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This article originally appeared in the May 2007 issue of

Outlook

The journal of high-performance business

Industry Report | Alcoholic Beverages

Spirited performance

By John Jackson and C. Keith Barringer

The lion's share of future value in this industry will go to a select group of companies that have unlocked value through a restructuring and reinvestment cycle—one that not only finds new sources of revenue but also makes existing revenues more profitable. Above all, they will develop a model that embraces all three major sectors of the business.

The $970 billion global market for alcoholic beverages is experiencing a period of unprecedented change. While about 60 percent of the market is still in the hands of small, local enterprises, truly global players are steadily emerging.

Six of these leaders meet Accenture's criteria as high-performance businesses. And although they have yet to command the premium from investors that high-performance businesses in other consumer goods sectors enjoy, they are well positioned to do so, thanks mainly to highly focused M&A strategies in key, value-growth markets.

There remains much to play for. But Accenture research suggests that the lion's share of future value will go to a select group of companies that have unlocked value in developed markets and bought new revenue streams in emerging markets. We also believe that the product port-folios of future winners will eventually encompass all three major categories of alcoholic beverages—beer, spirits and wine.

The alcoholic beverages industry offers few opportunities for organic growth. The notoriously high costs of distribution and brand building have created huge barriers to entry—hence the importance of acquisitions. Consolidation continues apace as aggressive acquirers seek to demonstrate that they can wring value out of the companies they buy, especially if they have paid a premium. Yet the market remains very fragmented. UK-based

Diageo, which is by far the world's biggest spirits company (see sidebar, page 7), accounts for less than 10 percent of the total market.

Like many others, the alcoholic beverages industry is also feeling the effects of dramatic shifts in demographics and lifestyle. Today's drinkers are more affluent and sophisticated. They also are increasingly health conscious. The combination of these trends is curbing alcohol consumption overall but driving demand for all manner of premium products, from better-quality wines and premium lagers to malt whiskeys—products that consumers are willing to pay more for (see chart, page 10).

What's more, the trend toward drinking less but paying more— "premiumization," in industry parlance—is not restricted to developed markets. Increasingly affluent urban, middle-class drinkers in several Asian countries, Eastern Europe and parts of Latin America are also slowly trading up and will account for an increasing share of value growth in the future.

There are, to be sure, wide variations globally in these megatrends. Western Europe, where aging populations and a high number of financially independent female drinkers power the premiumization trend, must be managed for value rather than volume growth. Meanwhile, Eastern Europe, which combines growing populations with rising levels of disposable income, offers the potential for both, as does much of Asia.

With few exceptions, premiumization has yet to have much impact in Latin America. Yet Mexico is already among the largest and most profitable markets for beer and spirits in the world. Moreover, the region is a key location for some of the emergent global brewers, Mexico's Grupo Modelo among them.

Plainly, the path to future success lies in being global—but with a focus on the right local markets and the right categories within them. However, virtually every company in the industry is jostling to do just that—and struggling to squeeze the last drop of cost out of the bottom line.

How do the industry's high-performance businesses manage to stay ahead of the pack?

Accenture defines a high-performance business as one that consistently outperforms its peers through economic cycles, industry cycles and changes in leadership. Our extensive cross-industry research has identified three building blocks—market focus and position; distinctive capabilities; and performance anatomy—that underpin high performance in any industry and that all high-performance businesses have mastered. The alcoholic beverages industry is no exception.

Market focus and position

Consolidation has shaped the industry since the mid-1990s, when stagnant growth and high fixed costs in developed markets put a drag on profit growth in those same markets, which are home to the leading brewers and distillers. By 2000, a regional operating model had evolved into the current "global category" configuration—characterized by restructuring (largely through divestiture of noncore and less profitable units), rigorous cost cutting, an acquisitions strategy designed to capture incremental profit streams outside home markets, and the broadening of portfolios to include a range of both global and local brands.

High-performance businesses are masters of this model, and in the past five years, they have gained an even greater global market share as a result. Indeed, by expanding into carefully

(Continued on page 4)

About the research

The peer group set for the study comprised 24 international beer, wine and spirits companies with annual revenues in excess of $1 billion. Six of these companies emerged as high-performance businesses.

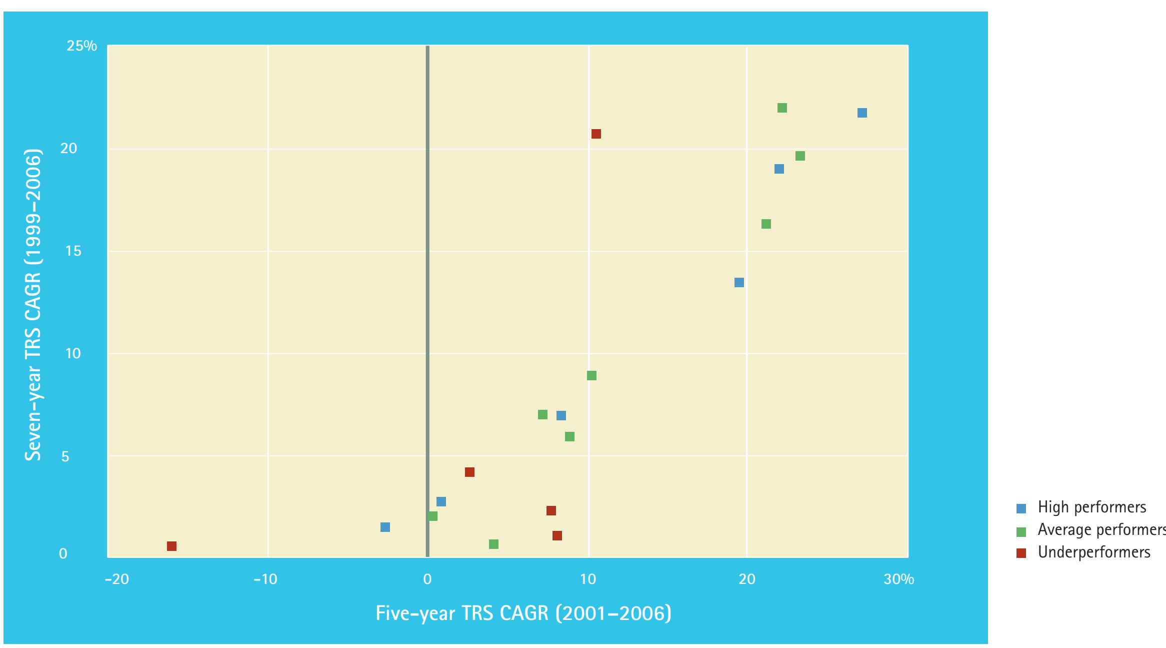
These six outstrip their competitors in terms of revenue growth (although this is clouded by the industry's high level of consolidation) and returns on invested capital (which is three times as good as the peer group), as well as total returns to shareholders. Indeed, these high performers are returning four times as much to their shareholders as the S&P 500.

