective 2

_quantify the perception of Allied Domecq Personnel and industry professionals to the drivers of mergers and acquisitions._

The questionnaire is contained in appendix D. The Burke Institute’s Center for Implied Marketing Research identified that a seven-point scale should be used in self-administered
testing. The results of the questionnaire, contained in table 25, shows the importance of the drivers as determined by the respondents.

**Table 24**

Presence of drivers in Project Boston and Diageo

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Project Boston</th>
<th>Diageo</th>
<th>Drivers</th>
<th>Project Boston</th>
<th>Diageo</th>
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<td>Obtaining Distributor</td>
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<td>R&amp;D personnel &amp; facilities</td>
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Table 25
Variable, Mean Score, and Std Deviation

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<tr>
<th>VARIABLE</th>
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<th>STD. DEVIATION</th>
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<th>MEAN SCORE</th>
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Based on the Top-2-Box scores the drivers (variables) which scored the highest are contained in table 26. The Top-2-Box scores are a relevant test as it highlights the conviction a respondent has to a variable. In marketing research (product) the desire is to have responses at both end of the scales. Responses in the middle generally show little passion for the variable. Researchers would rather have extreme low scores compared to a higher degree of neutral responses.
Table 26
Top 2 Box Ratings of Drivers

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<tr>
<th>DRIVERS</th>
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<th>TOP - 2-BOX SCORE</th>
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</tr>
<tr>
<td>Distributor Consolidation</td>
<td>17</td>
<td>Management Hubris</td>
<td>0</td>
</tr>
<tr>
<td>Strategic Synergy</td>
<td>17</td>
<td>Avoid Profit Slumps</td>
<td>0</td>
</tr>
</tbody>
</table>

The variable in table 25 with the highest standard deviation was the political reasons driver. This question caused as one senior executive in North America said, “A great deal of uneasiness. I believe the articles in the papers and the recent position rationalizations have hurt morale. When your Chief Executive comments that consolidation is not a consideration but only a matter of time people become concerned about their own well being,” commented a senior Finance Director.
The top drivers in both analysis formats remains the relatively the same and is dominated by:

- Size
- Portfolio Expansion
- Competition Removal
- Company Survival
- Market Expansion
- Market Dominance
- Plant Utilization
- Customer Expansion

Cross tabulations are used to compare the number of cases that fall into each cell resulting from treating two or more variables simultaneously. In order to gain a better understanding of the respondents a cross tabulation was utilized to compare the respondent’s departments. Each department will be presented separately.

5.2.1 Finance Personnel

“Cost Reductions through merger or acquisitions are not ownable and as such should not be a reason for merger activities. Whatever company Allied Domecq Plc decides to merge with there will be cost savings to be realized,” commented one senior South American Finance Director. “The focus should be on increasing the value to shareholders.”

Table 27 contains the top five drivers for finance personnel. When asked why he thought that the standard deviation for Political Reasons was the largest, the above respondent contributed the following, “The results to the changes that the company has been going through over the last five or six years has been difficult for employees. As the company continuously consolidated it operations and removed local market representation as well as made cuts at the corporate level there is a strong feeling that the company has lost its direction.”
Table 27
Top drivers for Finance Personnel

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant Utilization</td>
<td>5.88</td>
<td>.62</td>
</tr>
<tr>
<td>Low Cost Producer</td>
<td>5.81</td>
<td>.66</td>
</tr>
<tr>
<td>Profit Growth</td>
<td>5.81</td>
<td>.75</td>
</tr>
<tr>
<td>Portfolio Expansion</td>
<td>5.81</td>
<td>.75</td>
</tr>
<tr>
<td>Strategic Synergy</td>
<td>5.69</td>
<td>.70</td>
</tr>
</tbody>
</table>

5.2.2 Marketing Personnel:

"The opportunity associated with an alliance of some sort with major competitor is the expansion of the brand portfolio on a depth level. Most people believe that it will be beneficial to add new categories. This is not Allied Domecq Plc's problem in South America. Our problem here is that Allied Domecq Plc does not have enough depth in one particular category. Allied's scotch brand, Ballantine's, does not have another support brand to enable us to use one of the brands at the low end to help generate penetration for the category as a whole," commented Alberto de la Iglesia, V.P. Marketing - Latin America.

Dave Waluk, V.P. Marketing - Allied Domecq USA, commented that he believes that AD's portfolio weakness in the areas of clear spirits, primarily Gin & Vodka, will be directly related to the company AD seeks to merge with. In the U.S., the most profitable market, the top brands are clear. AD's goal is to expand the breadth of the portfolio. Expanding the portfolio is crucial to increase AD's level of persuasion with Distributors."
"Size in the U.K. will help AD gain share in its home market which it has a limited presence in. After the disposal of Victoria Wines, the directly owned retail arm in the U.K., Allied will need to merge with someone to hold on the share it has or to have any opportunity of making gains either on or off premise," commented Stuart Wooten - Marketing Director, Corporate Marketing.

Based on mean scores, the leading variables for marketing respondents are contained in table 28.

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size</td>
<td>5.19</td>
<td>1.11</td>
</tr>
<tr>
<td>Portfolio Expansion</td>
<td>5.74</td>
<td>.81</td>
</tr>
<tr>
<td>Market Dominance</td>
<td>5.50</td>
<td>.89</td>
</tr>
<tr>
<td>Customer Expansion</td>
<td>5.25</td>
<td>.77</td>
</tr>
<tr>
<td>Competition Removal</td>
<td>4.75</td>
<td>1.00</td>
</tr>
</tbody>
</table>

It is interesting to note that the variable, Marketing Competencies, which relates to the quest to raise the marketing competencies of the company, had one on the highest standard deviations. This was not surprising, as the marketing respondents have been under pressure for a number of years to increase the results of their activities without increasing the levels of expenditures.
Cost reductions contained the largest standard deviation as the respondents were mixed on how savings would be utilized. Most of the respondents hoped that any cost savings would be utilized to increase marketing resources to grow the company’s core brands.

