KIRIN:
BUSINESS STRATEGIES FOR THE JAPANESE BEER MARKET

by

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ABSTRACT

Some scholars argue that Japanese companies show excellence in developing operational effectiveness but rarely have strategies (e.g., Porter, 1996). One reason might be the persistent mindset (especially among large companies), formed during Japan's rapid growth period, which prioritized the pursuit of effective production and broad distribution of products to fully realize market growth, rather than adopting a distinct competitive strategy. Although the Japanese economy has been stagnant for more than two decades, the above-described mindset remains deeply embedded in the guise of "continuous improvement" or "customers are everything"—strategies that are still found across many Japanese industries.

Another reason for the lack of strategies relates to the fact that, during the economic stagnation, an increasing number of companies have diversified their business portfolio in the search for new growth opportunities overseas. While globalization itself is a reasonable option—even inevitable for some industries—implementing such a corporate strategy can lead some companies to vague business strategies. Moving into another industry can make management even more complicated (Markides, 1999), requiring that the strategy of each business must be given considerable attention when a firm embarks on globalization.

This thesis explores Kirin's strategy for its Japanese beer business based on the factors described above. Although each player in the beer business worked hard to improve its product development and customer-facing skills in order to survive in a market that has been in decline for the past nearly twenty years, in the end every player competes fiercely for the same customers while offering similar products in the same fields. Ironically, this homogeneous effort maintains commoditization of the entire market over the long run. Product strategies or operational improvements are not enough to move away from this conundrum; Kirin needs a new business strategy, immediately.

Therefore, the aim of this thesis is to explore what distinct strategic position(s) Kirin should adopt and what type of organizational system it should develop in the future.

Through my analysis of Kirin using strategic frameworks and case studies, I found that Kirin has managed to survive the competition so far, cultivating many and varied capabilities in response to external changes. However, to deal with possible mid- and long-term changes in the beer market and the business model currently in place, Kirin has to review its strategic position and reform its organizational environment to focus on the development of new capabilities.

Note: The views expressed in this thesis are solely my own and do not necessarily reflect the views of Kirin Holding Co. Ltd., my employer.

Thesis Supervisor: Michael A. Cusumano
Title: Sloan Management Review Distinguished Professor of Management

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INTRODUCTION

PURPOSE OF THE THESIS

In the past ten years, Kirin Group, headquartered in Japan, has expanded its business by aggressively implementing mergers and acquisitions, primarily overseas. Nevertheless, almost half of the Group's revenue comes from its Japanese businesses, especially the Japanese beer business, one of the Group's core profit centers.

However, the business is facing a critical inflection point in the market and competitive environments that are witnessing profound and rapid change. This thesis will explore what future steps Kirin could take within its Japanese beer business, make recommendations for strategies that should be adopted, and provide suggestions for strengthened organizational structures and capabilities that should be developed.

THESIS STRUCTURE AND METHOD

As a foundation for exploratory research, Chapter 1 provides an overview of the industry structure, history, and "rules of the game" of the Japanese beer market to briefly illustrate the frameworks and mindset of the players in the market.

Chapter 2 discusses the current situation and future prospects of the external environment surrounding the Japanese beer market, including trends of market size, consumers, competitors, regulations, and potential innovations. This chapter explores what Kirin's businesses are, who are its customers, and suggests possible strategies (to be offered more fully in Chapter 6).

Chapter 3 reviews Kirin's current business strategies and organizational systems. My purpose is not to evaluate their effectiveness but to look for ways to explore new business strategies and organizational systems by laying out the full picture of present internal structures. This will enable the reader to think about how to design Kirin's future operating systems (to be offered more fully in Chapter 6).

In Chapter 4, based on discussions in previous chapters, I look at commoditization in the Japanese beer market—a phenomenon also facing other industries—through the framework of *Beating the Commodity Trap* by Richard A. D'Aveni. I believe effective business strategies need to include methods for dealing with commoditization.

In Chapter 5, I provide three case studies that illustrate how companies in the U.S. beverage market have dealt with declining and fragmenting markets by focusing on the linkages between their business strategies and organizational systems. Their strategies can be classified into three categories:

- Fight and dominate strategy (The Coca-Cola Company)
- Escape and diversify strategy (PepsiCo, Inc.)
- Create and focus strategy (The Boston Beer Company).

Chapter 6 discusses possible mid-term future strategic positions for Kirin's Japanese beer business based on the analyses conducted in Chapters 4 and 5, using D'Aveni's framework. I also offer suggestions for Kirin's future organizational environment, which would help the company to not only implement the strategies discussed above but also develop long-term competitive advantages, using the framework provided in *Staying Power* by Michael A. Cusumano.

The Conclusion summarizes the findings from this thesis study and research.

CHAPTER 1

OVERVIEW OF THE JAPANESE BEER MARKET

1.1 BASIC INDUSTRY STRUCTURE

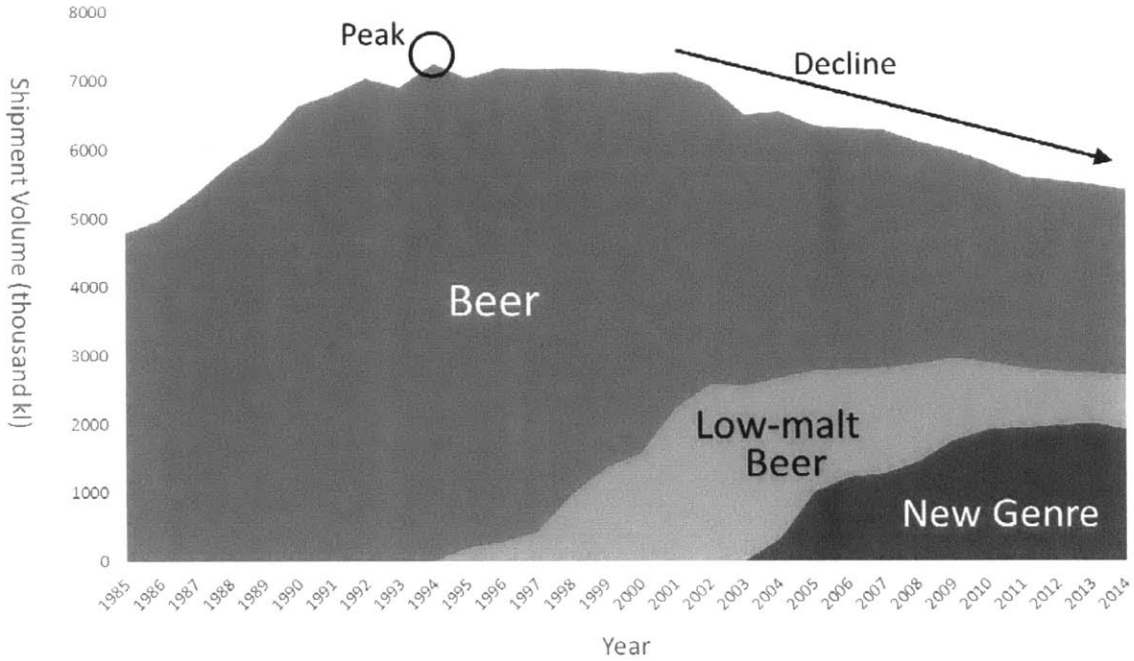
The Japanese beer market is the world's seventh largest market, representing 2.9% of world beer consumption.[1] It reached a peak in 1994 and began declining continuously after 2002 (see Exhibit 1-1). Reasons for the decline include the long-term slump of the Japanese economy, a decreasing Japanese birthrate, the steadily aging population, and an outflow of the market toward other alcoholic and non-alcoholic beverages.

When comparing the Japanese beer market to the markets of other countries, the most obvious characteristic is Japan's three price categories: beer, low-malt beer, and new genre,[2] each within a unique Japanese system of liquor taxes. Because the cost of raw materials is quite similar for each category, while the difference in the ratable value is reflected only by the price gap, these three categories show no significant difference in the amount of profit by volume. For 2014, the market composition ratio was 50.2% (beer), 14.4% (low-malt beer), and 35.4% (new genre).

[1] Kirin Brewery Company, News Release, "2013 World Beer Consumption Report," December 24, 2014.

[2] I define "new genre" as a type of beverage that tastes like beer, invented in the early 2000s. There are two types: one uses alternative ingredients instead of malt (e.g., soybeans); the other is a low-malt alcoholic beverage mixed with a small amount of other alcohol, such as vodka.

Exhibit 1-1. The Japanese beer market size (1985-2014)



Graph: Created by thesis author
Data source: Kirin (estimation based on disclosed shipping data of 5 major Japanese breweries.[3])

Products sold by the four major breweries account for the majority of domestic beer consumption. The 2014 market share for each of the major breweries is: 38.2% (Asahi Breweries, hereafter "Asahi"), 33.2% (Kirin Brewery, hereafter "Kirin"), 15.4% (Suntory Liquors, hereafter "Suntory"), and 12.3% (Sapporo Breweries, hereafter "Sapporo"). Most products are produced in each brewery's own factories and sold through wholesale shops to retail stores, and thence to consumers and restaurants/bars. Household consumption

[3] Asahi, Kirin, Sapporo, Suntory, and Orion Breweries. Official data on beer shipping in Japan usually includes these five. Orion Breweries has its business presence almost exclusively in Okinawa and is ranked fifth largest in the Japanese beer market with less than 1% market share.

represent approximately 75%, and consumption in restaurants and bars (most of which is beer) is approximately 25%.[4]

1.2 THE KEYS TO COMPETITION

Historically, there are several keys to understanding the nature of competition in the Japanese beer market.

The first key is the shift that occurred when the supply chain moved from upstream to downstream, which happened in the beer industry as well as many other consumer goods industries. During the period of high growth experienced by the Japanese economy following World War II, the key was to manufacture superior-quality products in large quantities and distribute them effectively through a network of national wholesale shops. Kirin excelled at this, thereby enabling it to maintain market share of more than 60% beginning in the early 1970s. However, in the mid-1980s, as market growth slowed and beer consumption shifted quantitatively, players in the beer market began to pursue brand differentiation and emphasized sales in retail stores and restaurants, which are major points of contact with consumers. The turning point came when Asahi began marketing a hot seller called "Super Dry," which increased the company's market share dramatically, and made Kirin and Asahi comparable rivals.

In the mid-1990s, when the Japanese economy entered the current period of recession, the beer market began to decline, and two new competitive keys appeared: market price and two low-price categories—low-malt beer and new genre. Taking advantage of this

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[4] The three categories (beer, low-malt beer, and new genre) are collectively called "beer" throughout this thesis.

trend, Suntory increased its market share with an aggressive pricing policy and excellent advertising.

1.3 RULES OF THE GAME

What rules govern the Japanese beer market? First, the universal characteristic of the entire beer industry is that the supply chain is local: production, distribution, and consumption occur solely within the country, and there are few exports and imports owing to the fact that beer is not suitable for long-distance transportation due to low value per weight and quality maintenance issues.

Second, the beer industry is considered a typical scale business. Large-scale capital investment is necessary in order for a company to become a major player, and scale expansion is an inviolable rule for recouping investment and enhancing profitability. Consequently, the number of major players is limited, and none of them can downplay market share.

Third, brand reinforcement through advertising and sales promotions is considered the most effective means of expanding market share. Functional differentiation or technological innovation does not play a key role in the beer industry.

Fourth, the tactics of the major Japanese breweries tend to be imitative and sometimes very aggressive because only four major players compete in a small country for consumers with relatively similar preferences compared with other countries. This tendency has continued to grow since the market entered the decline phase.

Fifth, the market decline itself requires breweries to identify and take actions that will increase profits, especially given the increasing voice of institutional investors in the Japanese capital market.

For these reasons, each player in the beer market needs to strike a strategic balance between market share expansion and improvement of profit.

CHAPTER 2

EXTERNAL ENVIRONMENT

2.1 MARKET SIZE

The size of the beer market is obtained by multiplying three factors: (1) the population of alcoholic beverage drinkers, times (2) the alcohol consumption per person, times (3) the amount of beer as a component of total alcohol consumption. The size of the 2014 market was 5.41 million kl—a decrease of 25.4% compared with the market peak in 1994 of 7.25 million kl.[5] The decline occurred mainly as a result of decreases in the size of the drinking population, and a reduction in the amount of beer being drunk as drinkers shifted to drinking non-beer beverages (factors 1 and 3 above).

According to reports of the Statistics Bureau, the number of people ages 15 to 64 years old, who comprise the majority of the alcoholic beverage drinking population, decreased by 10.6%—from 87.0 million in 1994 to 77.9 million in 2014.[6] At the same time, the volume of liquors (including beer) shipped from manufacturers decreased by 15.0%—from 9.61 million kl in 1994 to 8.16 million kl in 2014.[7] Finally, the consumption of beer as a proportion of total alcohol consumption declined from 75.5% to 66.2%.

It is expected, with some certainty, that the Japanese alcohol-drinking population will continue to decline in the future. If either of factors (2) and/or (3) were to increase such that

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[5] Estimation by Kirin, based on the disclosed shipping data of the major five Japanese breweries.

[6] Statistics Bureau, Ministry of Internal Affairs and Communications, "Population Estimates of Japan 1920-2000" and "Current Population Estimates as of October 1, 2014," April 17, 2015.

[7] Estimation by Kirin, based on the disclosed shipping data of alcoholic drink companies in Japan.

their combined effect compensated for the expected decrease in factor (1), then it would be reasonable to expect that the beer market size would not shrink. However, given the continuing and foreseeable future decrease in the alcohol-drinking population (factor (1)), combined with little expectation that alcohol consumption per person (factor (2)), or beer consumption as part of total alcohol consumption (factor (3)) will increase, I believe it is fair to expect that the beer market will continue to decline in size. In fact, test calculations by the Ministry of Health, Labor and Welfare found that by about 2030, the drinking-age population will decrease to 67.7 million, and in 50 years (2060) decrease further to 44.2 million.[8] This projection will become reality unless the Japanese government switches its population policy dramatically (i.e., adopts a new policy regarding emigrants).

2.2 CONSUMERS

As noted in the previous section, the declining rate of total alcohol shipments slightly exceeds the decrease in the drinking-age population, which leads to the conclusion that alcohol consumption per person is gradually decreasing as well owing to a steadily aging population and the younger generation's decreasing consumption of alcohol. In addition, consumers are shifting away from beer to other alcohol categories such as RTD[9] and wine (see Exhibit 2-1) due to diversifying consumer preferences and an increasing desire for low-alcohol beverages.