Most strikingly, our research shows that during the past five years, the high performers have, on average, demonstrated better efficiency in generating economic profit, not only in terms of accessing new markets and dominating categories but also by ruthlessly stripping out costs from both their base and acquired businesses. Diageo, Anheuser-Busch, SABMiller and Heineken own 62 percent of the total industry economic profit pool. And it is this drive to profit that is compelling the leaders to develop the operating model of the future.

Nevertheless, no single player dominates across all metrics. And measurement of future value (that component of enterprise value that relates to future growth, profitability and returns on invested capital) is somewhat distorted by as-yet-unresolved expectations about emerging markets.

Clearly, the current gap between high and average performers is far from insurmountable (see chart, below).

Five-year total return to shareholders (CAGR) versus seven-year total return to shareholders (CAGR)



Source: Accenture analysis

(Continued from page 2)

selected value-growth markets, high-performance businesses have achieved what might be called maximum value-growth exposure. There are also powerful reasons why these companies were the first to make the move.

High-performance businesses display an exceptionally deep understanding of both volume and profit dynamics across different markets. They recognize exactly where future profit opportunities lie. They continuously reassess evolving opportunities within categories and geographies. And their superior business intelligence and analytics support the sort of partnerships and alliances that help strengthen their leading positions. (For a related article, see "Winning with analytics," *Outlook*, May 2007.) The upshot: They are in the right category and the right market at the right time. (For more on market focus and position, see "The right place, the right time," *Outlook*, October 2005.)

Take brewing, where according to Accenture research, eight countries—five of them emerging markets—will account for almost three-quarters of the incremental profit pool over the next eight years. The American brewer Anheuser-Busch Companies already dominates the US market, which represents by far the greatest opportunity for incremental profit growth in the beer category. Moreover, the company's stakes in Mexico's Grupo Modelo and China's Tsingtao Brewery Co. brands also give it significant upside in two key, high-growth emerging markets.

Distinctive capabilities

Each high performer in this industry displays what Accenture calls a distinctive capability—a unique and robust combination of connected business resources and functions, including sales and marketing, finance, IT and supply chain management. These distinctive capabilities, which vary from company to company, set the high performers apart from their peers and make them difficult to emulate. In this industry, what these companies have in common is their use of these distinctive capabilities to accomplish three strategic goals: to leverage scale; to control the route to the consumer; and to establish exceptional brand and category leadership.

Success in no single area would, on its own, ensure high performance. Nor is every high-performance business equally good at achieving all three goals. Each distinctive capability nevertheless represents a set of hard-to-replicate skills and attributes without which high performance would not be possible. (For more on distinctive capabilities, see "Marks of distinction," *Outlook*, June 2005.)

Consider the ability to leverage scale. Companies obviously need scale to succeed in the global alcoholic beverages market because embracing a high-volume, global model with a wide portfolio of brands can offset high fixed costs. Leveraging scale, moreover, has two aspects: cost and capability.

Belgium-based InBev, for example, is known for a culture of strict cost control. The company is not yet a high-performance business—it was formed very recently, in 2004, from the merger of Brazil's AmBev with Belgium's Interbrew—but it is clearly on the path to becoming one. Its zero-based budgeting initiative saves money so that resources can be redirected and invested in winning brands and geographies, as demonstrated by the company's purchase of the Chinese beer business of Malaysia's Lion Group, which gives InBev leading market positions in six Chinese provinces.

The Dutch brewer Heineken is similarly renowned for its strong

SABMiller: A local focus

Thinking local comes naturally to SABMiller. As South African Breweries (SAB), the company enjoyed decades of a near monopoly in its home market, where primitive distribution networks and antiquated production methods—the sorts of bottlenecks that daunt so many overseas buyers in emerging markets—were the norm. After 1994, when democratic elections ended South Africa's status as an international pariah, SAB was swift to exploit the experience.

Breweries in Eastern Europe were a particular focus of interest, and SAB used its considerable African cash flow to snap them up. By closing down the inefficient operators and staying with the strongest brands in Hungary, Poland, the Czech Republic and Romania, SAB, which transferred its main listing from Johannesburg to London in 1999, demonstrated one of the core strategies of high-performance businesses in this industry—creating a global market of key local brands (see story).

SAB became a truly global player (and the world's second biggest brewer by volume) in 2002, when it bought Miller Brewing of the United States from Philip Morris and changed its name to SABMiller. The focus on emerging markets, however, remains central to its positioning.