5.2.3 Human Resources Personnel

Based on mean scores, the leading variables for Human Resource respondents are contained in Table 29.

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost Reductions</td>
<td>5.67</td>
<td>1.33</td>
</tr>
<tr>
<td>Plant Utilization</td>
<td>5.33</td>
<td>.82</td>
</tr>
<tr>
<td>Distributor Consolidation</td>
<td>5.00</td>
<td>.82</td>
</tr>
<tr>
<td>Market Dominance</td>
<td>5.17</td>
<td>.41</td>
</tr>
<tr>
<td>Competition Removal</td>
<td>5.17</td>
<td>.41</td>
</tr>
</tbody>
</table>

A senior HR official commented that consolidation is inevitable, as there is no other way to grow the industry. As the industry continues to erode in major markets and the opportunity of raising prices continues to diminish the only way to grow is to control costs. Also, the opportunity of attracting qualified candidates from leading schools or industries is becoming tougher everyday as the industry is not as attractive as it once was.

5.2.4 Strategy Personnel

“The merger of Grand Metropolitan Plc and Guinness Plc has required all the companies within the industry to immediately start exploring their own options,” commented Rupert
Barclay, Director of Group Strategy. "He further commented that "senior management has continuously commented that we believe consolidation is in the best industry of Allied Domecq Plc and other leading industry participants." In order to compete on a global scale we need to be able to protect our mature markets and have a competitive advantage or at least parity against Diageo or we run the risk of losing market share in emerging markets. The belief is that emerging markets represent the growth for the industry and as such we can not enter these markets or can we afford to enter these markets without the scale of our major competitors.

Through portfolio expansion Allied Domecq would be able to solidify its opportunities and decrease its distribution and administrative costs while presenting distributors and retailers with a full range of brands. Based on mean scores, the leading variables for strategy respondents are represented in Table 30.

"In order to increase the return on investment on our brands we need to increase the excellence associated with marketing these brands. As the rules and regulations continue to be relaxed in mature markets like the United States, the need for marketers with disciplined consumer packaged goods marketing is crucial," Commented Paul Francis, Analyst - N.A. Group Strategy.
Table 30
Top drivers for Strategy Personnel

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Dominance</td>
<td>5.19</td>
<td>1.11</td>
</tr>
<tr>
<td>Portfolio Expansion</td>
<td>5.74</td>
<td>.81</td>
</tr>
<tr>
<td>Size</td>
<td>5.50</td>
<td>.89</td>
</tr>
<tr>
<td>Foreign Expansion</td>
<td>5.25</td>
<td>.77</td>
</tr>
<tr>
<td>Plant Utilization</td>
<td>6.00</td>
<td>.58</td>
</tr>
<tr>
<td>Marketing Competencies</td>
<td>4.75</td>
<td>1.00</td>
</tr>
</tbody>
</table>

5.2.5 Sales Personnel

“The ability to get equity brands and price brands placed is to be able to offer a full stable of products. While we are strong in brown products (whiskies) we are missing key white good products (Vodka) which impede us in getting our full portfolio placed,” commented Mr. Robert Shea - V.P. Sales - ADSUSA.

Paul Finch, Managing Director of Australia / Asia commented that in Australia distributors are tied to one major distiller. In order to be effective that distributor needs to market brands with high equity measurements to be profitable and develop and sustain brand-building activities. Through merger we would be able to add categories that we are now week in and add brands to existing categories that we have strengths.
Table 31
Top drivers for Sales Personnel

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost Reductions</td>
<td>5.92</td>
<td>.67</td>
</tr>
<tr>
<td>Size</td>
<td>5.67</td>
<td>.78</td>
</tr>
<tr>
<td>Customer Expansion</td>
<td>5.67</td>
<td>.78</td>
</tr>
<tr>
<td>Market Share</td>
<td>5.58</td>
<td>.79</td>
</tr>
<tr>
<td>Distributor Consolidation</td>
<td>5.58</td>
<td>1.00</td>
</tr>
<tr>
<td>Marketing Competencies</td>
<td>4.83</td>
<td>.83</td>
</tr>
</tbody>
</table>

Bill Donan, V.P. Sales - Southwest Division - ADUSA comments, “While I was at Campbell’s we were on a cost cutting initiative to be able to increase the internal funds within the company to invest back into growing the equity of the brands. The cost cutting initiatives we are currently under will hopefully create internal funds to be invested back into the brands. Based on mean scores, the leading drivers for Sales respondents are contained in Table 31.

5.2.6 Supply Management

Based on mean scores, the leading drivers for supply management respondents are contained in Table 32. “In order to increase the return to our shareholders we need to either grow through foreign expansion or drive the cost out of the system. In North America alone we are down nearly 50% in volume from the highs of the early 1980’s. This drastic decrease has left a great deal of capacity available through the industry. Even after we closed three plants in the last ten years we still are faced with excess capacity. Through merger we would be able
to better utilize the assets that would become available, commented Michael Booth - VP

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant Utilization</td>
<td>6.18</td>
<td>.60</td>
</tr>
<tr>
<td>Low Cost Producer</td>
<td>5.91</td>
<td>.54</td>
</tr>
<tr>
<td>Cost Reductions</td>
<td>5.55</td>
<td>.82</td>
</tr>
<tr>
<td>Market Share</td>
<td>5.55</td>
<td>.52</td>
</tr>
<tr>
<td>Portfolio Expansion</td>
<td>5.27</td>
<td>.65</td>
</tr>
<tr>
<td>Customer Expansion</td>
<td>5.27</td>
<td>.47</td>
</tr>
<tr>
<td>Strategic Synergy</td>
<td>5.27</td>
<td>.65</td>
</tr>
<tr>
<td>Shareholder Pressure</td>
<td>5.09</td>
<td>.70</td>
</tr>
</tbody>
</table>

5.3 Objective 3

Assess the suitability of merger and acquisition partners as determined by the research respondents based on the importance of the drivers identified.