At the same time, the behavior of beer consumers is also changing. As the range of beer prices broadened over the past two decades, it enabled consumers to select the type of

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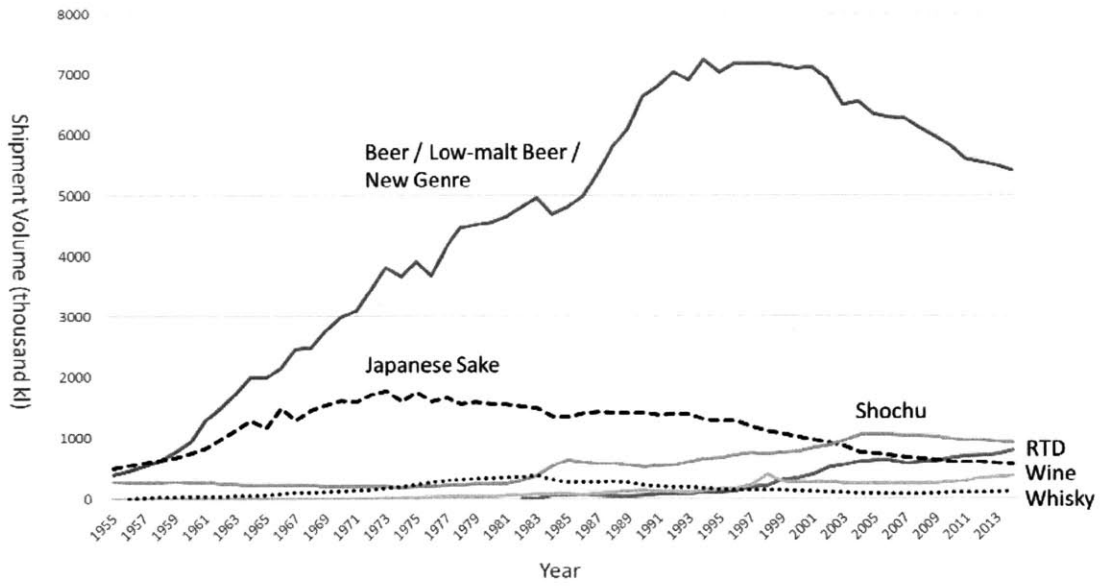
[8] The National Institute of Population and Social Security Research, "Population Projections for Japan," January 2012.

[9] RTD (Ready To Drink): premixed, low-alcohol beverages that can be enjoyed straight from the can or bottle.

beer they wanted to drink based on their lifestyle patterns (i.e., drinking a new genre product on weekdays to save money, and a premium beer on weekends to enjoy a special occasion). Another trend is the shift from bulk buying to more frequent small purchases due to the increasing number of single-person households. Simply put, the behavior of Japanese beer consumers is becoming more diversified and fragmented, and there is less loyalty to one single brand.

Exhibit 2-1. Alcoholic drinks shipments in Japan (1955-2014)



Graph: Created by thesis author
Data source: Kirin (estimation based on disclosed shipping data of alcoholic drinks companies in Japan)

In the future, alcohol consumption per person is likely to keep decreasing gradually in Japan, taking into account the universal trend in health-consciousness as well as the worldwide movement to tighten regulations on alcohol. In addition, the behavior of beer consumers will become more fragmented as the trend toward more nuclear social groups (families, workplace colleagues) increases, and income ranges broadens. If players in the

beer market do not properly address these circumstances, it is likely that beer sales as a proportion of total alcohol consumption will further decline.

2.3 COMPETITORS

There is general consensus that domestic beer brands attract more consumers in a country than imported or foreign brands, and Japan is no exception. While that remains true in Japan, major global beer brands (Budweiser, Heineken, and Coors) also add to the competitive market. None of them can have their own supply chain in Japan, so they enter the market via partnerships with the Big Four (Asahi, Kirin, Suntory, and Sapporo) Japanese beer companies. The net result is that the Big Four continue to be the largest domestic companies, and all four companies market their products in the three price categories (beer, low-malt beer, and new genre). Exhibit 2-2 shows price category composition and each player's market share.

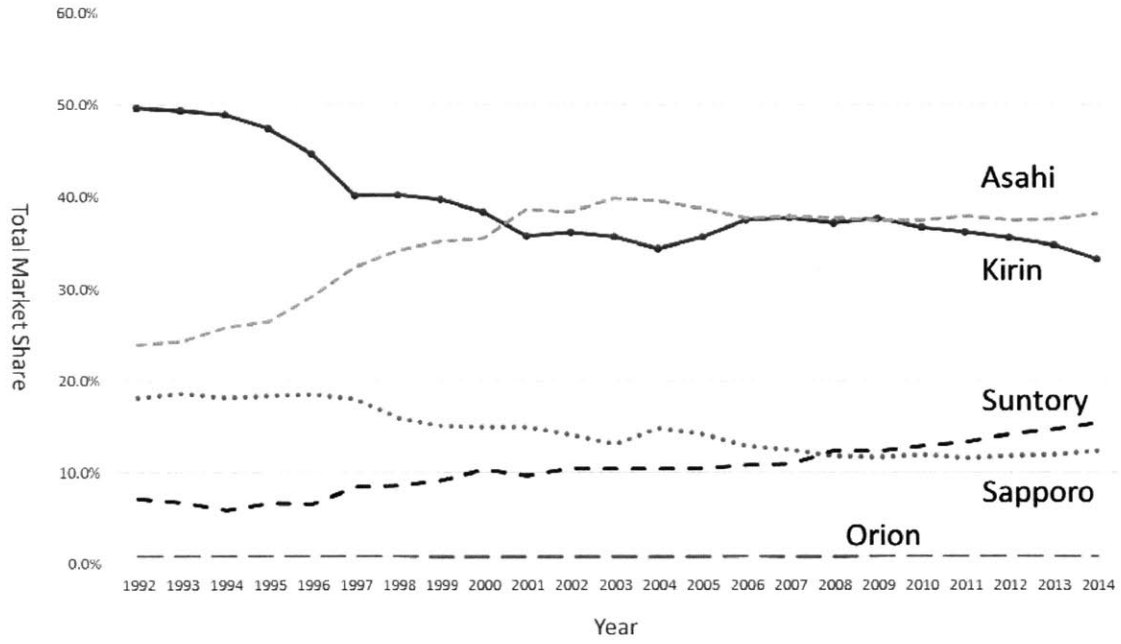
Exhibit 2-2. Market share by category (as of 2014)

		Beer	**Low-Malt Beer**	**New Genre**	**Total**
Category Composition		50.2%	14.4%	35.4%	100.0%
Market Share	Asahi	50.5%	26.4%	25.6%	38.2%
	Kirin	24.1%	65.2%	33.1%	33.2%
	Suntory	11.0%	0.9%	27.4%	15.4%
	Sapporo	13.6%	6.4%	13.0%	12.3%
	Orion	0.8%	1.1%	0.9%	0.9%

Source: Kirin (estimated based on disclosed shipping data of each company)

During the past two decades, Asahi and Suntory increased their market share, while Kirin and Sapporo saw their shares decrease (see Exhibit 2-3).

Exhibit 2-3. Total market share by company (1992-2014)



Graph: Created by thesis author
Data Source: Kirin (estimation based on the disclosed shipping data of each company)

As noted earlier, the keys to successful competition in the Japanese beer market are brand and market price, so the decision as to whether each player will establish business operations that enable efficient and flexible investment in these areas will make the difference between winning or losing the battle for market share. In the case of Asahi, its number one product, Super Dry, generates a large revenue stream that enables the company to make major reinvestments back into the company. Suntory has strong market positions in other beverage businesses, including whiskey and soft drinks, and those revenue streams have supported the firm's aggressive investment in the beer business. In comparison, Sapporo lacks such financial backing.

Kirin's story is more complicated. It was very successful in rebuilding its Japanese beer business and associated profitability after losing the top market position to Asahi in

2001. Kirin moved ahead by implementing a global strategy through investment in overseas business using its domestic business as a cash cow. However, around 2010, when the beer price wars became fierce, Kirin limited its investment in the domestic market due to a downturn among acquired overseas businesses. This situation is generally regarded as one cause of Kirin's recent hard times.

There is no guarantee that the Big Four competition will continue, while further market declines are a virtual certainty. In fact, the number of players is likely to be reduced via industry consolidation. However, other competitors have emerged in the market recently: private-label brands and craft beers. While their positions in the competitive markets are as yet unknown because their portion of the market is still small (private label, 3%; craft beer, 1%) and there are many firms with varied backgrounds, my research finds it likely that they will be important players in the future Japanese beer market.

2.4 REGULATIONS

The fundamental regulation governing alcohol consumption in Japan is the one that prohibits minors (i.e., those less than 20 years old) from drinking. Therefore, the beer companies' targeted customer base focuses solely on adults. In addition, all players that are part of the alcohol supply chain (producers, wholesalers, retailers), are required to be licensed by the National Tax Agency (NTA), which regulates the alcohol industry, and enforces compliance with NTA regulations and administrative guidance. Moreover, the World Health Organization (WHO) functions as a regulatory body for alcohol industries worldwide, so it influences Japanese alcohol manufacturers in the areas of advertising and sales promotions. Finally, the opinions of consumer groups carry considerable weight.

The liquor tax system is an integral component in any discussion of the Japanese beer industry. This system determines a tax rate based on the alcohol content of each product. However, beer remains the biggest exception, despite its low alcohol content. In the Meiji Era, the government imposed a high tax rate on beer as a luxury commodity. As beer became more widely available to the general population, the tax rate should have dropped, but instead the government made the political decision to raise the beer tax rate as another means of acquiring additional tax revenue—especially since beer now represents a large portion of liquor consumption.

As a result of the strict definition of the term "beer" in the Liquor Tax Act as it applies to ingredients and malt content ratio, a lower tax rate is imposed on categories that taste like beer but do not fall into the narrow definition of "beer." After the mid-1990s, major Japanese beer companies took advantage of this peculiar tax system—in ways the government never expected—and developed two low-price, beer-taste beverage categories: low-malt beer and new genre. These categories became very popular, which caused liquor tax revenues to decline, in turn causing the NTA to realize that a more appropriate beer tax system might be required. While the government and major stakeholders have not yet reached agreement on a new tax system, pending revisions are expected to narrow the gap between the tax rates of the three categories, which would definitely cause a major reorganization of the beer price categories.

2.5 SUPPLY CHAIN

The relaxation of regulations significantly changed the balance of power within the supply chain of the Japanese beer industry. Until the 1980s, the beer distribution network

consisted mainly of the major beer producers, and small, local specialty wholesalers and liquor shops that were supervised by the NTA. There was little competition in market pricing, for two reasons: (1) wholesalers enjoyed guaranteed business territories owing to widespread and exclusive deal contracts that were introduced by producers when the market was growing, and (2) liquor shops were protected by a restrictive licensing operation promoted by the NTA to stabilize both retailers' businesses and liquor tax revenues. This paternalistic structure eliminated any incentive for price competition, and as a result, wholesalers and liquor shops simply complied with prices quoted by the producers.

Eventually, however, the scheme collapsed downstream. As deregulation gained momentum in Japan after the 1990s, the regulation governing the opening of large stores was relaxed. In addition, the requirement for a retailer liquor license (originally designed by the NTA to maintain a balance between supply and demand) was phased out. As a result, consumers' point of purchase shifted from small specialty liquor shops to large discounters, supermarkets, and convenience stores, thus triggering full-scale price competition in the overall alcohol markets, including beer. Large-chain retailers required wholesalers to provide not just low prices but also a broad range of goods, which caused a shakeout among wholesalers and the virtual collapse of the exclusive-deal contract system that had benefited wholesalers and producers for so long.

Meanwhile, while not directly related to the deregulations discussed above, large chain restaurants have increased their presence in the market as well. As a result, today the Big Four beer manufacturers and the large chain retailers and restaurants compete vertically to capture value in the supply chain. Price competition is a given, and wholesalers are forced to accept a lower margin in their new position as intermediate distributors.

In the future, a major consideration for the beer supply chain will be how and to what extent the traditional structure of producer => wholesaler => retailer will change. Direct transactions between producers and retailers are more common in other consumer product industries. On the other hand, possible changes in points of purchase cannot be overlooked. For instance, a shift from bulk buying to more frequent small purchases could threaten the future of large supermarkets, which have taken a leading role in revolutionizing the Japanese liquor distribution system for the past two decades. Such a shift also might boost the power of other players, such as convenience stores and Internet shopping, both of which are huge innovations in the Japanese retail industry. As the Internet causes manufacturers to accelerate their ability to sell products directly to consumers, this will dramatically change the traditional supply chain structure as well.

2.6 INNOVATIONS

The fundamental process of manufacturing beer has not changed since the third or fourth century BC, when it is believed the world's first beer was manufactured. The core of the process is fermentation of malt using yeast, but continually changing beer production efforts improved this process as they became more sophisticated. Large-scale beer-manufacturing systems, established in the 19th century, are generally regarded as the latest innovations in the world beer industry.

Today, however, innovations focus on adapting to a country's market and its consumers. In the case of Japan, the development of beer with an added functional benefit (e.g., low-calorie, low-carbohydrate), is classified as content innovation. Putting beverages into aluminum cans was another major innovation that brought significant changes to the

Japanese beer industry. The development of low-malt beer and new genre products were category innovations. Various ideas, such as powdered beer and beer in plastic bottles, have been widely examined but have not yet become reality for reasons relating to return on investment, quality, and customer acceptance.

While it is hard to predict what future innovations might appear, the common perception in the beer industry is that disruptive technological innovation is less likely to happen, at least in the near future. Therefore, when future innovations are discussed at the industry level, such discussions might fall into the category of innovative business strategy or attempts to enter a new business by leveraging already-present technologies in the beer business.

CHAPTER 3

KIRIN INTERNAL SYSTEMS

3.1 COMPANY PROFILE

Japan Brewery Company, which was founded in 1885 after taking over the business of Spring Valley Brewery, began to sell the brand "Kirin Beer" in 1888. Kirin Brewery Company was established in 1907, taking over the business of Japan Brewery Company. On a consolidated basis, the Kirin Group's 2014 sales (including liquor tax) and net income were ¥2,195.7 billion and ¥32.3 billion,[10] respectively. Exhibit 3-1 shows part of its consolidated statements of income for the last three years.