SABMiller concentrates, always, on the leading local brands. The company owns 49 percent of China Resources Snow Breweries, China's largest brewer and owner of the country's top-selling brand, Snow. And in 2005, SABMiller acquired almost 97 percent of Bavaria, the second largest brewer in South America, whose brands include Atlas, Cristal and Pilsener—all leading beers in the Andean countries.

The company's local focus extends to a belief in locally accountable management. The entire beer value chain is run locally, with local procurement, production, distribution, laws and customs. What's more, that local knowledge serves SABMiller well when it comes to innovation. The brewer has successfully leveraged the healthier drinking trend, now spreading to emerging markets, by developing Lech alcohol-free and Lech Lite for Polish drinkers. In China, meanwhile, it has learned to position its flagship Snow brand to appeal to upwardly mobile Chinese youth, slapping an eye-catching label on the 50-year-old brew and launching a national ad campaign that stresses the beer's freshness.

track record in cost optimization. Heineken has instituted what it calls a Total Productive Management program, aimed at minimizing the cost of production in 80 of its 108 breweries worldwide. The company's overall goal is to reduce fixed costs (excluding marketing costs) by €200 million in absolute terms by 2008 (see sidebar, page 6).

Constantly scaling and restructuring to optimize costs and acquisitions, high-performance businesses in this industry never rest on their laurels. Indeed, they miss no opportunity to challenge the status quo. They continually seek to reduce duplication in processes and functions, and regularly refocus investment to prioritize the spending that will achieve the highest returns.

High-performance businesses are also keenly aware that in-market scale is even more important than global scale in delivering profitability, and that they need relevant capabilities to achieve it. For brewers this means, in effect, creating a global market of key local brands that deliver high market share and drive profitability. Take SABMiller: With leading brands like Miller Lite in the United States, Tyskie in Poland and Pilsner Urquell in the Czech Republic, it is a top brewer in 35 of its 50 markets, many of which are dominated by one brewery—a powerful position indeed, since profitability in brewing is so highly correlated with scale (see sidebar, above).

Ownership of the principal high-value local brand also captures the universal drift to premium products. Such ownership is equally important for distillers, which can derive a similar advantage by building a strong portfolio of premium brands that can be tailored to consumers in each market. Diageo, for example, ensures that

Heineken: A culture of cost control

With 115 breweries and distributors in more than 65 countries, Heineken is one of the largest beer producers in the world. It sells more than 170 international premium, regional, local and specialty beer brands, including Heineken and Amstel, which together account for about 30 percent of total sales. What's more, the Netherlands-based company has mastered a cost-conscious approach to business that helps set it apart as a high performer in this industry (see story).

In 2005, as part of an ongoing commitment to enhance efficiency by reducing costs across all its supply chain processes, Heineken unveiled its Total Productive Management program. As much a philosophy as a methodology, the program aims to transform the company's culture by streamlining purchasing activities, improving production network efficiency and boosting the more economic use of energy.

Heineken has established a Total Productive Management department within its group supply chain function, and local program coordinators help individual breweries to establish their own related organizations and activities. The coordinators train local employees in best practices that are identified through audits and then incorporated into the group's knowledge management system.

Total Productive Management teams are active in about 90 percent of Heineken breweries, where they analyze line stoppages in the bottling halls to identify performance problems and then take corrective action to improve efficiency. Production and engineering staff are being encouraged to work more closely together, and employees at lower levels of the organization are being given more responsibility.

The results of any improvements—in product quality, productivity, cost control, customer satisfaction, social responsibility, or organization and people development—are reported to the group supply chain head on a quarterly basis. And these improvements already have been substantial. The cost-cutting program is credited with helping Heineken achieve significant reductions in production costs, in part through environmentally friendly improvements in water consumption and energy use.

high-end consumer-centric brands like Smirnoff underlie each of the spirits categories—whiskey, gin, rum, tequila, liqueurs and vodka—in which it has critical mass. Meanwhile, US-based Constellation Brands, which produces more wine than any other company in the world, has been rapidly building up its premium-wine portfolio through acquisitions that include California's Ravenswood Winery and Australia's largest wine producer, BRL Hardy.

In an industry where distribution costs are inordinately steep and so much consumption takes place outside the home, high-performance businesses are distinguished by their ability to control the route to the consumer. These leaders ensure the availability of their products and brands to target consumers in the outlets of their choice—whether off-trade (hypermarkets, supermarkets, convenience stores) or on-trade (bars, nightclubs, restaurants). And they can do so because they are able to connect directly with their customers.

Indeed, thanks to their in-depth understanding of not only who their customers are but also where and on what occasions they buy, high-performance businesses drive greater pull-through at the point of purchase.

Every Anheuser-Busch salesperson is equipped with a handheld computer to send up-to-the-minute information about developments in every sales outlet back to company headquarters in St. Louis. SABMiller, similarly, developed the Miller Consumer Database, which captures data directly from the consumer through a variety of touchpoints, including website registrations, kiosks and handheld data collection devices. SABMiller uses information it harvests from the database and other data sources to gain

Diageo: A brand-building behemoth

Its name—an amalgam derived from the Latin word for day (*dies*) and the Greek word for world (*geo*)—says it all. The products of Diageo, the world's biggest and most profitable alcoholic beverages company, are consumed every day, world-wide. With leading brands in every spirits category, the company is a truly global presence.

Formed in 1997 from the merger of the London-based Grand Metropolitan conglomerate with the company that owned Ireland's iconic Guinness brand, Diageo was also the first in its industry to develop a truly global operating model.

Globally integrated business functions, common processes and a global IT footprint have facilitated post-merger integration and reduced the costs associated with it—advantages that Diageo put to good use in the acquisition and integration of Bushmills Irish whiskey in 2005. The company also leveraged its IT footprint to develop the analytics that deliver critically important consumer insight. And when it finished selling off all of its food interests with the sale of Burger King Corp. in December 2002 and became fully focused on beverages, the UK-based company has been consolidating its exceptional brand and category leadership, one of three areas of strength that distinguish high-performance businesses in this industry (see story).