5.3.1 Introduction

Appendix A, B, & C were utilized to aid the discussion with respect to the suitability of merger partners for Allied Domecq PLC. Thirty (30) respondents who submitted complete surveys were interviewed. The interview format was unstructured to allow respondents latitude for their answers or insights they wished to provide. Although the responses to this objective are subjective they serve a meaningful purpose for the research.
The position of Allied Domecq Plc, relative to the Life Cycle Portfolio Matrix as developed by Arthur D. Little, was classified within the following categories according to the respondents.

- Favorable / Mature
- Favorable / Aging
- Defensible / Mature
- Defensible / Aging
- Weak / Mature
- Weak / Aging

Of the above categories, the first “Favorable / Mature” can be viewed as favorable with the others being viewed as disadvantageous. “The problem for industry participants is that the emerging markets we have been waiting for seem farther off then originally predicted. Culturally there are difference in consumption patterns and lifestyles that we depend on so heavily to make decisions,” commented Rupert Earclay - Group Head, Strategy, Allied Domecq PLC.

“The question for Allied Domecq relative to the matrix is how to move from the Favorable / Mature box to the Strong / Growing box. While mature markets continue to decline the emerging markets like Asia and Latin America show great promise,” comments Alberto de la Iglesia, VP Marketing S. America.

Bill Donan VP Southwest Division - ADUSA, comments “There are numerous companies in other industries that would like to have our problems of huge margins and basically a mature market that has remained relatively flat. Seagram has used their spirits business to deliver their new vision on the entertainment side. The cash for Seagram still comes from the spirits
their new vision on the entertainment side. The cash for Seagram still comes from the spirits arm. My point is simple; this industry even in mature markets is not dead. We need to find a method of improving our competitive position.”

The perception of industry participants is that Diageo Plc has now set themselves up to capitalize on emerging markets due to the merger. They now have the portfolio depth and width and the infrastructure that is cost effective that will support its brands relative to its competitors.

The same respondents graded Diageo relative to the Life Cycle Portfolio Matrix as follows:

• Clear Leader / Growing
• Clear Leader / Mature

Allied Domecq’s market strength is North America, Mexico and Europe with a special emphasizes on Spain. Its portfolio strength is in Canadian, Liqueurs, Cognac, Scotch and Tequila. The investment by Warren Buffet, in early 1999, as an investor who pursues undervalued companies with excellent brands, has created excitement within Allied Domecq. In order to improve its competitive position Allied Domecq may need to merge or acquire another industry participant. If this is not possible they may need to seek further joint ventures or strategic alliances.

5.3.2 LVMH

The merger of Grand Metropolitan and Guinness effected LVMH greatly. LVMH and Guinness had multiple joint ventures and strategic alliances that have been dissolved since the merger. They have joined forces with many local companies in different geographic
regions to maintain distribution. The brand portfolio of LVMH is limited and would not complement the brand portfolio deficiencies within Allied Domecq. However, since consolidation is the main issue in the industry it would not be surprising to see a second tier global supplier acquire a leading industry participant.

“LVMH would not be able to deliver any of the top variables identified in the discussion matrix like Portfolio Expansion, Size compared to Diageo, or Company Survival,” commented Lou Sterlin - V.P. Sales ADSUSA.

5.3.3 Seagram

The strategic alignment was set between Seagram and Allied Domecq. John DeBoer, V.P. Taxation - Allied Domecq commented, “Seagram and Allied Domecq agreed to merge during the summer of 1998 after a long courtship following the establishment of Diageo. Seagram personnel were going to manage the Americas and Asia Pacific and Allied Domecq personnel were going to manage Europe. The board of Allied Domecq approved the deal. However, the merger was denounced by Edgar Brofman senior who refused to dilute his holding in Seagram spirits operations.”

The synergies between Allied Domecq and Seagram are the most advantageous of any of the industry participants. Seagram is strong in the Americas and Asia Pacific and Allied Domecq strengths are in Europe and the Americas. Within mergers or acquisitions duplication will need to be rationalized. The plan for the Americas was addressed above and is consistent with Seagram’s strengths in the United States.
The disposal of brands between Seagram and Allied Domecq would most likely focus upon the Canadian whisky segment in Canada alone. First, in the U.S., while the Canadian category is the largest, the combined companies would hold the fifth, sixth and seventh leading brands which are Seagram’s V.O., Canadian Club, and Crown Royal respectively. Second, within the Gin category Allied Domecq is strong in Europe with a special emphasis on Spain and in the premium category segment in the United States with Beefeater Gin. Seagram is strong in the African American market with Seagram’s Gin. This is an ideal example of expanding the breadth of a company’s portfolio. Third, within Europe Allied Domecq has Ballantine’s the leading Scotch brand where Seagram has little presence in the category in Europe or the Americas. Fourth, Seagram participates in the Tequila segment at the premium end with brand such as Patron while Allied Domecq has the second largest and fastest growing brand in the segment with Sauza. Fifth, Seagram has the worldwide distribution contract for Absolut Vodka; the government owned brand from Sweden, while Allied Domecq does not have a major brand in any country. Sixth, Seagram has Captain Morgan’s rum, which has a loyal following in the U.S. amongst the LDA (legal drinking age) to 25 year old.

While Mr. DeBoer would not elaborate further with respect to the identity of the organization or the structure, the market pressures surrounding the fit between Seagram and Allied Domecq is expected to continue especially since the emphasis for Seagram’s is firmly focused on the Entertainment segment.

“While Seagram offers market expansion and brand expansion there are other opportunities present for Allied Domecq, which include growing our organization on our own. Merger or
acquisitions are an option that needs to be explored with great care. We will merge if it creates value for our shareholders that we can not create on our own,” comments Ian Jamieson, V.P. - Planning, Development & Information.

5.3.4 Pernod Ricard

Allied Domecq’s chief executive, Philip Bowman, hit out at rival spirits giant Pernod Ricard, claiming it was encouraging rumors of an impending merger. Mr. Bowman said, “They’ve been banging the lid of their dust bin for some time now, although they’ve not approached us at all. I find it very strange. If they were going to make a friendly approach, I wouldn’t have thought this was the way to go about it. If they were going to make a hostile bid, I wouldn’t have thought they’d want people to know.”