Exhibit 3-1 Kirin's consolidated statements of income (2012-2014)

(¥ billion)	2012	2013	2014
Sales	2,186.1	2,254.5	2,195.7
Japanese Beverage Business	1,190.0	1,180.1	1,152.9
Japanese Beer Business	648.8	626.5	593.4
Operating Income	153.0	142.8	114.5
Net Income	56.1	85.6	32.3

Source: Kirin Holdings

The internal systems of Kirin, in particular those of Kirin Brewery, which is the pillar of Kirin's Japanese business, were formed during three different periods. The first

[10] $1 = approx. ¥120 (as of April 2015).

period was when Kirin held an overwhelming position in the Japanese beer market (i.e., from the 1950s to the late 1980s). The second period was when the company managed to transform itself after struggling with declining market share (i.e., from the late 1980s to around 2007). During the third period, Kirin was required to streamline its business as the entire Kirin Group pursued overseas growth (i.e., from around 2007 to the present). It is helpful for the reader to know that the organizational characteristics formed in these periods are an inherent part of the company aspects that I discuss in this chapter.

3.2 CURRENT BUSINESS STRATEGY

The current business strategy for the entire Kirin Group is an extension of Kirin Group Vision 2015 (hereafter "KV2015"), the long-term business framework developed in 2006, which had two key points: (1) pursue collaborations and synergies between alcohol beverages and the soft drink businesses (i.e., an Integrated Beverages Group strategy), and (2) internationalize Kirin's businesses and secure a base for new overseas growth.

While Kirin has operated its alcohol beverage and soft drink businesses for a long time, like its major competitors in Japan, conducting both businesses in the world beverage market required new strategies. The main purpose for developing a strategy for the Integrated Beverages Group was to highlight its uniqueness and turn it into a differentiation strategy that would work in the global market. While internationalization was not new to the company (its overseas business began in the late 1940s), the biggest difference from the past was that KV2015 specifically positioned overseas business as the growth driver of the group, recognizing that ultimately, the Japanese market would decline over the long run.

Based on these two policies, the Japanese business has focused on two fundamental initiatives: (1) creating new customer value through integrating the alcohol beverage and soft drink businesses, while enhancing the value of their common corporate brand "KIRIN", and (2) building a cost-efficient business structure to generate stable cash flow by streamlining the product portfolio and overlapping functions across business units.

In terms of its entire beverage portfolio, Kirin focuses not only on beer but also on its RTD, wine, and soft drink businesses in order to respond to a range of consumer preferences. However, competitors seeking to enter these businesses (with the exception of beer) do not need a huge capital investment. Thus, the markets have a low entry barrier, an enormous number of products, and fierce competition, which make it almost impossible for the markets to be as profitable as the beer business. Thus, it is critical for Kirin to maintain and reinforce the competitive advantages of its beer business while expanding its other beverage businesses. In 2014, Kirin's Japanese business revenues was 51.5% (beer), 6.3% (RTD), 6.0% (wine), and 30.0% (soft drinks).

The company focuses on two basic customer values: (1) product quality, which Kirin pursues keenly as part of its identity, and (2) novelty for consumers. Kirin's current brand message, "Quality with Surprise," represents these ideas very well. The main Kirin target is people in their 30s and 40s. The company offers products for sale through all types of liquor channels all over the country and through traditional distribution network (with a few exceptions). Among these strategies, it is hard to find a significant point of differentiation. Also, there is no factor that breaks the "rules of the game" as described at the beginning of this thesis.

However, Kirin's product portfolio does have some features that are different from its competitors. For example, its major brands hold the first or second rank in sales by volume for each price category (i.e., beer, low-malt beer, and new genre), which can be regarded as a typical full-line strategy for a top player in the market. The remarkable fact is that each of the three categories represents about the same percentage of Kirin's total sales volume (see Exhibit 3-2). This is one of Kirin's strengths, but at the same time it is a kind of weakness because it forces the company to disperse much of its resources.

Exhibit 3-2. Composition by category (%, as of 2014)

	Beer	**Low-Malt Beer**	**New Genre**	**Total**
Asahi	66.4	9.9	23.7	100.0
Kirin	36.5	28.2	35.3	100.0
Suntory	36.0	0.8	63.2	100.0
Sapporo	55.3	7.4	37.3	100.0
Orion	46.1	17.8	36.1	100.0
Total	50.2%	14.4%	35.4%	100.0%

Source: Kirin Holdings (aggregated data from each company)

Historically, Kirin formed its brand portfolio by developing new products in response to fierce competition. For example, in 1987 Asahi Super Dry beer was released, which quickly deprived Kirin's long-lasting flagship brand Kirin Lager Beer (released in 1888) of market share. The current major brands are Kirin Ichiban (beer, released in 1990), Kirin Tanrei (low-malt beer, released in 1998), and Kirin Nodogoshi (new genre, released in 2005). The three brands comprise 81.1% of sales volume in Kirin's beer business, including related extension products.

Exhibit 3-3. Kirin's major beer brands

Kirin Ichiban

Kirin Tanrei

Kirin Nodogoshi

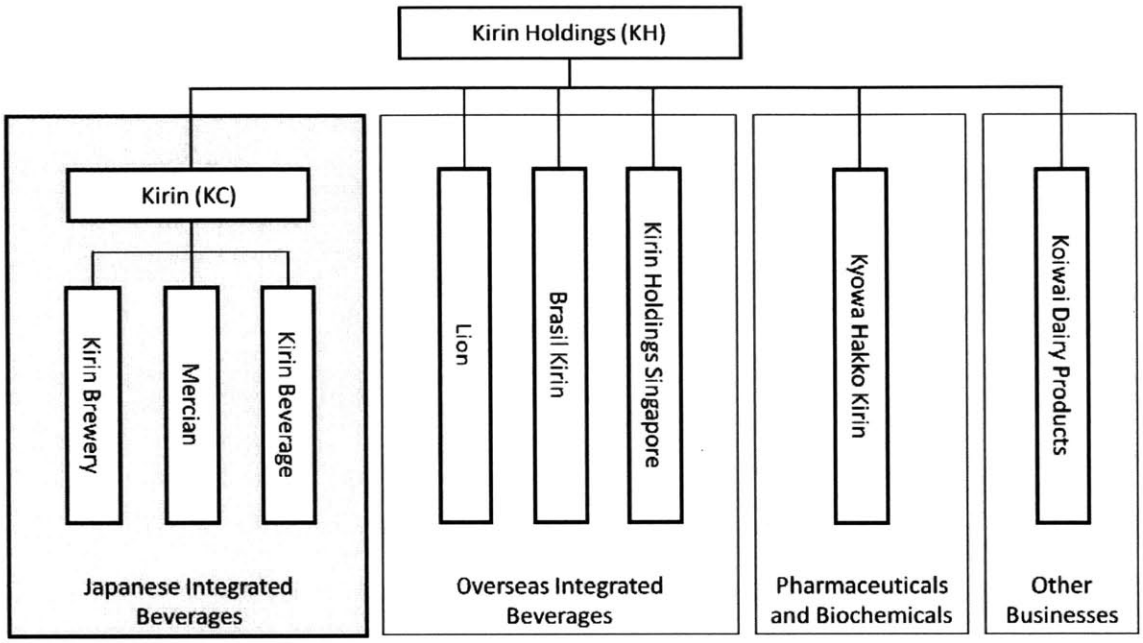
Source: Kirin Website

While there has been stiff brand competition in the Japanese beer market, it is now less likely that a brand-new product can redraw the competitive landscape now that the growth rate of new genre (the latest price category among the three) has slowed down. In fact, although Kirin also tried to foster another pillar brand several times following the enormous success of Kirin Nodogoshi, every potential new brand resulted in failure. This experience caused the company to focus its strategy on reinforcing the existing brands, coupled with a policy to streamline the overall Japanese beer business.

3.3 ORGANIZATIONAL STRUCTURE

The Kirin Group is comprised of the holding company, Kirin Holdings (hereafter "KH"), 216 subsidiaries, and 16 affiliates as of the end of December 2014. The current organizational structure of Kirin Group is shown in Exhibit 3-4. The group's major business domains are integrated beverages (i.e., alcohol beverages and soft drinks) and pharmaceutical/biochemical, both have Japanese and overseas businesses.

Exhibit 3-4. Kirin Group's general organizational structure (as of December 2014)



Source: Kirin website, modified by thesis author

Kirin's organizational structure prior to 2007 was simple: Kirin Brewery was the parent company of the group, which held stakes in its subsidiaries and affiliates while doing its own alcohol beverage business in Japan. The company held the full group control functions, and its subsidiaries and affiliates had all the functions required to operate their businesses.

However, as a result of KV2015, which declared new strategies for the integrated beverage group and for internationalization, the group control function was transferred in 2007 to a newly established holding company, KH, and the back-end functions of the domestic group companies were integrated in a step--by step process. In addition to accelerating the integrated beverage group strategy, an intermediate holding company, Kirin Co. (hereafter "KC"), was established not only to further integrate back-end functions but

also to preside over developing strategies for beverage business in Japan. The matrix of products, functions, and organizations that comprise the current Japanese business are shown in Exhibit 3-5. Regarding the Japanese beer business, all the functions were transferred from Kirin Brewery to other group companies, including KC, except for strategic planning, product development, marketing, and production.

Exhibit 3-5. Kirin's Japanese beverage business: products, functions, and organizations[11]

			Products			
			Beer	RTD	Wine	Soft Drink
Functions	Strategy Planning		KC			
			Kirin Brewery		Mercian	Kirin Beverage
	Value Chain	R&D	KC *1			
		Procurement				
		Market Research				
		Product Development/ Marketing	Kirin Brewery		Mercian	Kirin Beverage
		Production				
		Logistics	Kirin Group Logistics			
		Sales	Kirin Beer Marketing		Mercian	Kirin Beverage
	Administration	HR, PR, CSR, Accounting, Legal, IP, Audit	KC *1			
		IT	Kirin Business System			
		Clerical Support	Kirin Business Expert			

*1 Partly operated by Kirin Brewery, Mercian, and Kirin Beverage

Source: Created by thesis author

Although the group businesses were controlled in a relatively centralized way under the structure before 2007, the group has recently begun to move toward decentralization

[11] Although Kirin also produces, imports, and sells other alcohol beverages such as shochu, whiskey, and spirits, I have excluded them from the matrix to simplify the chart.

because the limitations of a centralized system became apparent as the revenue portion of the overseas integrated beverage business and the pharmaceutical business increased under the current holding company structure.

This organizational integration/segmentation and decentralization were undertaken to improve the company's cost structure, the number of specialized employees, and the autonomy of each business unit. On the other hand, the series of restructurings also brought challenges such as a more complicated operating process, communication difficulties between organizations, and less unity among the group.

The official decision-making system in Japan, centered on the two holding companies, KH and KC, is very structured. Rules of organizational authority were developed that provided detailed definitions about what each division or department executes, and the scope of operations and decision making. A number of committees, including the executive committee, general manager committee, and risk management committee, make decisions that a division or department cannot undertake. In addition, some divisions require detailed processes for make decisions that they are expected to complete alone. As result, it is a long-time tradition that inter-organizational barriers are high and decision-making process are lengthy and weighty. They are a kind of organizational "instinct" or DNA, which Kirin developed when it focused on the company's organizational operations rather than on developing a system of agile responses to the market during the days when it enjoyed an overwhelming dominance of the Japanese beer market. Some would describe this characteristic as bureaucratic. However, since falling from number one position in the market in 2001, the company and its people have begun to rethink this rigid organizational structure and burdensome decision-making process. These days, formulating

projects across departments is more common than before, and casual discussions between leaders, members, and inter-organizational collaboration are encouraged on a daily basis.

Like many companies in Japan, internal personnel transfers have become a great way to energize and activate the organization. Employees who work for divisions that require highly professional skills (e.g., R&D, IT, legal) or those who work for departments that have their own training and promotion system (e.g., production, sales, accounting) are more likely to be transferred within the same divisions. However, transfers between the other divisions and departments have become much more frequent. Personnel exchanges to other countries, while more difficult to complete than transfers within Japan, most are also encouraged now as well.

As is often pointed out about Japanese companies, the internal personnel transfer system tends to make the company and its people acquire more capabilities that are valuable, but typically only within the organization. At the same time, however, the system is effective in the sense that it enables divisions to introduce new perspectives and enhances inter-organizational communications and collaborations. All employees (excluding executives and general managers) have an annual guaranteed opportunity to talk with their supervisor about what kind of internal career they want to develop in the future.

3.4 ASSETS, CAPABILITIES, AND PEOPLE

Kirin's traditional strengths exist upstream in the supply chain because the company cultivated fundamental capabilities during the period of growth in the Japanese beer market. It accumulated R&D capabilities by attracting many talented agricultural researchers owing to its status as a top company in the Japanese food industry. Further, it has strong

procurement capabilities to secure quality raw materials by developing its own supply routes, as well as taking advantage of the Mitsubishi Group network. Another of Kirin's strengths is manufacturing technologies, which enable the company to pursue the highest product quality, long held as a key part of its management philosophy. Kirin continues to maintain a significant advantage in brewing high-quality beer owing to its excellent technology and supply of raw materials.

In turn, these capabilities brought about important assets: a trusted brand image backed by high product quality and a strong distribution network built on Kirin's brand power. However, now that the market environment has greatly changed from decades ago, these capabilities and assets do not ensure the company's competitive advantage in the market.

After the power began to move downstream in the beer supply chain, and fierce competition with Asahi began, Kirin focused on improving the capabilities it needed to maximize value at various consumer touch points. One new capability which the company acquired was market research skills, which help with product development and sales activities by providing market and consumer data analyses. Today, Kirin's market research division has enough researchers to maintain incomparable quality among Japanese food and beverage companies. However, data analysis is no more than a backup function. The most important capabilities for creating customer value are product development and sales skills, which are based on real market reactions. While Kirin has also improved these skills, and they contributed to slowing the decline in market share for a number of years, it still requires considerable effort to sustain these capabilities because they often depend on individual skills which can be easily lost when the market changes.

Since then, the company continues its initiative to realize low-cost operations in every function by streamlining its domestic business. Cost-reduction efforts were implemented at the production facilities in the form of factory shut-downs and personnel retrenchment, until finally, in the past few years those streamlining efforts in all functions are now accelerating. However, Kirin also confronts a difficult dilemma: it accumulated the capabilities and assets just described by emphasizing added value creation rather than cost efficiency, a strategy that was applied not only to the value-creating functions but also to administrative functions. High-quality in all its operations, based on a certain amount of manpower, is a key component of the company's organizational identity. Since the company is still struggling to find a good balance between high quality and low-cost operations, it will take time to achieve new capabilities that will enable Kirin to be more competitive.