Eight "global priority brands"—Baileys, Smirnoff, Johnnie Walker, J&B, Cuervo, Tanqueray, Captain Morgan and Guinness—underpin Diageo's extraordinary 6 percent annual organic growth rate. Ireland's imposition of a broad smoking ban has hit sales of Guinness on the brew's home turf, but the company's other brands continue to do well, especially in North America. Its biggest challenge, indeed, is to stay ahead of the game at a time when competitors are busy trying to replicate the successful Diageo model.

Leveraging scale to expand in emerging markets is a key strategy. The December 2006 acquisition of a 43 percent stake in Sichuan Chengdu Quanxing Group Co., China's oldest distiller of *baijiu*, a traditional "white spirit," consolidated the company's position in a country it first entered more than a decade ago. Sales of Diageo's leading whiskey brands have enjoyed double-digit growth in China, and the new, Singapore-based Diageo Asia Pacific logistics hub, which dramatically cuts time to market, will bring the company even closer to its Asian consumers.

insights that help it better engage with consumers through both new and traditional mediums.

Special relationships also lie at the heart of high-performance businesses' distribution models. SABMiller, for instance, when faced with the challenge of servicing 265,000 mostly rural points of sale in South Africa, set up an entrepreneurial distribution network, operated by independent wholesalers who use runners to redistribute to local bar operators. Independent truck drivers—whose loyalty is enhanced by assistance with vehicle financing—augment the network by acting as additional distribution agents for the company.

High-performance businesses leverage superior segmentation by matching brand portfolio priorities and trends within each sales channel. They identify the relative attractiveness and opportunities offered by each channel. By optimizing returns from its investments in each channel, Heineken successfully matches brand propositions with target consumers at points of purchase or consumption. This not only ensures that the brewer remains competitive at the point of sale. It also consistently reinforces core components of Heineken's brand equity.

Exceptional brand and category leadership is the third defining distinctive capability of high-performance businesses in this industry. By spotting trends and opportunities early—a function of being able to control the route to the consumer—these companies are always ahead of the pack in delivering desirable brand imagery.

Witness how the Diageo Way of Brand Building initiative has helped the company build a portfolio of iconic global spirits brands, drive increased customer commitment and convert it into higher sales of the distiller's products. The company now occupies top positions in almost every spirits category in virtually every region of the world.

Diageo has created a website, thebar.com, to promote all of the company's brands through the medium of a virtual bartender who tells amusing stories while he mixes a customer's requested drink. Another Diageo website provides a fictitious daily blog on the life of Uri, star of Smirnoff Ice vodka ads on TV. It also allows for comments and feedback aimed at fostering a community of Smirnoff consumers.

Performance anatomy

In contrast to the experience of so many industries, high-performance businesses in the alcoholic beverages industry are adept at delivering synergies from their acquisitions. And the strength of their performance anatomies helps explain why.

These companies have developed operating models and corporate cultures that can drive higher levels of performance from both established businesses and new acquisitions, managing largely for value in mature markets and for growth in emerging markets. They have crafted an approach to post-merger integration that protects and leverages the unique assets acquired—usually important brand equity but also customer and distribution assets, especially in emerging markets—while simultaneously integrating noncore, back-office functions into highly efficient regional service models.

Performance anatomy is really all about mindset—and in the case of brewers and distillers, it describes the acquisitions culture that permeates their organizations from top to bottom. (For more about performance anatomy, see "In search of performance anatomy," *Outlook*, October 2004, and "How to create a culture of high performance," *Outlook*, January 2007.)

High-performance businesses are constantly on the lookout for acquisition opportunities in high value-growth markets. Witness SABMiller's acquisitions of Italy's Birra Peroni, Romania's Aurora, Colombia's Grupo Empresarial Bavaria and the Chinese division of Lion Nathan—all in the past five years. A similarly highly focused M&A strategy has boosted Diageo's share of the global spirits market and made Constellation Brands the market leader in the wine category.

Some high-performance businesses have created partnerships and alliances with other companies in the industry to build the critical mass necessary for distribution scale and efficiency in key markets. Heineken USA, for example, has struck a deal with brewer FEMSA Cerveza of Mexico that will give it an edge in that market. Heineken USA will benefit from greater scale and from having a broader portfolio of brands, which will allow the company to increase its leadership in the import segment. Anheuser-Busch uses third parties—including local Heineken companies—to brew and sell its leading brand, Budweiser, under license in Italy, Russia, Argentina and Spain, among other countries.

Raising the bar

By creating an international distribution model that provides competitively advantaged and sustainable routes to market in each country, high-performance businesses develop a global footprint that can help leverage future acquisitions.

High-performance businesses have achieved their advantaged position by maximizing their exposure to incremental profit streams and by developing a value-led operating model with three distinctive capabilities that rest on outstandingly efficient business functions and resources (see chart, page 3).

But what will it take to be a high-performance business in alcoholic beverages in the future?

The bar to high performance is being raised constantly as all companies seek to cut costs and maximize revenue growth in difficult, sometimes declining markets characterized by complex distribution systems, high fixed costs and capricious consumers.

The industry's future winners will be distinguished by their success in driving a restructuring and reinvestment cycle that not only finds new sources of revenue but also makes existing revenues more profitable. Above all, they will develop a model that embraces all three major sectors of alcoholic beverages—beer, spirits and wine. Those that succeed will end up dominating the industry. Those that fail will struggle to grow—or succumb to acquisition themselves.