Pernod’s director-general Thierry Jacquillat fueled merger speculation by declaring that the group’s founding families would be willing to dilute their shareholdings in any deal. However, Mr Bowman said Pernod lacked the global brands, particularly in vodka and white rum, which Allied would look for in any deal, “The degree of synergy would be significantly less than would come about through a combination with other major players. French booze is about as popular as French beef” (London Stock Exchange, 2000).

Mr. Jacquillat commented, “Pernod Ricard is interested in global brands. We think there are such things as worldwide brands in wines and spirits, more than you get in things like computers” (London Stock Exchange, 2000).

“Allied needs to strengthen its distribution network and add to its brand portfolio in order to compete with its giant rival Diageo and its UDV arm. Pernod Ricard is not an ideal partner:
its aniseed-based spirits are hardly the drinks of the younger generation. The likes of Bacardi and Seagram would be better candidates,” commented one City Analyst (London Stock Exchange, 2000).

5.3.5 Bacardi - Martini

The sure size of Bacardi’s Rum business would help Allied Domecq or any other company in the industry to rationalize and expand its international operations in emerging markets. Bacardi purchased Dewars and Bombay Sapphire from Diageo when government regulators ordered the disposal of the brands.

Paul Francis, former Brand Manager for Allied Domecq and Current Brand Manager of Bacardi, comments, “Bacardi is focused on growing their business through acquisitions in the years to come in order to decrease their reliance on the rum category. There is speculation within the company that Bacardi is considering an IPO to raise funds to pay down the debt associated with the purchase of Dewars and Bombay Sapphire and to consider other acquisitions.”

Bacardi’s strength in South America would compliment Allied Domecq. Their combined position in Mexico would lead to market dominance and in the U.S. they would increase their presence through offering a comprehensive portfolio. Allied Domecq’s market presence in Europe would aid Bacardi. Even though neither enterprise is strong in Asia / Pacific the combined portfolio would provide the mass to expand distribution and market share in this emerging market segment.
Allied Domecq has the number one Scotch brand in Europe and Bacardi has the number one brand in the United States. Bacardi’s position in clear spirits (rum and premium gin) would compliment Allied’s position. Allied’s position in Canadian whisky, Liqueurs and Tequila would aid Bacardi’s position.

The greatest challenge to a strategic alignment (merger) between Bacardi and Allied Domecq is the private ownership of Bacardi. However, the ownership structure should not be an obstacle as each industry participant has identified consolidation as necessity for the industry. “Bacardi would significantly improve our competitive position in mature markets. In emerging markets their brands would add the critical mass to allow us to move forward exponentially. Bacardi, Allied Domecq and a possible third participant would put Allied on a similar size as Diageo, ensure some form of our survival, and answer the critics from the City,” commented Bob Fowkes - Director Planning, Development & Information.

5.3.6 Brown - Forman

A consistent theme through the presentation of the strategic initiatives of the major global participants is the goal of expanding into emerging markets. Brown - Foreman, a privately held company, is focused primarily on the U.S. market. Jack Daniels and Canadian Mist are number one in their respective categories in the U.S. and globally. Jack Daniel’s possesses one of the strongest brand equity measures in the industry and in consumer packaged goods. Internationally, local market distributors distribute Jack Daniel’s. The possibility of increasing the performance of the brand would need to be determined on a market by market
basis and the assumption that alignment with another major supplier would increase performance is precarious.

The possible combination of Allied Domecq and Brown - Foreman would create little strategic synergies between the two organizations. The market strengths and portfolio strength would overlap in the categories of Canadian Whisky, Liqueurs, and Bourbon. The market strength would be focused solely upon the U.S.

Ken Candela, V.P. Sales - Alliance Brands, ADUSA comments “Brown - Forman would add brands like TGIF cocktails and JD Country Cocktails. These brands would fit in with the Alliance organization compared to adding brands to the core equity side. While these brands have lower gross margin they have large volumes that would deliver additional profits to Allied Domecq. Adding Brown - Forman would increase our size, answer the shareholder pressure that Allied is continuously under, and increase plant utilization”

5.3.7 Jim Beam Brands

Jim Beam Brands, part of the American Brands family, is focused on gaining excess to emerging markets. However, with a limited portfolio of brands the cost / benefit equation for Jim Beam and other industry participants is not advantageous. Jim Beam, like Brown - Foreman, relies upon joint ventures to gain market share on an international basis. Like Brown - Foreman, the duplication of market and portfolio representations would not aid Allied Domecq in growing in emerging markets.
As described above, this does not limit the actions of Jim Beam Brands. Allied Domecq would be able to provide inroads to markets which currently JBB is not well represented, which include Europe and Mexico.

5.3.8 Summary

The objective was to assess the suitability of merger partners for Allied Domecq relative to the primary research conducted and based on the companies’ strategic situation. This does not preclude the actions of the companies assessed above. All the industry participants have acknowledged that consolidation is the number one issue facing the industry.
Chapter 6: Research Conclusions

6.1 Research Question 1:

*What are the drivers of mergers or acquisitions activities that can be identified from the literature that may be relevant to the spirits and wine industry?*

"It is interesting to see the results of your research in the order of importance. This will lend insight into future actions of Allied Domecq. Also, some of the categories identified would not come to “top of mind” without it, like profit protection," commented Nick Johnstone - VP Global Marketing.

The drivers (variables) have been presented from three sources of information:

- Secondary Research
- Project Boston
- The merger of Grand Metropolitan and Guinness

The objective, to identify the drivers of mergers and acquisitions that are extendable to the spirits and wine industry was adequately met. The application of the drivers to the two industry cases proves that the concerns are uniform for companies seeking mergers and acquisitions. The review of literature provided theoretical and practical applications of mergers and acquisitions. These drivers (variables) are evident in the merger of Grand Metropolitan Plc and Guinness Plc and in the merger of the two Allied Domecq Sales and Marketing Companies, Hiram Walker & Sons Inc. and Domecq Importers.
6.2 Research Question 2:

Of the drivers identified, which are the most important drivers for mergers or acquisitions as perceived by personnel within Allied Domecq spirits & wine?