What are the characteristics of people who build and support these capabilities and assets? There is no doubt that the company has secured a number of brilliant people who are happy to work with Kirin as a leading food and beverage company in Japan. In the past, Kirin had many people of the bureaucratic type people who were unwilling to change the status quo and prioritize the interests of the organization. Today, the number of people who enjoy a challenge or can facilitate inter-organizational collaboration is increasing. However, it remains true that most people are sincere and have a strong attachment to the organization, and they work hard to achieve individual or organizational goals. At the same time, such people are rarely what could be called "mavericks" who might try to bring big changes to the company.

That said, these modern characteristics seem to have been reinforced during the past 10 years of organizational segmentation. Executives and managers are, in general, smarter

and more balanced business people rather than experienced and shrewd merchants. In addition, the company has a thick layer of people who are familiar with operations, which is a good example of many Japanese companies' field-oriented policy (*Genba Shugi*). There is no doubt that this thick layer greatly contributed to the accumulation of organizational capabilities and assets described above. On the other hand, this field-oriented policy has prevented the company from establishing a system to select promising people early in their career and train them to be future top management, coupled with a promotion system that is still more seniority-based rather than merit-based. Dispatching employees to small subsidiaries functioned as a kind of management training system in the past, but Kirin divested a number of small subsidiaries during the past 10 years to focus on its core businesses and improve its asset efficiency. Thus, I believe the company needs to wrestle with the difficult challenge of how to train younger managerial talent effectively within the large and structured Kirin organization.

3.5 INCENTIVES

Since many of the Kirin Group companies, especially purchased companies, have built their own incentive system corresponding to their own business needs and historical backgrounds, I will limit my discussion to incentive systems related to the Japanese beer business.

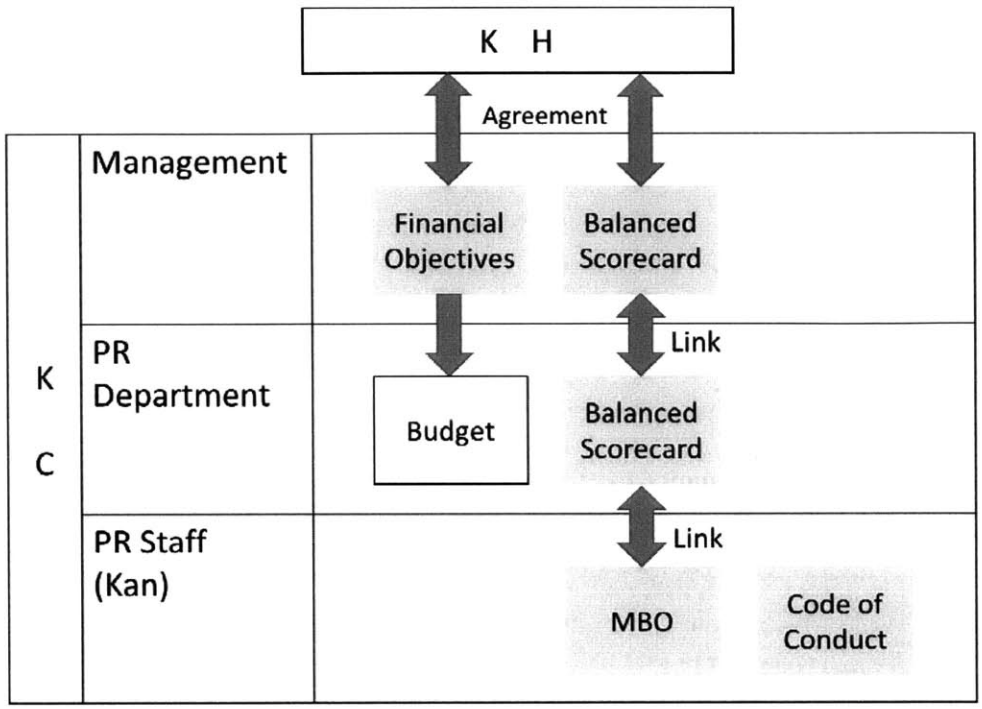
An outline of compensation and promotion, which are typical and fundamental incentives, is as follows. Compensation is comprised of a monthly salary payment, a bi-annual bonus, and a retirement benefit. Stock options have not been introduced; instead, business performance is reflected in bonus. The company also has a voluntary employee

shareholding association. The monthly payment and bonus are linked to the promotion system, that is, an employee in a higher position receives a higher level of compensation. The system defines a range of monthly payment and bonus for each position, and the amount an employee receives within the range is determined by his/her annual individual evaluation. The accumulated individual evaluation influences the pace of promotion, which in turn determines the amount of retirement benefit.

The system outlined above aims to inspire employees' willingness to make a deeper commitment and contribute to the organization over the long run. The compensation level at Kirin is a little higher than that of most large companies in Japan, and also the highest in the food and beverage sector. However, the pace of promotion is far from fast compared with recent practice among Japanese companies. The fastest promotion model at Kirin is: manager by late 30s, general manager around age 50, and director by middle 50s.

The key to the incentive system of compensation and promotion is the individual evaluation. To understand how it is executed, we need to understand the links between organizational and individual objectives. Let me explain the evaluation system by using Kan as an example. The same process applies to all the group companies and employees involved in the Japanese beer business. Exhibit 3-6 is a rough sketch of how the system works.

Exhibit 3-6. Kirin's performance evaluation system



Source: Created by thesis author

The top management of KC are evaluated every year on the basis of how well each person attained their level of annual performance goals which are agreed with the parent company (KH) at the beginning of a year. KC's performance goals include financial objectives of the company and behavioral objectives set in the four perspectives of the balanced scorecard. The financial objectives are broken down as revenues or expense budget for each department, including PR. The behavioral objectives of Kirin's balanced scorecard are linked to the annual goals of the PR department and how well Kan follows those objectives. The PR department sets its own balanced scorecard, which consists of KC's behavioral objectives related to PR, and PR's own behavioral objectives based on recognized specific issues for PR. The PR general manager takes full responsibility for the

PR department scorecard and assigns PR managers to accomplish the objectives outlined in the scorecard.

Meanwhile, Kan, one of the PR staff, sets his own individual performance goals every year, which consist of process and results objectives. Kan consults with his supervisor to match what he wants to achieve as an individual and what the department wants him to try as part of the organization. This method of setting individual performance goals is commonly referred to as "management by objectives" (hereafter "MBO"). Kan's supervisor, one of the PR managers, takes into account his own responsibility for the PR department balanced scorecard as part of his consultation with Kan. Kan is evaluated not only by how well he attained his MBO goals but also by how well Kan followed Kirin's employee code of conduct, which consists of four values: Integrity, Commitment, Challenge, and Collaboration. A combination of the two frameworks, MBO and the conduct of code, provides the basis for Kan's annual individual evaluation and bonus. The promotion system takes into account his accumulated annual evaluations and Kan's reputation as perceived by his supervisors, colleagues, and other departments.

The above example illustrates how organizational and individual performances are evaluated at Kirin based on a combination of financial objectives, the balanced scorecard, MBO, and the code of conduct. Each of the evaluation tools has its own purpose. The balanced scorecard emphasizes process management including non-financial measures; MBO enables a good balance between organizational goals and individual initiatives; and evaluation via the conduct of code helps the organization continually develop excellent human assets. The system that integrates these tools is elaborated very well to prevent the company from pursuing just short-term quantitative results with a top-down approach. On

the other hand, it is not easy, both for organizations and individuals, to review their goals flexibly in a short cycle and continually respond to changes in the market and progress in business performance, because the framework of the evaluation system is very structured. In addition, since each department and individual pursues specific performance goals, it sometimes creates a conflict between departments and individuals and becomes an obstacle to inter-organizational collaborations, especially as organizations and functions have been segmented in the past ten years.

Kirin also emphasizes measures other than the fundamental incentive system to enhance each employee's motivation and commitment. These include: satisfactory employee welfare benefits, skill development opportunities by personnel transfer, a training system according to each employee's career stage, forums between executives and employees, commendation system for high-performing companies/departments/teams, a variety of initiatives to enhance work-life balance, and events to promote casual interactions among departments. The work environment often receives good feedback from external institutions.

3.6 CULTURE

While I have already discussed many aspects of Kirin's organizational culture in this chapter, I would like to summarize the key points. Kirin has long maintained its management policies of "high product quality" and "sound management" and nurtured a solid and sincere corporate culture. During the period when the company dominated the Japanese beer market, it also developed strong pride in its corporate and product brands as well as its structured and centralized organizational culture—both of which are sometimes criticized as conservative or bureaucratic. However, the stiff competition after the late 1980s

motivated Kirin to move away from its tradition of imperious business ways and to move toward new challenges.

In particular, ceding the top position in the beer market to Asahi in 2001 inspired the newly appointed CEO, Koichiro Aramaki, to release "The New Kirin Declaration" to all employees, which provided a major turning point. It advocated a new organizational policy that moved from competitor-driven behavior to customer-driven behavior and a focus on creating customer value. After that, the company proceeded along a path toward revival, until 2009 when it temporarily regained top ranking in market share by creating a number of innovative products and fostering customer-oriented and value-proposition style.

These ups and downs helped the company develop a more balanced and mature organizational culture. However, some challenges remain. The company failed to watch and study its competitors' strategies, falling into the trap of pursuing the dogma of "customers are everything," which impaired its combat capabilities in the market. Also, while the number of people who enjoy a challenge increases, the company still maintains a persistent culture of avoiding failure while never trying again what once failed, which may be inextricably linked (again) to the culture of rigidly adhering to goals once they are put in place.

CHAPTER 4

COMMODITIZATION OF THE BEER MARKET

4.1 COMMODITY TRAPS

In order to develop a future business strategy for Kirin's beer business in Japan, taking into account the external and internal environments described in the previous chapters, one must first identify and evaluate current and future issues in the industry. I believe commoditization is the biggest issue for Kirin (and for many companies in other industries as well). Richard A. D'Aveni, author of *Beating the Commodity Trap*, discusses the concept of commoditization, which he defines as "a particularly virulent form of hypercompetition . . . [that] has the potential to destroy entire markets, disrupt whole industries, and drive previously successful firms out of business."[12]

He suggests that the solution lies in identifying the kind of commoditization trap facing the company. He describes three types of traps: deterioration trap, escalation trap, and proliferation trap.[13] In the following sections, I briefly discuss each kind of commodity trap and how it may or may not apply to Kirin.

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[12] Richard A. D'Aveni, *Beating the Commodity Trap: How to Maximize Your Competitive Position and Increase Your Pricing Power* (Cambridge, MA: Harvard Business Press, 2010), Preface, x.

[13] D'Aveni, *Beating the Commodity Trap,* Preface, xii.

4.1.1 Deterioration Trap

This trap occurs when a low-end firms enter the market with low-cost/low-benefit offerings that are attractive to consumers in the mass market. The company may not be able to beat them, but if it ignores such low-cost offerings, it could mean losing market share in segments where the company has been successful and may eventually result in the erosion of profit.[14]

During the past 20 years, the Japanese beer market has experienced two types of significant pressures to lower price: (1) pressures from large chain retailers and restaurants and (2) an expanding range of lower-price products. However, I do not believe these transformations can be ascribed completely to a deterioration trap, for the following reasons:

- In 1993, the Japanese liquor distribution system changed dramatically when Daiei, one of the largest Japanese retail chains at the time, began to sell an imported private-label beer named "Bergen Brau." That caused a dip in the overall price of domestic beers, and led the rise of big retailers and the decline of smaller traditional liquor shops. The prices established in the ensuing price war between the big retailers have now become an established competitive condition for all beer companies. Overall, this represents a structural shift stemming from consumers' desire for lower-priced products, especially because of the lengthy and continuous deflation in the Japanese economy. As D'Aveni notes:, "As sharp economic downturn . . . [makes] market prices and benefits deteriorate as customers feeling the pinch seek

[14] D'Aveni, *Beating the Commodity Trap,* 20.

bargains . . . [it is] technically not commoditization."[15] Such a pervasive situation cannot be overcome by just one company's effort or strategy.

- The advent of low-malt beer in 1994, with Suntory's new product called "Hops," established low-malt beers as a new category of low-priced products in the beer market. Today, there are two low-price categories—low-malt beer and new genre—in the beer market, and their combined market share is about 50%. However, the expansion of lower-priced beer products did not decrease the amount of profit by volume because the difference in price between the three categories can be largely attributed to differences in the liquor tax rate.

Taking these points into consideration, I do not believe a deterioration trap is ongoing in the Japanese beer market. That said, while considering the possibility of a deterioration trap, I identified two other issues that could become relevant in the future:

1) Large retail chains may develop private-label beer within the category of cheaper imported new-genre beers. If this movement expands further, it will have considerable negative impact on the profitability of the Big Four.
2) While it has not yet occurred, the expected reorganization of beer price categories, associated with future revisions of the beer tax system, could create a new low-price category that will reflect a price that is lower than just the difference in the liquor tax rate.

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[15] D'Aveni, *Beating the Commodity Trap,* 41.

4.1.2 Escalation Trap

This trap occurs when several players offer more or better benefits for the same or lower price, thus squeezing everyone's profit margins. Price-benefit competition can be costly, but no company can afford to "be the first to blink and end the game of one-upmanship."[16]

However, I believe the Japanese beer market does not fall into the escalation trap because there is virtually no contest among the players regarding the benefits of beer. While the Big Four do compete on product features such as manufacturing process, malt content, and calories, such kinds of differentiation do not significantly increase production costs.

4.1.3 Proliferation Trap

This trap becomes apparent when competitors develop combinations of price and unique benefits that are attractive to consumers, thereby causing an erosion in the market share for other competitors. D'Aveni gives a good analogy: "You can't fight everyone, everywhere, all the time. But if you don't, you are stung to death by a swarm of bees."[17]

I believe the proliferation trap is the most serious and ongoing aspect of the commoditization of the Japanese beer market. As I discuss later in this chapter, the example of the dispersion of brands and categories within the small field of pilsner beer is causing considerable commoditization, despite the fact that there are few differences in benefit. Most consumers agree with this, but many beer marketers would disagree.

A prime example of the proliferation trap can be found in the answer to this question: how many beer products are there in the Japanese beer market? I counted the numbers, taken

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[16] D'Aveni, *Beating the Commodity Trap,* 84.