By the numbers

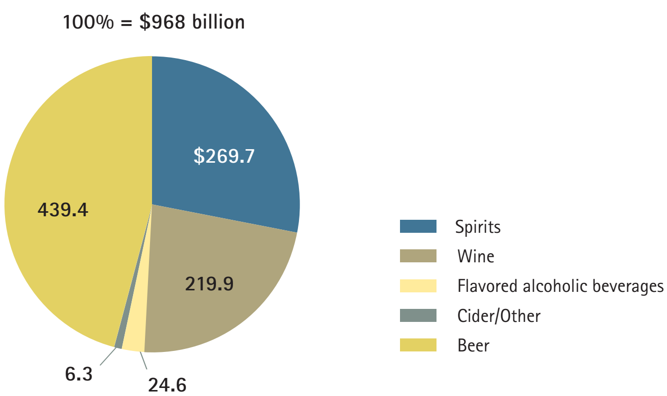
A changing business mix

Four main forces are driving change in the industry, leading to increased consolidation and profitability.

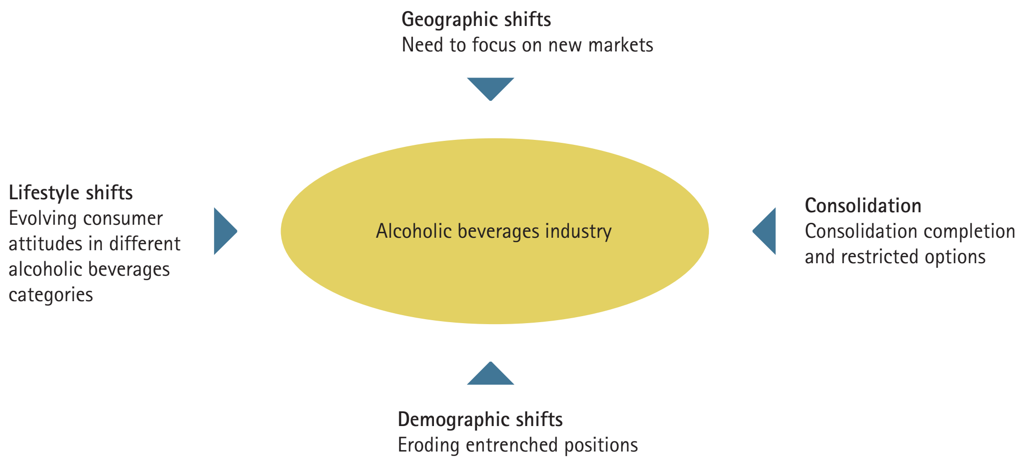
Alcoholic beverages market

Alcoholic beverages as a global industry hit nearly $1 trillion in 2005.

Sales value, 2005



Four main forces are driving change across the industry.



Lifestyle shifts
- Increasing health consciousness
- Consumer sophistication increases; traditional products unfashionable
- Trend toward experimentation
- Trend toward mixing drinks
- Development of ethical consumption
- Competition from more increasingly interesting soft drinks
- Increasingly restrictive legislation (drunk driving; advertising)
- Fashion-preoccupied consumers

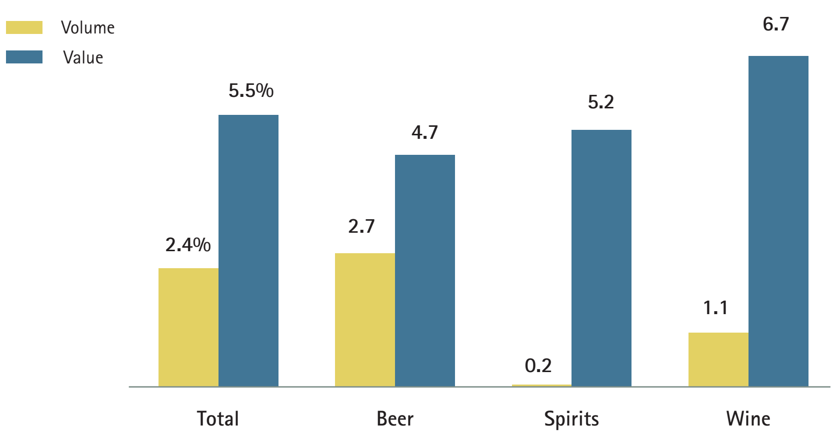
Demographic shifts
- Aging population in developed markets—less consumption/different consumption
- Growing numbers of financially independent women
- Increasing urbanization
- Rising numbers of young consumers in emerging markets

Consolidation
- Industry consolidation driving growth in global brand strength
- Options for inorganic growth increasingly limited within categories (wine, beer, spirits)
- Cross-category opportunities looking increasingly attractive (i.e., total beverage alcohol)
- Fewer, larger players left standing compete more aggressively

Geographic shifts
- Increasing affluence in developed markets
- Expansion in emerging markets, including in urban middle class
- Increased demand for prestige spirits in emerging markets

Between 2000 and 2005, the market has been growing more in value than in volume across all categories as people drink less—but pay more for what they do drink.