Using SPSS software we were able to identify and rank the perception of drivers (variables) of merger and acquisitions for Allied Domecq as they seek to partner with other industry participants. Also, using cross tabulations we were able to measure the perception of different departments within Allied Domecq. Based on the macro view of the respondents there is overwhelming support for a merger based on the theory of revenue enhancement. This further supports the belief that a merger without the benefit of revenue enhancement or cost effectiveness is not well supported within the organization. The information from the primary research was useful as it provided insight into the beliefs of different departments. Although some of the sample sizes were small to draw definitive conclusions they did provide adequate insight.

What was more illuminating was the insight gained through interviews. Individuals, in some cases, represented different ends of the spectrum with respect to their comments regarding their acceptance of variables identified in the secondary research.

The goal of research questions 1 and 2 was to define criteria to use in the assessment of suitable merger partners for Allied Domecq based on the subjective opinions of company personnel. This will be addressed under research question 3.
In conclusion, research could have been conducted solely on this area alone. This area provided the most gratifying feedback when interviews were conducted. Comments from respondents varied from the knowledge of the variables to those who appreciated seeing the results and absorbing the beliefs of their associates.

6.3 Research Question 3

*How can the drivers identified as ranked by the respondents be used to assess potential merger or acquisition candidates?*

The research questions were presented in the order utilized to provide an understanding of merger and acquisition drivers (variables) and to assess the importance of each of these drivers as Allied Domecq Plc seeks a merger partner to improve its competitive position. Since the demerger of the U.K. retailing sector, Allied is clearly focused on growing shareholder value through the improvement of its Spirits & Wine operations.

The Life Cycle Portfolio Matrix (a tool used within Allied Domecq) referred to in chapter two has a clear focus for Allied Domecq. The strengths and weaknesses of each of the major global industry participants to merger or acquisition and the fit with Allied Domecq have been identified. In this end, the objective for research question 3 has been clearly met. We have not explored the merger or acquisition opportunities that exist on a regional basis as this is outside the scope of the thesis. There is limited information and knowledge with respect to these options, and the obtained scale would not suffice to improve the company’s strategic position on a global basis with Diageo.
In conclusion, we have identified that a possible alliance could include multiple companies in multiple regions under multiple organizational alliances. Phillip Bowman, Chief Executive of Allied Domecq has recently concluded that, “It is not a question of if, but has a question of when and with whom we merge to improve the value to shareholders.”
Chapter 7: Research Recommendations

7.1 Introduction

Mergers have always been a burr under the economist’s saddle. On the one hand, the business reviews have provided little or no evidence that mergers are profitable, and there is considerable evidence to show that they are not profitable (Kennedy, 1995). On the other hand, mergers continue to occur. This does not square with the vision of rational markets we reviewed in Chapter two.

This situation suggests that:

- Research is not sound
- Those who effect mergers are unaware of the research findings and of the underlying facts that mergers are unprofitable
- Those who effect mergers have motives (political reasons) for their actions other than the long-run profitability of the merged entity
- There are other forces (reviewed in chapter two) at work that are not observable in the firms’ public information that make mergers desirable

The first possibility would do the field(s) of research no credit, and the second and third possibilities call into question the extent of profit-seeking rationality in the economic environment; the fourth possibility is consistent with the concept of a rational market and soundly - performing directors and companies (Kennedy, 1995).

In light of the results presented in chapter two, the question: If mergers are not profitable, and if ignorance is not the explanation, why do mergers take place? One possible explanation is the fact that a merger may itself be a signal that the merging company’s future is relatively weak.
7.2 Implications for Allied Domecq:

7.2.1 Operating Divisions

The information provided through the Review of Literature and the primary research conducted ranked the drivers that Allied Domecq should consider in the selection of a merger or acquisition partner. In the short term the Allied Domecq operating companies should consider their operating options. First, the portfolios of the operating companies should be rationalized as conducted by Allied Domecq – USA. In this end, Allied will be able to concentrate resources behind core brands as outlined in the 15 brand market combinations and be able to eliminate non priority brands. Second, through the rationalization, the operating companies will be able to align their activities with the vision of the organization as it seeks merger or acquisition partners. Third, duplicate operating companies (production companies and sales and marketing companies) that still exist in various geographical regions should be consolidated and efficiencies realized.

7.2.2 Allied Domecq Group Strategy Department

There are many reasons to seek merger or acquisitions as a corporate strategy. However, given that the majority of merger or acquisitions are not successful relative to the original objectives a great deal of planning needs to be executed in a disciplined fashion. Richard Z. Gooding in the September / October 1998 edition of Financial Executive blamed the failure of the buying firm’s management to thoroughly investigate the seller and the over-optimistic goals of the deal and the premium price paid and extracted by the seller (Kudla and McInish, 1999). Other empirical research identified the failure to achieve successful post merger integration as a major cause. (Kudla et al, 1999).
Given the comments attributed to senior executives of Allied Domecq with respect to industry consolidation and Allied's desire to be at the middle of any action taken the Group Strategy department must act during the short-term in a disciplined approach. Allied should adopt a universal process that calculates the odds of success that can be adapted to different situations.

One possibility could be the approach identified by Kudla and McInish allows the acquirer to systematically identify and harness all the relevant factors and determine which factors are the most critical (Those drivers have been established in this research). By treating the M&A process as a combination of forces, the model generates calculations on the probabilities of success or failure of the deal.

The broad categories – Corporate Objectives (strategy), Operations (cost enhancements), and Marketing (revenue enhancements) form the basis of the structure. It is up to the company to determine the underlining components in each category and the weight to assign to each.

Whatever method is selected must be consistent with the corporate strategy of Allied Domecq and the goal of maximizing shareholder value. An assessment should be made on a quantitative basis of the industry participants. The evaluation of the possible target companies should include the target’s profitability, growth patterns, and other corporate objectives. Strategic fit is viewed as a primary corporate objective and a critical factor in merger and acquisitions. The primary research conducted indicated that the respondents, all
Allied Domecq employees, believe that any merger or acquisitions should focus on revenue enhancement synergies. As a result cost enhancement synergies will be realized.