[17] D'Aveni, *Beating the Commodity Trap,* 48.

from the websites of the Big Four, and results are shown in Exhibit 4-1. All of the products available from the Big Four beer producers are available at retail stores in Japan.

Exhibit 4-1. The number of brands among the Big Four (as of March 2015)

	Beer	Low-Malt Beer	New Genre	Total
Asahi	18	7	8	33
Kirin	13	6	4	23
Suntory	13	3	7	23
Sapporo	14	3	9	26
Total	**58**	**19**	**28**	**105**

Notes:
- Numbers include extensions of domestic major brands, plus import beer brands which the companies sell as exclusive agencies in Japan.
- Some products are limited to specific time, area, and channel. but exclude products only sold in restaurants and bars

Source: respective company websites

Does Kirin face a similar situation in other countries? I looked at the company's overseas beer subsidiaries:

- Lion (Australia) has 65 products; Brasil Kirin (Brazil) has 34. Note that these two countries are very large and brand availability differs by region. In addition, both sell a number of craft beers and are not limited to the pilsner type. However, this comparison does not meant to imply that the Japanese beer market is better.
- A comparison with South Korea is useful because of the similar market environment: both countries are small, and the type of beer is limited almost entirely to pilsner beers. The two big beer companies in South Korea, Hite Brewery and Oriental Brewery, have 7 and 15 beer products, respectively. By contrast, the average number available from the Japanese Big Four is 26—far too many if one takes into account the fact that the size of

the South Korean beer market is less than half the Japanese market size. Such a proliferation of products in Korea might lead to a decline in customer value as well.

Such proliferation in the Japanese beer market occurred as a result of dispersion, which happened in three phases. I will explore the circumstances that brought the current situation.

4.2 DISPERSION OF BRANDS, CATEGORIES, AND PLAYERS

During my research, I found that the Japanese beer market has experienced, and continues to experience, three phases of dispersion, that cause the current proliferation: (1) dispersion of brands, (2) dispersion of categories, and (3) dispersion of players. The key to explaining these dispersions is the shift in consumer touch points associated with major transformations in purchasing behavior.

4.2.1 Brand Dispersion

Until the 1970s, only four beer brands existed in Japan: Kirin, Sapporo, Asahi, and Suntory, each of which sold just one product under its company name. This had everything to do with the fact that the majority of beer consumed at home was bottled. The most popular size of bottled beer was 21.4oz. (633 ml), and the bottles were heavy and bulky. In addition, the empty bottles had to be returned to the retailers. Consequently, it was common for consumers to ask a nearby liquor shop to deliver and retrieve the bottles, and the consumer rarely went into the shop. Thus, there was no process that allowed consumers to select beer by choosing from an array of possibilities. In addition, the shop delivery person, who was the only consumer touch point in this purchase sequence, typically had few

opportunities or little capacity to convey product information. This scenario made it quite difficult for beer companies to differentiate their product brands.

The advent of aluminum cans for beer after the mid-1970s dramatically altered this situation. The aluminum can is both light and compact, but more important, it did not have to be returned to a retailer. As a result, consumers again began going to liquor shops to buy beer. Interesting consumer touch points were created in the form of multiple products in refrigerated open cases and display racks in the retail shops; now consumers could see multiple beer brands and make a selection from among them. This change paved the way for beer companies to disperse their product brands, creating a healthy competition that has lasted up to the present.

4.2.2 Category Dispersion

The dispersion of categories followed a similar path as the one described above. Key to this shift was the appearance of the lower-priced low-malt beer and new genre, which I discussed earlier. In addition, some categories also expanded because of manufacturing processes and/or ingredients; pilsner beer is a prime example. Other examples include products made without a heating process, with more malt content, or with less calories (the last one has become popular due to the recent health trends).

These two differentiating factors—dispersions of brands and categories—are promoted mostly among the Big Four. They all have greater accessibility to distribution networks, which is critical to delivering their products to a broad range of retailers, thus increasing the selection available to consumers. Small breweries are not able to compete with the Big Four because they have a major disadvantage in terms of distribution.

4.2.3 Player Dispersion

One major change is now occurring, which will again influence consumers' purchasing behavior: Internet purchasing. Today, many consumers shop online daily at websites like Amazon, eBay, Rakuten,[18] and the websites of numerous retailers. Google provides enormous amounts of information regarding products and prices, and consumers can rapidly exchange information via text and SMS. When a consumer's touchpoint for beer moves away from a retail shop to surfing online from site to site, the entry barrier of distribution accessibility is less important for small breweries. It also explosively increases the number of beer options for consumers, with the corresponding effect that the value of the Big Four national brands becomes less important to consumers. This is what I call "dispersion of players."

Although it is not yet a major trend in Japan, I believe the signs are already surfacing: cheaper new-genre products, imported from Asian countries, flowed rapidly into the Japanese market from 2009 to 2012, while at the same time, domestic craft beers with higher prices have thrived since 2010. This strongly suggests that marginal competitors have created pressure on the range of beer prices, which had long been under the control of the Big Four. If dispersion of players becomes a real threat, the existing beer brands would be further commoditized.

4.3 DECLINING VALUE TO CUSTOMERS

Although it does not fall well into D'Aveni's framework of the commoditization trap, I would like to point out another aspect of commoditization in the Japanese beer market:

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[18] The major online shopping site in Japan.

declining value to customers. It requires a different approach than the one suggested by D'Aveni.

Until about 20 years ago, beer was the overwhelming choice among alcohol drinkers in Japan. Prior to that time, Japanese sake was very popular, but after World War II, the Japanese people acquired a liking for beer not only at home but also at restaurants and bars, as their lifestyle rapidly became westernized.

Despite these trends, the customers' perception of beer value has declined in recent years. One reason is that other alcoholic drink categories, such as RTD, wine, and Shochu,[19] became more popular as consumer preferences began to diversify. Although the Big Four compete to differentiate themselves among all the beer brands and categories, most continue to brew pilsner beer, which is just one type of beer among many types in the world. Producers like it because it is most suitable for large-scale production but, from a consumer's perspective, people want to try other alcoholic drinks and a variety of products.

Another reason is a shift to low-alcohol or non-alcohol drinks, especially among the younger generation. In an analysis conducted by Kirin, three major consumer types were discovered:

1) An increasing number of young people in Japan are more interested in their personal diet, and they rarely drink liquor.
2) The younger generation embraces a different lifestyle and values. In general, they choose to enrich their current life, make themselves as comfortable as possible, and maintain their present values. While there are numerous familiar and comforting consumable options (e.g., fast fashions, games, smartphones,

[19] A clear Japanese liquor that is distilled from rice, wheat, or sweet potatoes.

animation), the younger generation does not perceive any special value in alcoholic drinks; indeed, some young people even shy away from liquors because they believe drinking a lot will label them as failures or speak poorly of their lifestyle choices.[20] Coupled with the fact that the average Japanese drinker is genetically not a strong drinker, the younger generation prefers low-alcohol and casual liquors with less than 3% alcohol content—when they choose to drink.

3) A less visible but nevertheless significant change has occurred among younger people: they no longer see any special value in liquor consumption as a "reward for doing work well." This traditional value was unique and strongly upheld in the context of a typical Japanese success story: strong economic development based on a disciplined work ethic and a strong spirit of teamwork. Today, however, the younger generation finds fewer reasons to be enthusiastic about their work. A number of Japanese firms that were once successful are now in trouble; there is virtually no assurance of life-time employment (which past generations enjoyed) and "non-regular" employment opportunities increase; even the future prospects of the country and its economy are uncertain. As a result, the number of people who appreciate the value of being rewarded for "doing work well" is dwindling.

[20] Research by Kirin.

4.4 SUMMARY AND IMPLICATIONS

In light of these circumstances and changes in the industry structure and external environment as described in previous chapters, it is apparent that major commoditization is occurring within Kirin. I believe Kirin's future business strategy should first try to overcome the continuing proliferation trap. Second, it should address the deterioration trap, which could be a significant threat in the future. Lastly, Kirin should consider whether any new strategy derived from implementing the above processes would actually improve consumer value. That said, even developing a new strategy could be a thought-provoking exercise for Kirin, which has to date engaged in a process of narrowing its overall vision while pursuing a strategy of "customers are everything."

Having focused on Kirin and its current market condition, I will now present the results of three case studies of companies in the beverage industries. Some are competitors, others are not. But in each case, there are organizational and strategic ideas that I believe Kirin would do well to consider.

CHAPTER 5

CASE STUDIES

5.1 STRATEGIES FOR DEALING WITH DECLINING AND FRAGMENTING MARKETS

As discussed in Chapters 2 and 4, both the long-term market decline and the fragmentation of markets caused by the proliferation trap, are occurring in the Japanese beer market in which Kirin competes. This chapter presents three case studies that show how other companies have dealt with this kind of market.

Three types of strategies have been identified for dealing with declining and fragmenting markets (other than full withdrawal from the market):

(1) *Fight and Dominate*: Increase market share by fighting in all segments of the market

(2) *Escape and Diversify*: Limit fighting in certain market segments while diversifying into other markets

(3) *Create and Focus*: Create and focus on a new segment in the market.

I chose three companies in the U.S. beverage market that are examples of these specific strategies. In each case, I will discuss the firm's overall business strategies; its capabilities and assets for executing the strategies; its organizational structures; and the trade-offs facing the company when executing the chosen strategy. The case study companies are:

(1) The Coca-Cola Company (an example of the *Fight and Dominate* strategy)

(2) PepsiCo, Inc. (an example of the *Escape and Diversify* strategy)

(3) The Boston Beer Company (an example of the *Create and Focus* strategy).

Many business strategies do not fall nicely into just one of the three strategy types, but I will focus on the strategy that is most characteristic of each company in order to make the discussion clear.

5.2 THE COCA-COLA COMPANY: *Fight and Dominate* Strategy

5.2.1 Company Profile[21]

The Coca-Cola Company (hereafter "Coke") is the largest soft drink company in the world, selling more than 500 non-alcoholic beverage brands in more than 200 countries. For 2013, its market share of the world soft drink market, and the world carbonated soft drink (hereafter "CSD") market were 22.7% and 47.3%, respectively.

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[21] The discussion in this section largely relies on the following materials:

MarketLine Industry Profile "Global Soft Drinks" September 2014.

MarketLine Industry Profile "Global Carbonated Soft Drinks" August 2014.

MarketLine Industry Profile "Soft Drinks in the United States" September 2014.

MarketLine Industry Profile "Carbonated Soft Drinks in the United States" August 2014.

The Coca-Cola Company, News Release, "The Coca-Cola Company Reports Fourth Quarter and Full-Year 2014 Results," February 10, 2015.

Michael E. Porter and Rebecca Wayland, "Coca-Cola versus Pepsi-Cola and the Soft Drink Industry," Harvard Business School, October 12, 1994.

David B. Yoffie, "Cola Wars Continue: Coke and Pepsi in the Twenty-First Century," Harvard Business School, January 27, 2004.

David B. Yoffie and Renee Kim, "Cola Wars Continue: Coke and Pepsi in 2010," Harvard Business School, May 26, 2011.

David B. Yoffie and Renee Kim, "Coca-Cola in 2011: In Search of a New Model," Harvard Business School, August 14, 2012.

On a consolidated basis, its 2014 net operating revenues and net income were $46.0 billion and $7.1 billion, respectively. Regarding revenues by region, the largest portion of corporate revenues come from North America (45.4%), followed by Bottling Investments[22] (14.9%), Asia Pacific (12.1%), Europe (11.7%), Latin America (9.8%), and Eurasia & Africa (5.8%).

In the U.S., which Coke regards as its primary market, the company held 30.7% market share in the entire soft drink market, and 44.7% in the CSD market (as of 2013). Taking into account the size of each market, it can be inferred that the volume of Coke's CSD business comprises about 66% of its entire U.S. soft drink business.

Headquartered in Atlanta, Georgia, Coke's main business is manufacturing concentrate and marketing the end product. That product reaches the retail market via bottlers who purchase the concentrate from Coke and, in local facilities throughout the world, add carbonated water and sweetener, transfer the resulting liquid into bottles and cans, and deliver it to customers. For non-CSD products, Coke often produces the end product itself and sells it to bottlers. Coke's primary responsibility is promotion and advertising, the costs of which are borne partly by bottlers. While bottlers typically negotiate with suppliers and retailers, Coke often communicates directly with major suppliers and retailers.

5.2.2 Market Environment[23]

The market for CSD products can be characterized as oligopolistic, meaning the largest three players (Coke, PepsiCo, and Dr. Pepper Snapple Group) collectively hold

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[22] An operating group with associates located in four of Coke's geographic operating groups (Latin America, Europe, Eurasia & Africa, and Asia Pacific). See: Coca-Cola Company, 2012 Annual Review, 31.

[23] Hereafter, this discussion focuses on the U.S. CSD market.

88.7% of the market. However, beyond these major players, a number of active brands can also be found in fragmented segments of the market, mainly as a result of the ongoing competition between Coke and PepsiCo. In fact, Coke is a good example of the typical proliferation trap that became prominent in the 1980s and still continues today. For 2013, the segment composition ratio in the market was 38.7% (standard cola), 24.1% (diet cola), 22.2% (fruit-flavored carbonates), 8.1% (other carbonates), and 6.9% (mixers).

In addition, the U.S. CSD market is faced with a long-term downward trend: consumption per capita peaked in 1998 (54.0 gallons), slowly decreased to 46.0 gallons in 2009, and is still declining. Furthermore, the entire market size in terms of volume also has been shrinking over the past 10 years after reaching a peak in 2004. In the four years from 2009 to 2013, the U.S. CSD market declined by 4.9% (CAGR: 1.26%) while the entire U.S. soft drink market grew by 5.5% (CAGR: 1.35%). The market decline can be attributed primarily to a variety of efforts by the U.S. government, schools, and consumers to reduce or quit CSD consumption in the U.S. based on a perception that a CSDs cause health hazards including obesity. Consumers are shifting to non-CSD categories such as juices, juice drinks, sports drinks, energy drinks, tea-based drinks, and bottled water. I conclude that the U.S. CSD market is similar to the Japanese beer market: the overall market is declining, and the product line is fragmented as the company fell into the proliferation trap.