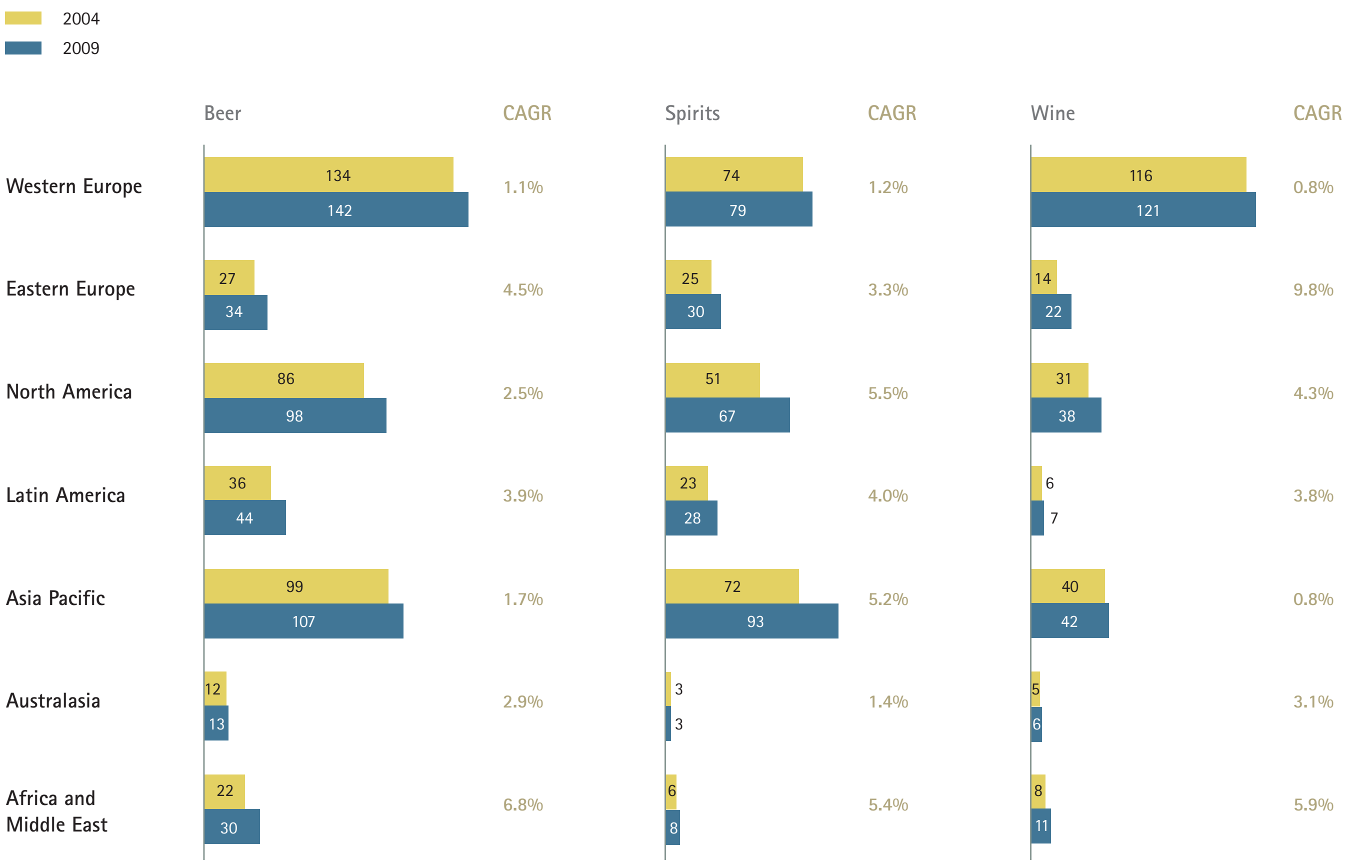
CAGR, 2000–2005



Source: Euromonitor: "The World Market for Beer, 2006"; "The World Market for Spirits, 2006"; "The World Market for Wine, 2006"

While the growth of consumption is projected to be attractive in emerging markets, those markets are not expected to deliver a future growth premium.

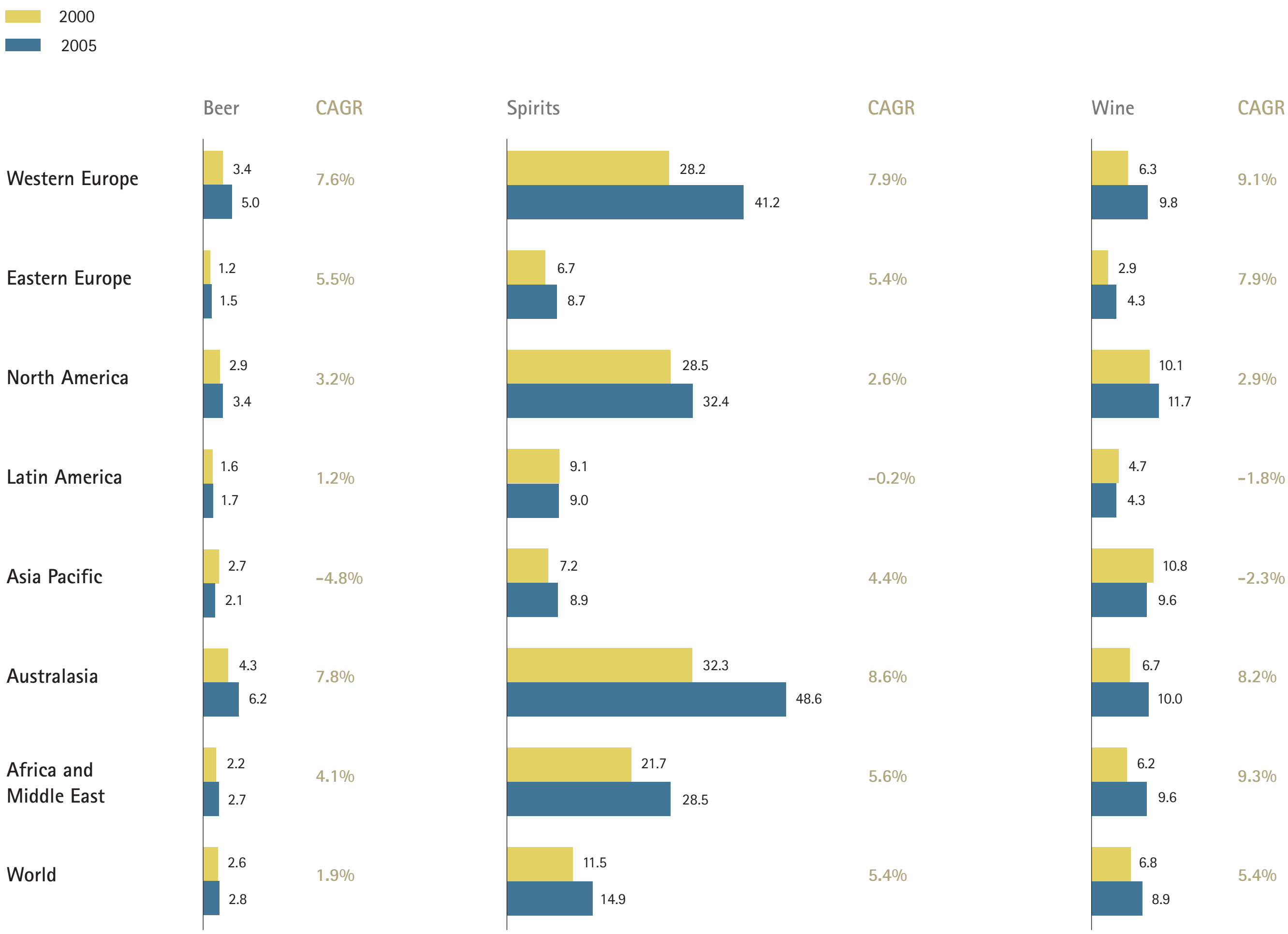
Forecast sales value growth (US$ billions), 2004–2009