7.2.3 Company overview

The third category of recommendations is more fundamental to the long-term approach to merger or acquisition as a strategic choice for the company to follow. The fundamental reason to seek mergers or acquisitions is to establish a competitive advantage in the marketplace relative to the competitive set. The belief of the author is that strategic assessments need to be performed by company by market to gain in-depth knowledge of the company’s strength and weaknesses. These assessments need to be included as part of the three year planning process that is currently executed yearly. The rationale for this is that the company cannot depend solely on a merger or acquisition. Any merger at any price would not be in the best interest of the company’s stakeholders. By performing the evaluations on a market by market basis the company will be able to identify regional opportunities that it may be able to capitalize on to extend it global brands. Either joint ventures, alignments, or direct purchases of regional companies may need to be implemented to meet the companies long term strategic goals if a suitable partner can not be found.

7.2.4 Merger and Acquisition Integration

Improving the acquisition integration process may be one of the most urgent and compelling challenges facing businesses today. Industry consolidations, the globalization of competition, technological developments and other drivers has touched off an unprecedented wave of mergers and acquisitions that shows no signs of abating.
Despite the enormous growth in merger activity, acquisitions that appear to be both financially and strategically sound on paper often turn out to be disappointing for many companies. Given the high number of mergers and acquisitions combined with high failure rates, it is increasingly important that companies learn how to manage the integration process and not as a one-time only event. It would be beneficial that Allied Domecq study and adopt a tested integration program. One such program is the GE Integration Process (Ashkenas et al, 1998) which is built upon the following four lessons:

- Acquisition integration is not a discrete phase of a deal and does not begin when the documents are signed. Rather, it is a process that begins with due diligence and runs through the ongoing management of the new enterprise.

- Integration management is a full-time job and needs to be recognized as a distinct business function, just like operations, marketing, or finance.

- Decisions about management structure, key roles, reporting relationships, layoffs, restructuring, and other career-affecting aspects of integration should be made, announced, and implemented as soon as possible after the deal is signed—within days, if possible. Creeping changes, uncertainty, and anxiety that last for months are debilitating and immediately start to drain value from an acquisition.

- A successful integration melds not only the various technical aspects of the businesses but also the different cultures. The best way to do so is to get people working together quickly to solve business problems and accomplish results that could not have been achieved.

As was previously presented, the reason for most merger and acquisition failures is the lack of a successful integration plan. Allied Domecq needs to ensure that it is in a position to realize benefits from any merger or acquisition it secures as quickly as possible to maximize shareholder value.

Peter Jobs, CEO, Reuters in his address in the Tom Peters’ Management Development seminar commented on his beliefs of mergers and acquisitions by stating, “There is a
difference between buying share and creating share. Mergers as a corporate strategy say more about the company than the initiative” (Peters, 1999).

7.3 Implications of Study

Merger or acquisition initiatives pursued by an organization should be the result of an assessment of a company’s competitive position. The choice to acquire or develop the competency and or assets should be based on the cost to the company and the return to stakeholders. A process can be extracted from this body of work that may be extendable to other organizations pursuing such corporate strategies.

Successful acquirers systematically determine and outline their needs. Multiple tools can be utilized by organizations to aid in the assessment of their competitive position and their desired position over a defined time period (Chaudhur & Tabrizi, 1999). Effective acquirers rely on elaborate road maps to drive the change required to fulfill the organizations needs. Once the gaps are known, companies face the choice between developing internally or purchasing.

The outcomes from mergers and acquisitions as reviewed in the Review of Literature highlighted that the results of such actions do not generally meet company expectations. Due to this a disciplined approach needs to be developed and adhered with to ensure the maximum probability of success. With the value of the merger generally being extracted by the target a firm needs to know the maximum price to pay to ensure the capability or asset it is acquiring will yield an acceptable return to stakeholders. Most acquisitions and mergers are onetime events that companies manage with heroic effort; few companies go through the
process often enough to develop a pattern. Thus it tends to be seen not as a process, as something replicable, but only as something to get finished. Despite the enormous growth in merger activity, acquisitions that appear to be both financially and strategically sound on paper often turn out to be disappointing for many companies. The acquiring company takes too many years to realize the expected synergies, or the expected benefits do not exist, or the company has assembled the new firm in such a way that the unique capabilities of the company dissipate. A study of 300 major mergers conducted over a ten-year period by Mercer Management Consulting found that in 57% of merged companies return to shareholders lagged behind the average for their industries (Ashkenas, et al, 1998).

Therefore, a process that could be followed by a company pursuing M&A is:

1. Perform a competitive analysis of the firm and the industry in which it competes.

2. Quantify a company’s core and desired competencies.

3. Develop and define the companies desired position over a predefined time scale.

4. Determine if the competency or asset can be developed internally or whether it needs to be acquired externally.

5. Determine, through management, the importance of drivers needed to meet the corporation’s objectives.

6. Develop a list of possible merger or acquisition targets and perform a probability of success calculation. Also, perform internal subjective assessments of targets from an advisory committee (Brown, 1996).

7. Determine the price to pay for the target before negotiations begin.

8. Develop a successful integration methodology to ensure planned benefits are realized as soon as possible.
Given the poor performance of merger and acquisition activities it would prove beneficial to test this process in future research. The purpose of this body of research was to develop the drivers for seeking merger and acquisitions and to provide an assessment of potential targets for a specific firm in the spirits and wine industry. However, it is the author's belief that many of the situations presented are faced within merger or acquisition activities regardless of the industry.

7.4 Limitations of the Study
The results of the driver evaluation and the assessment of potential targets relative to the importance of the drivers ranked depended upon the judgement and opinions of respondents. Such measures have gained acceptance in research. "The advantages of using human judgment as a means of measurement are generally thought to outweigh the disadvantages" (Blalock, 1974, p. 159). People know what they feel and consequently can give insightful reviews about the subjective nature of the subject studied (Brown, 1996).