5.2.3 Business Strategy

> We believe Coca-Cola has been particularly behind the curve in addressing the challenge posed by declining CSD sales in North America. . . . Coca-Cola actually increased its market share of the overall CSD market over the past

> years, while other players (especially PepsiCo) were aggressively seeking to exit the declining market.[24]

Looking back at Coke's history, it is apparent that the company has always dominated the U.S. CSD market through full-scale battles with competitors in all segments, backed by its overwhelming brand power, marketing capabilities, and distribution networks. Notwithstanding PepsiCo's rapid growth after the 1950s, Coke increased its market share, in the process creating a market dominated and controlled by these two giants. Today, Coke deploys strong brands in all categories (e.g., standard cola, diet cola, and fruit-flavored carbonates).

According to D'Aveni's framework, Coke's strategy falls into the "Destroy the Trap" strategy, which means that a firm with critical mass will fight on multiple fronts against proliferators.[25] Remarkably, Coke has never decreased its commitment to the U.S. CSD market even after facing market decline. In response, Coke exercised major efforts with the launch of Coca-Cola Zero in 2005; the introduction of its "Freestyle" machine, which can dispense more than 100 different types of customized flavored soft drinks (2009); and its global campaigns at sports events such as the World Cup. The launch of Coca-Cola Life in 2014, which features green on its packaging instead of red (Coke's traditional brand color) to target health-conscious and ecology-minded customers, is a recent good example. Coke's efforts aimed not only to pull ahead of PepsiCo but also to revitalize the global CSD market. However, it must be noted that Coke's fixation on the CSD market has hindered its full response to the growing non-CSD market.

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[24] Business Monitor International, "United States Food and Drink Report", Q4 2014: 106.

[25] D'Aveni, *Beating the Commodity Trap,* 65.

Coke has a far greater international reach than PepsiCo, with strong market positions in countries such as Germany, Mexico, and Japan. Why, then, does Coke continue with the "*fight and dominate*" strategy in the U.S. CSD market? Three reasons are apparent:

- The high value of the market. For FY2014, Coke's North America segment represented 45.4% of revenue and 21.9% of operating income. By extrapolation, its U.S. CSD business represents about 23% of revenue and 11% of profit if one supposes that it comprises half of the North America segment.
- Coke has a compelling reason to maintain maximum capacity utilization of its bottlers in the U.S., because the CSD bottling system basically cannot be diverted to non-CSD manufacturing.
- Coke's global brand image might affect its strategy in the U.S. because the Coke name has become synonymous with American culture as it has expanded throughout the world. Maintaining a strong position in the U.S. CSD market is critical to preserving the enormous global value of Coke.

5.2.4 Capabilities, Assets, and Organizational Structure

More than any other factor, an overwhelmingly strong brand works effectively to keep a firm dominant in both declining and fragmenting markets, because strong brand value can be utilized even when new market segments appear (e.g., the Coca-Cola brand was fragmented by Diet Coke and Coca-Cola Zero). Today, Coke sells 13 different products in the U.S. under these three umbrella brands—also a good example of the fragmentation trap. Big brands like Coke can maintain their superior position on the shelf even when the market shrinks and retailers stop selling medium and small brands. The incomparable brand

value of Coke, which has been built over the years, has enabled Coke to maintain its "*fight and dominate*" strategy.

There are the several organizational capabilities required to preserve and improve this great brand asset:

- Thorough and detailed production control, which enables Coke to always deliver the taste consumers expect.
- Excellent overall marketing skills, including (a) outstanding brand management that enables Coke to set a desired brand image and monitor its actual performance, (b) experienced and insightful advertising skills to develop effective communication with a changing consumer base, and (c) a powerful distribution network and sales force that always maximizes Coke's exposure at many consumer touch points.
- Management of bottlers is crucial because production, distribution, and sales rely on the bottlers.
- Economies of scale and efficient operations are required to provide sufficient funds to support the above capabilities.
- Most crucial, it is impossible to maintain the value of this huge brand unless Coke aligns all these activities and maintains them consistently. Such complex coordination requires stringent operating standardization, which in turn requires a centralized organizational structure. This recognition highlights even further the absolute power of Coke's headquarters in Atlanta.

5.2.5 Trade-offs

It is difficult for a centralized organization like Coke to respond quickly to changes in the market. In fact, Coke frequently has fallen behind PepsiCo's product innovations and advertising, especially from the 1970s through the 1980s (good examples are the famous comparison "Challenge Booths," the introduction of 100% aspartame to Diet Pepsi beverages, and Pepsi's new bottle size). However, these changes were not detrimental to Coke over the longer term because eventually it caught up with and outpaced PepsiCo by taking advantage of Coke's strong leadership and its organizational and financial power, which resulted in building a stronger market position.

A more serious trade-off occurs when there is strong dependence on a specific brand and a specific market. Even the greatest brand cannot cover all segments in every market, so a brand may attract fewer consumers if there is a proliferation of products. Also, dependence on a single market could severely harm a firm if the value of that market is impaired—a scenario that is occurring today in the current U.S. CSD market. When the CSD market was still growing, the launch of Coca-Cola variations was effective because it needed to grow the market via proliferation. However, the current impairment of CSD value caused by health-conscious consumers in the U.S., is turning them away from CSDs and toward a variety of non-CSDs. This could be another type of commoditization, one that is different from the proliferation trap, and it could have serious negative impacts on the value of the Coke brand. The recent release of Coca-Cola Life is undoubtedly part of an effort to overcome this predicament, but no one can yet tell whether this strategy will work.

5.3 PEPSICO, INC. : *Escape and Diversify* Strategy

5.3.1 Company Profile[26]

PepsiCo, Inc. (hereafter called "PepsiCo") has two business domains: the soft drink business and the snack food business. Although the company aggressively diversified into a variety of other businesses, such as restaurants, through acquisitions after its merger with Frito-Lay in 1965, it finally settled down in its current business domains in the late 1990s. PepsiCo is now the second-largest food and beverage company in the world (Nestle is number one), operating its business in more than 200 countries with 22 billion-dollar brands including such well-known names as Pepsi, Lay's, Gatorade, Quaker, and Tropicana.

On a consolidated basis, PepsiCo's 2014 net revenues and net income were $66.7 billion and $6.5 billion, respectively. By business segments, beverages comprise 47% of PepsiCo's net revenue, and snack foods comprise 53%. By region, the U.S. comprises 51%, and outside the U.S. 49%.

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[26] The discussion in this section largely relies on the following materials:

MarketLine Industry Profile "Global Soft Drinks" September 2014.

MarketLine Industry Profile "Global Carbonated Soft Drinks" August 2014.

MarketLine Industry Profile "Soft Drinks in the United States" September 2014.

MarketLine Industry Profile "Carbonated Soft Drinks in the United States" August 2014.

PepsiCo, Inc., News Release, "PepsiCo Reports Fourth Quarter and Full Year 2014 Results" February 11, 2015.

PepsiCo, Inc., Annual Reports, 2012, 2014.

Porter and Wayland, "Coca-Cola versus Pepsi-Cola and the Soft Drink Industry," 1994.

Dena Votroubek, Leonard A. Schlesinger, and Lynda M. Applegate, "PepsiCo: A View from the Corporate Office," Harvard Business School, November 30, 1994.

Yoffie, "Cola Wars Continue: Coke and Pepsi in 2006," Harvard Business School, April 16, 2009.

Yoffie and Kim, "Cola Wars Continue: Coke and Pepsi in 2010," 2011.

Yoffie and Kim, "Coca-Cola in 2011: In Search of a New Model," 2012.

Focusing only on the beverage business, in 2013 PepsiCo's share of the world soft drink market and the world CSD market were 6.8% and 20.4%, respectively. In the U.S., the company had 22.3% share in the entire soft drink market and 28.5% in the CSD market. Taking into account the size of each market, it can be inferred that the volume of PepsiCo's CSD business comprises about 58% of its entire U.S. soft drink business.

The company's business model in the beverage industry is basically the same as Coke's, which I discussed in Section 5.2.

5.3.2 Market Environment[27]

Details of the PepsiCo market are exactly the same as explored and applied to the Coke market, so I will skip further repetitious discussion here. Suffice to say, the PepsiCo market is, like Coke's, both declining and fragmented by many product offerings.

5.3.3 Business Strategy

PepsiCo has a long history of diversification beyond the CSD business. The first occurred in 1965 with the merger of Pepsi-Cola with Frito-Lay (which also caused the merged company to change its name from Pepsi-Cola to PepsiCo). While PepsiCo acquired a variety of new businesses after the merger, by the mid-1980s, the business portfolio was narrowed to beverages, snack foods, and restaurants; the restaurant business was spun off in 1997. It seems likely that PepsiCo made the decision to implement a strategy of selection and concentration on its business portfolio.

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[27] Like Coke, the discussion about PepsiCo focuses only on the U.S. CSD market.

However, the company also pushed forward with expanding its brand portfolio in two remaining core businesses through alliances and acquisitions, declaring a transition to the total beverage business (not limited only to CSDs) and to the total snack business (not just to snack chips). While there has been considerable debate as to whether PepsiCo can generate synergies between the two business lines, the company did establish a strong presence in both the entire beverage industry and the entire snack industry.

In the U.S. CSD market (in which the predecessor company, Pepsi-Cola, started the business), PepsiCo now deploys aggressive market strategies one after another: price cutting, innovative advertising, developing new sales channels, and quick launches of new products. These have proved to be major challenges to Coke. It is not too much to say that PepsiCo triggered the proliferation of new products in the U.S. CSD market.

However, when the decline in the beverage market became apparent, PepsiCo changed its strategy. In 2005, the company announced its marketing program would no longer be based solely on the regular Pepsi brand; instead it would treat Diet Pepsi as its flagship brand. Moreover, in some countries (not the U.S.), the company actually abandoned full-calorie CSD drinks altogether in favor of low-calorie options. These initiatives addressed not only the declining market but also the increasingly fragmented market. PepsiCo aspired to a more effective strategy in the CSD market by escaping from less-valuable segments and shifting its resources to other markets. It is a good example of the "*escape the trap*" strategy, which D'Aveni suggests for firms with limited resources: narrow the battle in a proliferating or fragmented market by selecting certain threats to focus on specifically.[28]

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[28] D'Aveni, *Beating the Commodity Trap,* 62.

PepsiCo's diversification out of the CSD market led to the acquisition in 2000 of two additional companies: Quaker Oats, which held the sports drink brand "Gatorade" as well as its breakfast cereal and snack businesses; and South Beach Beverages, which sold fruit juices and tea products. These were deals that Coke reluctantly gave up because of internal opposition in the company.

From 2004 to 2007, 77% of PepsiCo's new products released in the U.S. market were non-CSDs compared to 56% for Coke. Coke subsequently chased after PepsiCo when it became fully aware of the major changes occurring in the U.S. CSD market. For its part, PepsiCo stumbled over failures in marketing.

Notwithstanding these moves and shifts, PepsiCo has a more balanced brand portfolio than Coke as a total beverage business company. In addition, the total snack business is another one of PepsiCo's strengths, and Coke has nothing like it.

5.3.4 Capabilities, Assets, and Organizational Structure

What are the required organizational capabilities for adopting an "*escape and diversify*" strategy? First and foremost is the requirement for flexibility in order to respond quickly to changes in the market. PepsiCo not only enhanced its brand value but also adopted a thoroughly market-focused strategy in order to challenge Coke. PepsiCo has always been quick to meet client or consumer needs and to develop innovative product and marketing strategies. In addition to the initiatives described in the Coke discussion, such as comparative ads and introduction of new ingredients and packages, there are several good PepsiCo examples from the 1960s including "Pepsi Generation" marketing, which focused on the young and "young at heart," and the "store door" delivery system to secure retail

shelf space for PepsiCo products. Through this process of focusing on the market, I believe PepsiCo acquired flexible organizational capabilities that enabled it to be sensitive and responsive to what clients and customers want and how they change, which I also believe enabled the company to act quickly when the U.S. CSD market began to decline.

A second requirement is the skills to acquire and integrate external businesses and brands, because it is often the case that a company's own resources are not enough to quickly shift its priority fields and diversify its business portfolio in response to market changes. PepsiCo diversified its business early on through mergers and acquisitions—a strategy pursued by Coke as well. Ultimately, however, Coke divested most of the acquired businesses during the course of returning to its core business after the late 1980s, resulting in its negative stance toward mergers and acquisitions that might have diversified its business horizontally.

In comparison, PepsiCo continued to manage its three business lines (snacks, beverages, and restaurants), which expanded through mergers and acquisitions until 1997. I believe this accumulated experience helped PepsiCo make a success of acquiring businesses related to non-CSDs and snacks, and enabled it to outflank Coke.

One further, and perhaps most important capability, is PepsiCo's organizational insight into what economies of scope could be generated in its diversified business portfolio. While PepsiCo purchased businesses unrelated to foods and beverages (e.g., North American Van Lines (a trucking company) and Wilson Sporting Goods (a sports equipment manufacturer)) in the early stage of its diversification, in the end it narrowed its core to beverages and snack foods and divested the other businesses. During this focusing process, I believe the company learned which economies of scope are critical to PepsiCo. One is

marketing insight, which can be shared between categories and businesses. PepsiCo products cover a wide range of what consumers eat and drink as refreshment, which provides more useful knowledge about consumer preferences and trends than could be gathered if the firm covered only a small portion of the refreshment field. PepsiCo also generates marketing synergies between the segments in each business as well as between snacks and beverages. PepsiCo also acquired considerable knowledge of economies of scale in terms of cost and penetration, which means the snacks and beverages segments could share delivery logistics to distributors and retail stores.

To maintain these organizational capabilities, a company should not leave all the decisions regarding business strategy to its corporate headquarters that has little or no direct contact with the market. If this is done, it can take an extended period of time before decisions are reached. While Pepsi Cola originally began with a tradition of decentralization (before the merger with Frito-Lay), after 1990 PepsiCo decentralized both its snack food and beverage organizations around the same time the company started the transition to a total snack/beverage business. I do not think these moves were a coincidence. It quite likely occurred as a result of organizational reforms undertaken to enable its broadening business to respond to the market more quickly. However, diversified business requires more than decentralization. A system to encourage flexible and agile inter-organizational collaboration should be developed in order to realize economies of scope between categories and businesses.

5.3.5 Trade-offs

One of the trade-offs of the "*escape and diversify*" strategy is the risk that the firm will lose position in certain markets. For instance, PepsiCo maintained its market share above 30% in the U.S. CSD market for more than 20 years, from the mid-1980s to the mid-2000s. Just prior to 2010, PepsiCo fell below 30% and today it is still in gradual decline. By comparison, Coke consistently holds more than 40%. An article in *Business Monitor International* suggests that this may be an intentional outcome for PepsiCo, which narrowed the battle in the U.S. CSD market. It does not matter as long as the company's growth performance in other markets covers the decline in the U.S. CSD market.