Source: Euromonitor, "The World Market for Beer, September 2005"; Euromonitor, "The World Market for Spirits, October 2005"; Euromonitor, "The World Market for WIne, September 2005"

However, a premiumization strategy does not translate well into emerging markets, such as Latin America and Asia Pacific, where price per liter is not a strong upward trend.

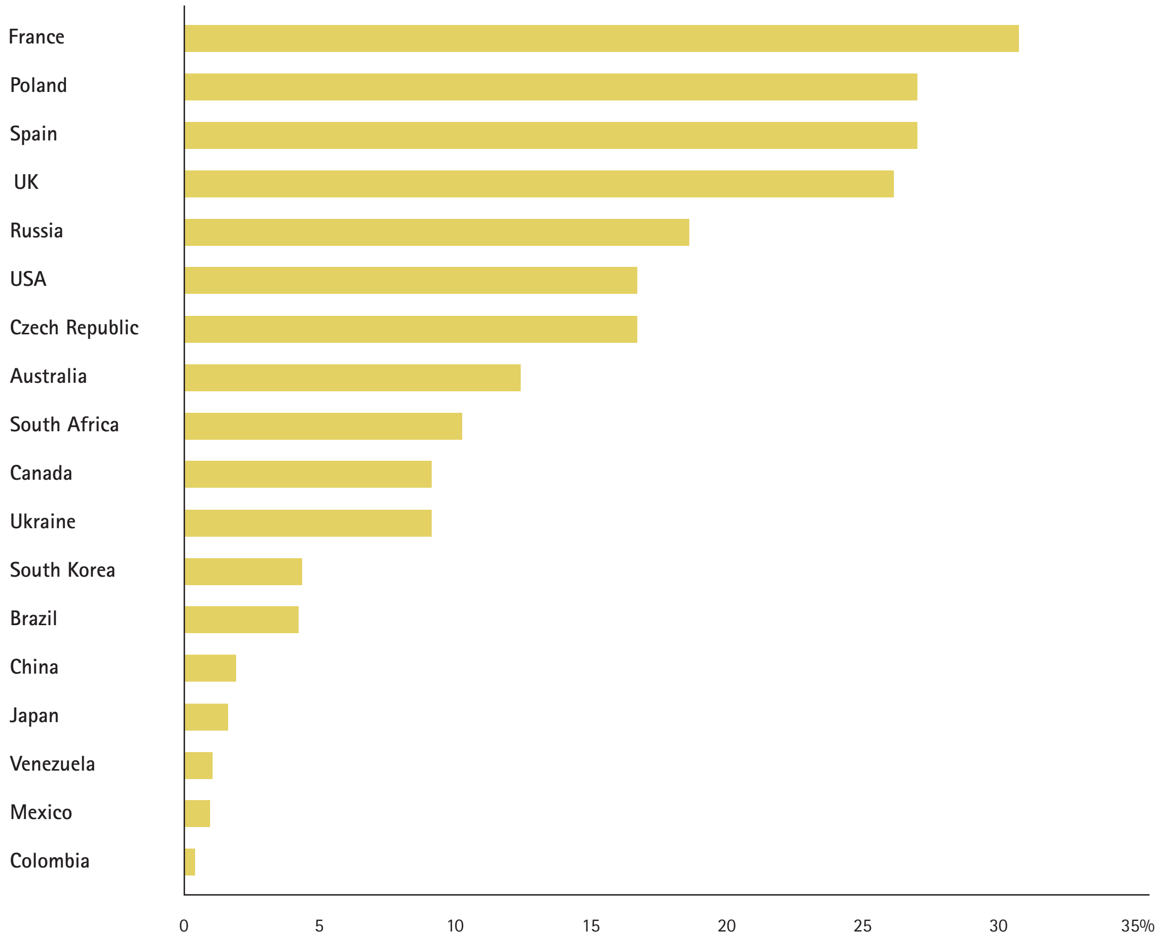
Price per liter of sales (US$/liter), 2000 and 2005



Source: Euromonitor: "The World Market for Beer, 2006"; "The World Market for Spirits, 2006"; "The World Market for WIne, 2006"