The focus of this research focused upon the strategic options available to a company which has publicly stated that it is seeking merger or acquisitions targets. This study sets the foundation for future research relative to the company as a merger target materializes. Also, long term research (three to five years) to test the drivers identified in the this study and the drivers identified as a merger unfolds would prove to be beneficial.

7.5 Recommendations for Future Research

The following recommendations are made for future research.

1. Additional statistical research may prove to be useful and add insight into the interdependencies between the different respondent subsets.

Multivariate techniques such as discriminant analysis can help analyze the influence of independent variables on the dependent variables in different ways. Factor analysis can offer meaningful insights into the data set by forming patterns of the data in one form or the other.

By utilizing multivariate analysis the relationship between several drivers (variables) can
be determined simultaneously. In this order the relationship amongst the respondents can be determined. Also, the relationship between the different function can be examined to gain further insight.

With respect to factor analysis, two prevalent arguments exist in literature that has been presented in the Review of Literature. In utilizing this approach the drivers could be grouped by factors. Furthermore, additional factors may be discovered that are unique to the industry. Finally, the factors may be useful in assessing the purpose of mergers or acquisitions and may aid in the assessment of suitable candidates.

2. A follow up study to track the identification of drivers and factors as a merger materializes would test the importance of the drivers identified by the respondents.

3. A third study to test the long term benefits of the identified drivers for a merger or acquisition would allow an assessment relative to the drivers identified by the respondents and the drivers identified through the media as a merger or acquisition unfolds.

4. The process model developed as a result of this body of research would allow further research within the area of mergers and acquisitions regardless of the industry. The research would be able to focus upon the process within the acquiring company before a merger was chosen as a corporate strategy, the process of selecting a merger or acquisition target, and the results of the merger for relevant stakeholders.
APPENDIX A:

Discussion Guide for the Assessment of Suitable Merger Partners for Allied Domecq PLC.

Drivers of Merger & Acquisition Activities:
The following drivers (variables) of merger and acquisition activities are extracted from the primary research conducted and are presented in the order of importance based on the responses assembled from the respondents interviewed.

<table>
<thead>
<tr>
<th>VARIABLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portfolio Expansion</td>
</tr>
<tr>
<td>Size</td>
</tr>
<tr>
<td>Market Dominance</td>
</tr>
<tr>
<td>Customer Expansion</td>
</tr>
<tr>
<td>Competition Removal</td>
</tr>
<tr>
<td>Plant Utilization</td>
</tr>
<tr>
<td>Market Share</td>
</tr>
<tr>
<td>Profit Growth</td>
</tr>
<tr>
<td>Company Survival</td>
</tr>
<tr>
<td>Cost Reductions</td>
</tr>
<tr>
<td>Shareholder Pressure</td>
</tr>
<tr>
<td>New To Market (NTM)</td>
</tr>
<tr>
<td>Foreign Market Expansion</td>
</tr>
<tr>
<td>Strategic Synergy</td>
</tr>
<tr>
<td>Low Cost Producer</td>
</tr>
<tr>
<td>Channels of Distribution</td>
</tr>
<tr>
<td>Distributor Consolidation</td>
</tr>
<tr>
<td>Obtaining Distributor Strength</td>
</tr>
<tr>
<td>Management Competencies</td>
</tr>
<tr>
<td>Industry Fragmentation</td>
</tr>
<tr>
<td>Political Reasons</td>
</tr>
<tr>
<td>Marketing Competencies</td>
</tr>
<tr>
<td>Financial Leverage</td>
</tr>
<tr>
<td>Government Regulations</td>
</tr>
<tr>
<td>Retailer Consolidation</td>
</tr>
<tr>
<td>Information Systems</td>
</tr>
<tr>
<td>New To World (NTW)</td>
</tr>
<tr>
<td>Avoid Profit Slumps</td>
</tr>
<tr>
<td>R&amp;D personnel and facilities</td>
</tr>
<tr>
<td>Management Hubris</td>
</tr>
<tr>
<td>Obtaining Ideas</td>
</tr>
<tr>
<td>Shareholder Pressure</td>
</tr>
</tbody>
</table>
APPENDIX B:

The Life Cycle Portfolio Matrix:

The following table highlights options that a firm can follow depending on the strategic situation it finds itself and the industry in which it participates.

<table>
<thead>
<tr>
<th>MATURITY</th>
<th>EMBRYONIC</th>
<th>GROWING</th>
<th>MATURE</th>
<th>AGEING</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMPETITIVE POSITION</td>
<td>Hold Position</td>
<td>Hold position</td>
<td>Hold position</td>
<td>Hold position</td>
</tr>
<tr>
<td>Clear Leader</td>
<td>Attempt to improve market penetration</td>
<td>Defend market share</td>
<td>Grow with industry</td>
<td>Reinvest as necessary</td>
</tr>
<tr>
<td></td>
<td>Invest slightly faster than market dictates</td>
<td>Invest to sustain growth rate (and preempt potential competitors)</td>
<td>Reinvest as necessary</td>
<td></td>
</tr>
<tr>
<td>Strong</td>
<td>Attempt to improve market penetration</td>
<td>Attempt to improve market penetration</td>
<td>Hold Position</td>
<td>Hold Position</td>
</tr>
<tr>
<td></td>
<td>Invest as fast as market dictates</td>
<td>Invest to increase growth rate (and improve position)</td>
<td>Grow with industry</td>
<td>Reinvest as necessary or reinvest minimum</td>
</tr>
<tr>
<td>Favourable</td>
<td>Attempt to improve position selectively</td>
<td>Attempt to improve position</td>
<td>Maintain position</td>
<td>Harvest, withdraw in phases, or abandon</td>
</tr>
<tr>
<td></td>
<td>Penetrate market generally or selectively</td>
<td>Penetrate market selectively</td>
<td>Find niche and attempt to protect it</td>
<td>Reinvest minimum necessary or divest</td>
</tr>
<tr>
<td></td>
<td>Invest selectively</td>
<td>Selectively invest to improve position</td>
<td>Make minimum and/or selective reinvestment</td>
<td></td>
</tr>
<tr>
<td>Defensible</td>
<td>Attempt to Improve position selectively</td>
<td>Find niche and protect it</td>
<td>Find Niche or withdraw in phases</td>
<td>Withdraw in phases or abandon</td>
</tr>
<tr>
<td></td>
<td>Invest (very) selectively</td>
<td>Invest selectively</td>
<td>Reinvest minimum necessary or divest</td>
<td></td>
</tr>
<tr>
<td>Weak</td>
<td>Improve position or withdraw</td>
<td>Turn around or abandon</td>
<td>Turn around or withdrawal in phases</td>
<td>Abandon position</td>
</tr>
<tr>
<td></td>
<td>Invest or divest</td>
<td>Invest or disinvest</td>
<td>Invest selectively or disinvest</td>
<td>Divest</td>
</tr>
</tbody>
</table>
APPENDIX C:

Competitor Assessment:

The following information is extracted from the industry analysis presented in the body of the thesis. The information is extracted from industry sources and or Allied Domecq internal documentation.

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>DIAGEO</th>
<th>LVMH</th>
<th>SEAGRAM</th>
<th>PERNOD RICARD</th>
<th>BACARDI - MARTINI</th>
<th>BROWN - FORMAN</th>
<th>JIM BEAM BRANDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy</td>
<td>Focus on Spirits and Wine operations</td>
<td>Focus on Premium Products Enter emerging markets Development of Multi-Cultural Organization</td>
<td>Focus is on Entertainment Spirits: Grow internal Protect brand equity Utilize strategic partnerships</td>
<td>Maintain French Spirits Develop Oversea spirit sales Diversify activities and categories</td>
<td>Maintain Rum Leadership Increase Global Penetration Diversify Portfolio</td>
<td>International Growth Seek growth through develop. or acquisition</td>
<td>Focus on Consumer goods that are growing Penetrating emerging markets</td>
</tr>
<tr>
<td>Distribution</td>
<td>Controls 90% of its own distribution</td>
<td>Utilizes joint ventures or distributors</td>
<td>Utilize joint ventures or distributors</td>
<td>Moving from JV to ownership</td>
<td>Owns 98% of distribution</td>
<td>Relies on JV or distributors</td>
<td>Relies on JV or distributors</td>
</tr>
<tr>
<td>Brand Category Strengths</td>
<td>Brewing Scotch Gin Vodka Liqueurs Tequila</td>
<td>Champagne Cognac</td>
<td>American Canadian Cognac Gin Vodka - agency Rum</td>
<td>Aniseed based brands Irish whiskey</td>
<td>Rum Scotch - US Canadian</td>
<td>Bourbon Canadian</td>
<td>Bourbon Canadian</td>
</tr>
<tr>
<td>Marketing Strategies</td>
<td>Gain share in mature markets Penetrate emerging markets Make add-on investments Introduce new products</td>
<td>Promote Cognac based drinks Focus on premium market with tie in with Cigar growth</td>
<td>Focus on 15 core brands Capitalize on brand strengths in emerging markets Continue Marketing excellence</td>
<td>Build sales in emerging markets Seeking diversify</td>
<td>Strategy focus remains on core asset of rum Introduction of line extensions</td>
<td>Focus on the international growth of Jack Daniels</td>
<td>Marketing company: Brand imagery Brand equity Heavy support for Jim Beam</td>
</tr>
</tbody>
</table>
APPENDIX D:

Allied Domecq Spirits and Wines
Merger & Acquisition Study
Survey

Respondent’s Department

Below, you will find questions that relate to the possible reasons or drivers that may
determine the merger and acquisition options available to the company.

Would you please assess the following drivers for possible reasons for merger and
acquisition on the following scale of “1” strongly disagree and “7” strongly agree as possible
reasons for Allied Domecq’s merger considerations.

1. Portfolio expansion (the addition of brands) is a driver of M&A.
   (1........2........3........4........5........6........7)
2. M&A activity is being driven by political reasons of company leaders.
   (1........2........3........4........5........6........7)
3. Overhead cost reductions are a driver of M&A activity.
   (1........2........3........4........5........6........7)
4. Size (relative to competition) is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
5. Increasing channels of distribution is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
6. Expanding the customer base is a major driver of M&A activity.
   (1........2........3........4........5........6........7)
7. Gaining market share and penetration of certain product lines through industry
   rationalization is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
8. Increasing plant utilization is a major driver of M&A activity.
   (1........2........3........4........5........6........7)
9. Becoming the low cost producer is a major driver of M&A activity.
   (1........2........3........4........5........6........7)
10. Creating or acquiring research and development personnel and facilities is a major driver
    of M&A activity.
    (1........2........3........4........5........6........7)
11. Expanding into a foreign territory is a strong driver of M&A activity.
    (1........2........3........4........5........6........7)
12. Shareholder pressure is a strong driver of M&A activity.
    (1........2........3........4........5........6........7)
13. A well-developed distribution is a strong driver of M&A activity.
    (1........2........3........4........5........6........7)
14. Profit growth expectations is a strong driver of M&A activity.
    (1........2........3........4........5........6........7)
15. A company’s financial leverage is a strong driver of M&A activity.
    (1........2........3........4........5........6........7)
16. Information system enhancements are a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
17. Increasing marketing competencies is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
18. Increasing management competencies is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
19. Market dominance and a role as industry leader is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
20. Distributor consolidation is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
21. Social pressures are a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
22. Retailer consolidation in developed countries is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
23. Welding together a fragmented industry is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
24. Strategic synergy is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
25. The removal of competition is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
26. Obtaining new ideas is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
27. Introducing existing products to new markets is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
28. Introducing new products to existing markets is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
29. Government rules and regulations is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
30. Avoiding profit slumps through buying profits is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
31. Management Hubris is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
32. Company survival is a strong driver of M&A activity.
   (1........2........3........4........5........6........7)
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VITA AUCTORIS

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