However, business is not that easy; the more brands and businesses brought by diversification, the more complicated their management becomes. This applies especially to a firm that has obtained many of its assets through acquisitions. After PepsiCo further expanded its non-CSD brand portfolio after 2000, it made many mistakes in marketing acquired brands, such as its rebranding efforts for Gatorade and packaging issues with Tropicana juices. Meanwhile, the Pepsi brand suffered a decline in its value.[29]

Another critical trade-off is that it advanced organizational management skills are required in order to pursue economies of scope and to realize decentralization and inter-organizational collaboration at the same time. Among many common obstacles in managing economies of scale, the independence of each organization is a major bottleneck for PepsiCo, as the words of one PepsiCo executive show: "Synergy is a dirty word here. . . . It's a

[29] Millward Brown, "BrandZ Top 100: Most Valuable Global Brands." The reports show that the brand value of Pepsi decreased from $14,996M (rank 44th) to $11,476M (rank 88th) during the five years from 2009 to 2014. Coca-Cola increased from $67,625M to $80,683M even as its rank dropped from 3rd to 6th.

cultural thing at Pepsi that you do it on your own."[30] However, during efforts to enhance its global expansion (widely regarded as less advanced than Coke), in 2010, the company clarified its policy to review its long-held tradition of each division's independence, as follows:

> PepsiCo has historically been managed as a loose federation of countries and regions. This organizational structure fostered an entrepreneurial culture in the company, not necessarily a culture of global efficiency. Starting in 2010 and accelerating in 2012, we began to modify our *global operating model*, balancing independence and scale, to become a globally networked company. Our in-country and regional teams are empowered to serve their markets, but through global groups and functions, we are harmonizing our efforts across the world around brand building, innovation, and the management of our supply chain.[31]

While this adjustment recognizes that there are limits to decentralization, keeping reform on track will not be easy because it is related to PepsiCo's inherent and keenly felt organizational culture.

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[30] Votroubek, Schlesinger, and Applegate, *Pepsico,* 11.

[31] PepsiCo, Inc., 2012 Annual Report, 5-6. (website only)

5.4 THE BOSTON BEER COMPANY: *Create and Focus* Strategy

5.4.1 Company Profile[32]

The Boston Beer Company (hereafter "BBC"), founded by James Koch in 1984, is the largest craft beer manufacturer in the U.S. (as of 2013)[33] and ranked sixth largest among all U.S. breweries (2013 U.S. beer shipment share 1.6%[34]). The company sells beer in all 50 U.S. states and about 30 countries. It has six umbrella beer brands centered under its flagship brand, "Samuel Adams," and sells nearly 100 products, as well as cider and flavored malt beverages. On a consolidated basis, its 2014 net revenue and net income were $903.0 million and $90.7 million, respectively. Driven by the craft beer revolution—in fact created and driven by BBC itself—the company has grown explosively in the past 30 years since its founding.

BBC's current business model is not much different from ordinary beer makers. It produces 91% of its core brand volume at company-owned breweries and sells its products through distributors (a network of approximately 350 wholesalers in the US, and a world

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[32] The discussion in this section largely relies on the following materials:

Boston Beer Company, 2013 Annual Report

Boston Beer Company, Press Release, "Boston Beer Reports Fourth Quarter 2014 Results," February 24, 2015

Mollie H. Carter and Ray A. Goldberg, "Boston Beer Company: Samuel Adams," Harvard Business School, November 13, 1996

Linda A. Cyr, Joseph B. Lassiter III, and Michael J. Roberts, "Boston Beer Company: Light Beer Decision," Harvard Business School, November 20, 2001

Richard G. Hamermesh, Karen D. Gordon, and John P. Reed, "Crown Cork and Seal Company, Inc.," Harvard Business School, April 17, 1987

David L. Ager and Michael A. Roberto, "Trader Joe's," Harvard Business School, December 9, 2013

[33] Brewers Association, Press Release, "Brewers Association Lists Top 50 Breweries of 2013," March 27, 2014.

[34] "Don't Count Beer Out Yet," *Beverage Dynamics*, September/October 2014: 33.

network of wholesalers, importers, or other agencies) to retailers such as pubs, restaurants, grocery stores, convenience stores, package stores, sports stadiums, and other retail outlets.

5.4.2 Market Environment

Here I will discuss the U.S. beer market environment beginning in 1985 when BBC started its first full year of beer production. This will enable me to examine the background of BBC's new segment creation in the market.

The overall U.S. beer market volume was virtually flat for the first few years while per- capita consumption was in decline, dropping from 24.5 gallons in 1980 to 23.9 gallons in 1985. This occurred because consumers were shifting to non-alcoholic beverages, such as CSDs and bottled water. There is no clear evidence showing to what extent proliferation and fragmentation in the U.S. beer market was occurring at that time. However, I can infer from the following facts that the market environment was quite similar to the current Japanese beer market, that is, a limited number of major players competing with fragmented segments but few varieties of beer types:

- Five major beer companies (Anheuser-Busch, Miller, Stroh, Heileman, and Coors) collectively held about 90% of the market share.
- The market was divided into five major segments (premium, light, popular, imports, and super premium).
- Koch described the market at that time as follows: "[He sensed] the boredom consumers in certain markets were feeling about the 'sameness' of beers they were offered."[35]

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[35] Carter and Goldberg, *Boston Beer Company,* 1.

Based on these points, it is safe to say that the U.S. beer market in 1985 was declining and fragmented. The largest segment, "premium beers," including Budweiser and Miller, was no longer growing; the second-largest "popular beers" segment was decreasing; the "light beers" and "imports" segments were growing.

It should be noted that "craft beer" has been in the U.S. for a long time. There were more than 3,000 local breweries in the 1870s, but that number decreased dramatically during the Prohibition era of the 1920s when the number of beer manufacturers reached a historic low of fewer than 40. It did not begin to rise again until the early 1980s when the market began to grow again. As a result, craft beers were virtually non-existent, representing less than 0.1% of the total beer market volume.

5.4.3 Business Strategy

BBC adopted a "*create and focus*" strategy to address the market decline and product-line fragmentation that occurred as a result of falling into the proliferation trap. The management field in general accepts that if a firm creates a new segment within a declining market, and assuming that they have some insight into customer behavior behind the scenes, that firm may be able to avoid replicating the negative economics of the industry. This was the approach taken by BBC.

According to D'Aveni's framework, BBC's strategy falls into one of the "*turn the trap to your advantage*" strategies, which means "outflanking threats with creative proliferation of your own."[36] This strategy creates a new customer segment and then deploys a variety of brands in that segment in order to establish and secure the field.

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[36] D'Aveni, *Beating the Commodity Trap,* 68-69.

This strategy was implemented by Jim Koch, who had a belief and vision that American beer drinkers should be able to enjoy a variety of traditional and complex-taste European beers of supreme quality. He intended to provide explicitly differentiated offerings in the U.S. beer market, which at the time had only one type—a pale lager. One of the remarkable points of his strategy is that BBC did not target the craft beer (i.e., the super premium) segment but instead focused on the growing imported beer segment. Koch found not only consumer acceptance of BBC's differentiated offerings in the imports segment but also the competitive advantage of domestically brewed craft beer that were free of imported beer's drawbacks: less freshness, high costs of transportation, and tariffs. While the imported beer segment represented less than 5% of total market volume, BBC narrowed the target customer to men aged 25 to 44, identifying their specific profile as follows: "[Educated] younger drinkers who liked drinking less, wanted more flavor, and were part of a more affluent society."[37]

There are two key components of BBC's targeting strategy: (1) an intense focus on the growing market based on insight into customers and the industry, and (2) creative segmentation. Regarding the first component, I found a similarity in the case of Crown Cork and Seal (CCS), a U.S. producer of metal cans and crowns. John Connelly, who took over chairmanship of the company in 1957, withdrew from fierce competition in the U.S. motor oil can market despite holding 50% of market share. Instead, Connelly focused on a growing need for beverage and aerosol cans, where the company had technological excellence.

An example of the second strategy, creative segmentation, is Trader Joe's, a U.S. supermarket chain that grew rapidly by creating a new segment in the saturated and

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[37] Carter and Goldberg, *Boston Beer Company,* 1, 8.

competitive market. Joe Coulombe, the founder of Trader Joe's, explains its segmentation strategy as follows:

> *Scientific American* had a story that of all people qualified to go to college, 60% were going. I felt this newly educated—not smarter but better-educated—class of people would want something different, and that was the genesis of Trader Joe's. All Trader Joe's were located near centers of learning.[38]

More remarkable is BBC's offering strategy. BBC invented a production strategy to brew its products by using regional beer makers as contract breweries instead of building its own new breweries, recognizing that regional breweries had a high level of excess capacity because of saturation in the U.S. beer market and the oligopoly control enjoyed by the major national breweries; in other words, BBC took advantage of an unfavorable market environment. The contract brewing system meant minimal fixed costs for BBC and lower transportation costs compared with company-owned brewery systems. BBC believed these two factors gave it a $1.44 to $2.28 per case cost advantage, even after taking into account manufacturing charge. This strategy undoubtedly ran contrary to industry norms at the time because originality and craftsmanship were integral parts of a craft beer's value and did not work ell in the general contract brewing system. However, when an offering strategy confronts industry norms and is supported by sufficient economic rationality, it often works quite effectively. Crown Cork and Seal and Trader Joe's again provide good examples.

CCS built plants across the country to lower transportation costs and encourage dependence on large customers, which ran contrary to metal container industry norms at that time — but greatly improved CCS revenues and profits. Trader Joe's drastically reduced the number of SKUs and downsized its store size, which again ran totally against supermarket

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[38] Ager and Roberto, *Trader Joe's,* 2.

industry trends toward more SKUs and larger stores. Instead, Trader Joe's developed a quirky and friendly store model with original and high-quality private-label goods occupying the greater portion of store items. This strategy soon generated a number of Trader Joe's "addicts" and pushed up its grocery sales per square feet to an incomparable level in the industry.

By investing the funds saved as a result of lower production costs into more critical activities, BBC was able to differentiate itself in the market, procuring the highest-quality raw materials, aggressively pursuing advertising, and developing a strong sales force. In addition, the contract brewing system not only worked as a cost-savings measure but also contributed to flexible production and stable quality. Those factors, combined with BBC's thorough instruction to contract breweries, helped the company gain huge advantages over import beers and other craft beers.

BBC's profitable year-round brews included "Samuel Adams Boston Lager," which quickly became BBC's flagship brand product, and enabled the company to launch a number of less-profitable but colorful seasonal brews. While this brand strategy is based primarily on Koch's vision of offering a variety of beers to American consumers, it is also a successful strategy that secures BBC's strong position by proliferating the craft beer segment which the company created itself.

5.4.4 Capabilities, Assets, and Organizational Structure

What are the required organizational capabilities needed to adopt the "*create and focus*" strategy?

- Create offerings with differentiated benefit from existing ones in the market, which requires both creativity and insight into customers.
- Devise a carefully planned value-chain structure that makes good business sense because a "*create and focus*" company often starts out as a small niche business. Offer an economically rational offering strategy that runs contrary to industry norms, which is often effective. In other words, being able to develop capabilities that break the "rules of the game" based on an insight into the industry, is a prerequisite. It is significant that BBC and Trader Joe's, both of which pursue a "*create and focus*" strategy, had professional leaders that were highly familiar with their respective industry structures.

These required or desirable capabilities combine with typical market settings to affect the kind of organizational structure a firm should create. In general, it is extremely difficult for a large organization to realize innovation in small and/or niche segments because the firm usually has an established position in existing markets and segments and tends to prefer investments that will yield larger returns. Thus, a small organization has a greater ability to create a new segment than a large organization.

The small size of an organization leads directly to the corollary that the quality of people in the company is critical. When recruiting new hires, BBC employed a "raise the average" policy, meaning that each new person should be better than the average current employee.[39] Also, the company encouraged employees to lead facility tours for consumers no matter what that employee's job was—and Koch himself led several. This initiative helped employees to enhance their knowledge of products and improve their understanding of BBC's value when conveying that information to customers.

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[39] Carter and Goldberg, *Boston Beer Company,* 3.

As a smaller organization, BBC needs to utilize it resources to maximize key capabilities and differentiate its offerings in the value chain, which requires an organization to choose "what to do" and "what not to do." From its founding, BBC decided that building an effective distribution network was the key to establishing brand awareness. Therefore, the company limited its investment in production resources to only eight brew masters on staff who control the contract breweries. More investment was spent on strong efforts to develop an excellent sales force, which today is widely considered among the best in the U.S. beer industry. In 1986, twelve years after its founding, BBC had 225 employees, and of that number 150 were in the sales force.[40] By 2013, of BBC's 1,122 employees, 380 were in the sales force, which the company believes is one of the largest in the domestic industry.[41]

5.4.5 Trade-offs

The "*create and focus*" strategy is accompanied by significant risk because it aims to create a new segment in the market instead of competing in existing mainstream segments. If differentiation of offering and strategy is insufficient—in other words, if a firm does not differentiate itself based on insight into customers and the industry—the business will likely fail because it is not attracting customers away from existing segments.

If a firm successfully creates a new segment, the firm's economies of scale will be limited as long as it focuses on the segment. This is especially true when a firm intentionally adopts a proliferation strategy within the segment. While BBC enjoys enough economies of scale compared with other craft breweries or import beer companies, it is hard for the company to compete at the level of cost efficiency with major national beer makers like

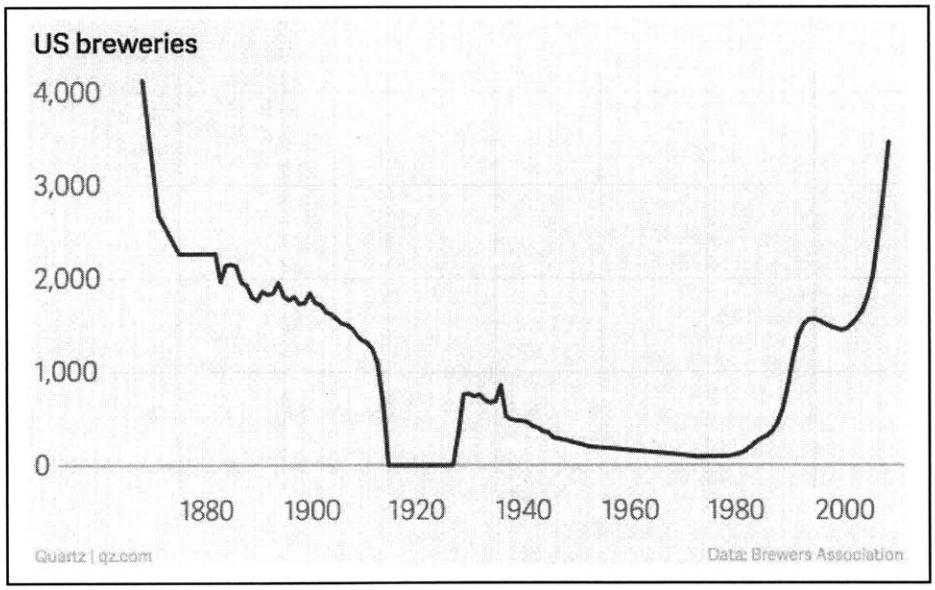
[40] Carter and Goldberg, *Boston Beer Company,* 3.