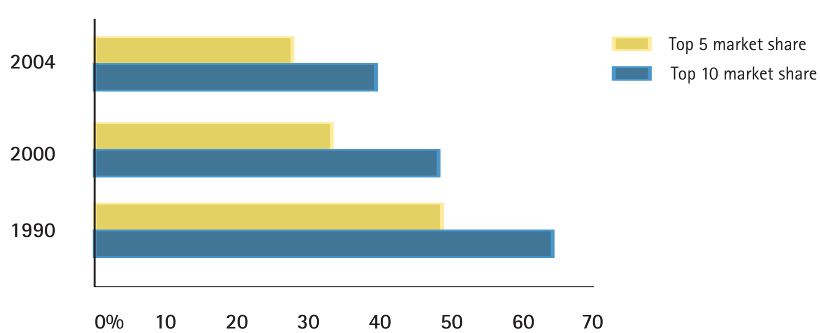
This has a particular impact in developed regions, where consumers have been increasingly willing and able to pay more for higher-priced products.

Penetration of premium segments in different markets, 2005



Source: Ambev; SC Equity Research

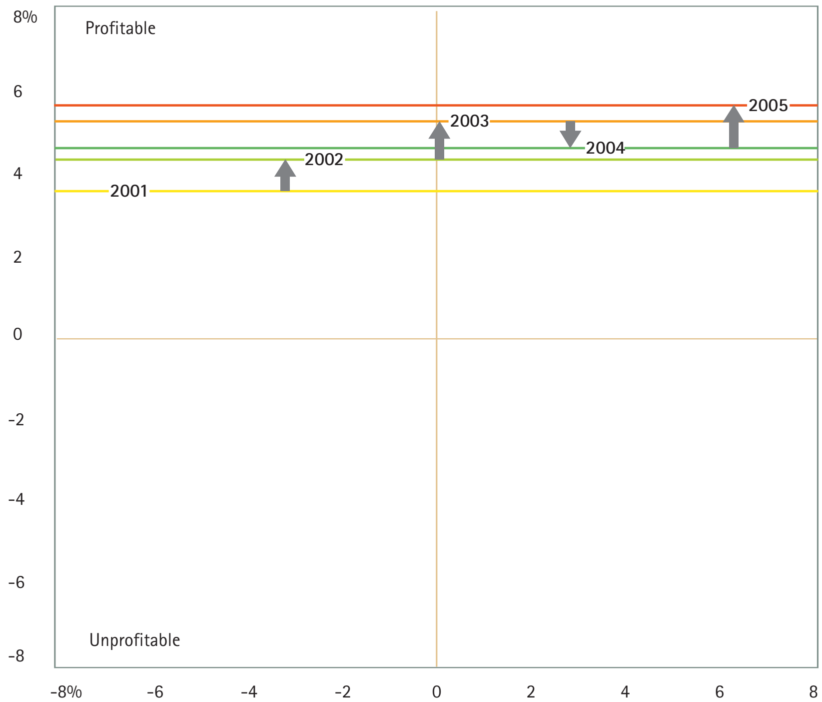
Since 1990, there has been significant consolidation in the industry, with top 10 companies now controlling more than 60 percent of the market share.



Source: Accenture analysis

Premiumization and consolidation have raised overall economic profitability, which has almost doubled, from 3.3 percent to 5.8 percent, during the past five years.

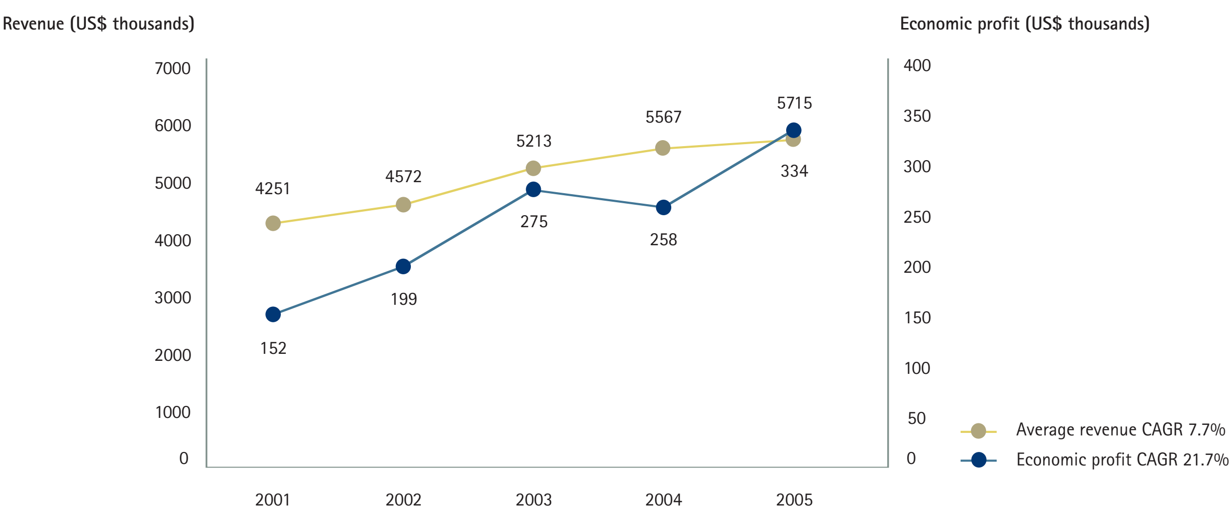
Industry average economic profit, 2001–2005



Source: Accenture analysis

However, the high level of capital intensity means that overall the industry has relatively low levels of economic profit. Yet growth in revenue has an even greater impact on the bottom line as the fixed cost base is leveraged.

Industry average revenue versus average economic profit



Source: S&P: Accenture analysis

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Outlook is published by Accenture.