[41] Boston Beer Company, 2013 Annual Report, 4, 15.

Anheuser-Busch InBev and SAB Miller. If these large breweries realize full-scale penetration into the craft beer segment (although it is not easy for a large organization to be competitive in a new innovative segment), BBC could lose its competitive advantage.

Related to the previous point, it is difficult for a segment innovator to maintain its initial competitive advantage because an attractive new segment without a high entry barrier could soon be flooded with a large number of new entrants that relentlessly imitate the innovator's business model. In fact, the number of local breweries in the U.S. has increased dramatically, from less than 40 in the early 1980s to more than 3,700[42] (see Exhibit 5-1), now reaching another historical high. BBC's contract brewing model immediately came into widespread use throughout the U.S. after BBC's demonstrated success.

Exhibit 5-1. The number of breweries in the United States (1870s-2000s)



Source: Phillips, 2015.

[42] Boston Beer Company, 2013 Annual Report, 7.

How does BBC deal with this problem of imitation? Its approach is intriguing: rather than competing with other craft breweries by trying to exclude them from the segment, the company works hard to support them. For instance, its program named "Alchemy & Science" coaches new entrants on brewing techniques as a craft beer incubator. The company also launched "Pitch Room," a national competition for small businesses in the food and beverage industry, which provides them with opportunities to pitch their products. The story that most clearly illustrates the company's approach is that when craft breweries suffered a world-wide shortage of hops in 2008, BBC shared ten tons of hops, at cost, with other breweries. Koch explained in his interview:

> Since we held the lottery, many people have asked me about the idea of helping competitors. . . . Of course, it seemed risky for us to part with our most important ingredient—especially without yet knowing if the 2008 hops crop will be healthy. But I knew it was riskier for Sam Adams if the choices in craft beers diminish or the quality deteriorates. Rather than worrying about stealing share from each other, I was thinking about craft beers losing share overall.[43]

From a strategic viewpoint, these supporting efforts by BBC can be considered as aiming to expand the craft beer segment by positioning itself as a platform that facilitates new entries and exploits the segment expansion as a driving force of BBC's growth, rather than dominating the segment by excluding new entrants. As a result, BBC is considered more of a goal than a competitor by many craft breweries. By 2013, the craft beer segment represents almost 8% of the total U.S. beer market volume.

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[43] Jim Koch, "Why I Shared My Most Valuable Ingredient with Competitors," *Harvard Business Review*, May 16, 2008.

CHAPTER 6

KIRIN'S FUTURE BUSINESS STRATEGY

6.1 INTRODUCTION

I will begin this chapter by summarizing points made in the previous chapters, before embarking on a discussion of Kirin's future business strategy.

Chapters 1 to 3 outlined the industry structure, market circumstances, and organizational environment surrounding Kirin's Japanese beer business. Regarding the external environment, the beer business has experienced several long-term changes including a decline in the overall Japanese beer market, and the future competitive environment is expected to be more fluid.

While Kirin successfully developed new beer brands amid these long-term external shifts, the company's business strategy is not essentially differentiated from those of its major competitors. With respect to the internal organizational environment, Kirin has managed to transform itself in response to changes in external environment. However, some of its old organizational climate still remains, and some issues have arisen following recent structural reforms. I will explore whether the current status of Kirin's business strategy and its organizational environment will be capable of surviving expected future changes in the external environment.

Chapter 4 discussed commoditization, which identifies the key market issue to handle when developing a future strategy for Kirin's Japanese beer business. By using

D'Aveni's framework, I determined that the overall market is now caught in the proliferation trap and may also become caught in the deterioration trap in the future.

Chapter 5 identified three types of strategy (*fight and dominate*, *escape and diversify*, and *create and focus*) for declining and fragmenting markets, into which the Japanese beer market falls. The chapter subsequently discussed each strategy using examples of U.S. beverage companies in order to explore how each business strategy and organizational environment relate and what trade-offs each strategy could face.

This chapter will discuss two topics:

- I will suggest a basic direction for a future mid-term strategy for Kirin's Japanese beer business, taking into account possible changes in the external environment and how to deal with the declining and fragmenting beer market. I will limit the discussion to a mid-term strategy because I believe trying to identify a long-term strategy would not be as useful given the changing business environment. Also, I will not go into specific details of the mid-term strategy design in order to retain flexibility in the design of future strategies.
- I will discuss Kirin's future organizational environment. Since strategies should change in response to the changing business environment, capabilities that will enable Kirin to flexibly re-create strategies and competitive advantages are much more important than capabilities to execute specific strategies, if a company hopes to survive and develop in the long run. Therefore, while discussing capabilities required for the suggested mid-term strategy, I prefer to focus on the kind of organizational environment Kirin should develop in order to establish a number of dynamic capabilities, all based on the concept of "six principles" introduced in the book *Staying Power* by Michael A. Cusumano.

6.2 FORECAST OF INDUSTRY STRUCTURE, MARKET ENVIRONMENT, AND COMPETITION

As described in Chapters 2 and 4, it is expected there will be ongoing shifts in the external environment, for several reasons:

- The downward trend of the Japanese beer market, which has began in 2002 and continues today, will probably remain for the medium and long term, mainly because of decreasing population and consumers' shift away from beer products stemming from a decline in the consumer value of beer.
- The behavior of beer consumers is becoming more diversified and fragmented, which has driven the Big Four to disperse their beer brands and categories at the same as a noticeable shift in consumer touch points. However, these dispersions resulted in promoting commoditization (i.e., the proliferation trap) rather than increasing customers' perception of beer value.
- The advent of the low-malt beer and new genre categories extended the range of beer prices downward. However, pending revisions in the Liquor Tax Act are expected to change the tax rates of three beer categories (beer, low-malt beer, and new genre) sometime in the near future, which would cause a major reorganization of beer price categories.
- There is no guarantee that the Big Four competition will continue. While industry consolidation could take place, new competitors such as private-label brands and craft beers could further emerge (i.e., a dispersion of players).
- The dominant power has shifted from upstream to downstream within the supply chain of the Japanese beer industry. A major consideration in the future will be how possible

changes in the behavior of beer consumers affect the traditional beer supply- chain structure (e.g., changes in points of purchase, Internet shopping).

- It is difficult to imagine that technological innovation will disrupt the beer industry structure. Strategic innovation (or differentiation) would be more critical.

Among these factors, the most important point that would have the largest impact on Kirin's mid-term business strategy is the expected revisions of the Liquor Tax Act. As discussed earlier, while the government has not yet finalized the bill, pending revisions are expected to narrow the gap between the tax rates for beer, law-malt beer, and new genre. The issue is whether or not the retail price range will converge with the corresponding tax revisions. My view is "probably NOT" because consumers are already accustomed to the current downward-extended price range, where they select the category of beer they want to drink based on their lifestyle patterns. If the price range converged following the revisions, there would be a "white space" of consumer needs where some industry players might find added opportunities. As a result, the retail price range would remain the same, or could even be further extended because there would be a variety of price options if beer companies accept the idea of loosening the link between liquor tax rate and price.

This forecast has a major effect on proliferation in the market. If the beer price range does not converge because of the loosened link between tax rate and price, there could be more than three price categories within the new price range. As a result, competition in each price category would take place, which would further accelerate dispersion of brands. This dispersion would provide emerging competitors, beyond the Big Four, with opportunities to expand their businesses, which would lead to further dispersion of players. Thus, there is

sufficient possibility that the proliferation trap in the Japanese beer market would become worse, at least in the medium term, after the upcoming tax revisions are implemented.

This new competition may temporarily cause consumers not to shift away from beer. If there were any positive effect, it would never compensate for the pace of declining population in Japan, which is the other major cause of decline in the beer market. Therefore, it is almost certain that the market will keep decreasing in the long run.

6.3 BUSINESS STRATEGY

In deciding on the basic direction of Kirin's mid-term Japanese business strategy, how can it be based on the prospects of the external environment as I described above? In Chapter 5, I identified three types of strategies that I believe would serve well as a framework for discussing this issue.

The "*fight and dominate*" strategy, which characterizes Coke's strategy, is unsuitable for Kirin. Kirin now holds second position to the leading player, Asahi, in the Japanese beer market, neither does it own an overwhelming leading brand like Asahi "Super Dry." In addition, as discussed in the case of Coke, dependence on a specific brand and a specific market creates a serious trade-off if consumer preference becomes increasingly diversified and fragmented in the shrinking market.

The "*escape and diversify*" strategy, which characterizes PepsiCo's strategy, is more suitable for Kirin based on the future prospects of the external environment and the current position Kirin holds in the market—although it is not as easy as the PepsiCo example would suggest. I explore why and how Kirin should apply this strategy from each of the two aspects of the strategy: first "*diversify*" and then "*escape*."

- *Diversify*: In general, the business model that mainly pursues economies of scale has already reached its limit in many Japanese industries because of decreasing market and diversified customer needs. Overseas expansion of business is an option to compensate for these limitations, and Kirin is going down the same path. However, it is difficult for a beverage business (including beer) to realize cross-border economies of scale because the beverage supply chain (i.e., producers, distributors, and consumers) is local in most countries, as discussed in Chapter 1. The differences in consumer preference by country or region also contribute to the dilemma. Therefore, in parallel with overseas expansion, Kirin should also develop strategies for additional economies of scope in Japan to exploit the home-country advantage. This could be a source of long-term competitive advantage because it would be harder for competitors to replicate economies of scope than economies of scale.

  Since specific details of future diversification would digress from the main topic of the thesis, I will just mention basic directions or principles. Kirin should diversify into businesses where it can expect economies of scope in at least two areas among the following: technology, supply chain, and marketing. The company should continue with other existing alcoholic and non-alcoholic drink businesses because they meet the criteria outlined above.

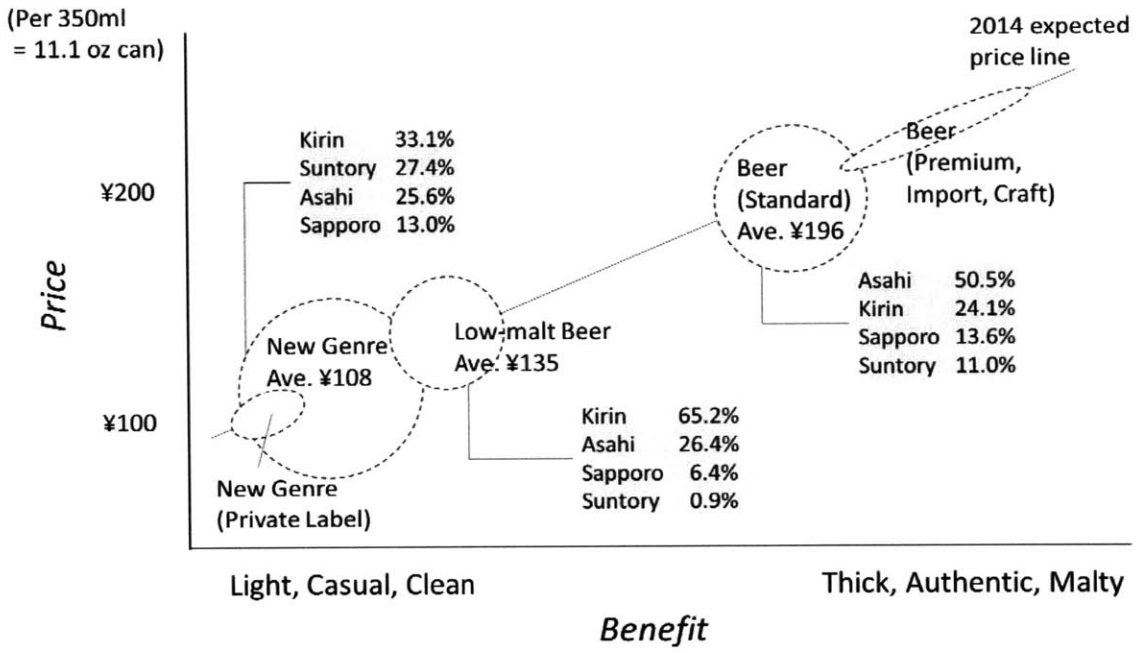
  The most reasonable option for further diversification would be the food business, although Kirin should take into account long-term rising consumer trends in the Japanese food market, such as health consciousness and shifts to easier cooking. In any case, it is most important to identify feasible economies of scope and develop an effective approach to managing them.

- *Escape*: It is not realistic for Kirin to shift drastically from its current full-line strategy in the Japanese beer business where the company has developed its traditional strengths and still depends on those for much of its revenue and profit. However, Kirin should at least prioritize its resource allocation in segments that could be vital in the mid-term, as PepsiCo did.

The "*create and focus*" strategy that BBC adopted is not sufficient to enable Kirin to survive in the Japanese beer market, for the same reason why the drastic "*escape*" strategy is unrealistic. However, it would be possible to use this as a complementary strategy to reduce the risk of losing position in certain markets, which is one of the trade-offs of the "*escape and diversify*" strategy. In particular, BBC's approach of expanding an identified growing segment is useful. I will explain below how to make these two strategies work for dealing with possible changes in the Japanese beer market, using the concept of a *price-benefit map*,[44] one component of D'Aveni's framework.

[44] D'Aveni, 131-155. Price-benefit map was developed as a tool to identify the three commodity traps (see Chapter 4). The tool represents the result of price-benefit analysis, which involves graphing the position of all products in a marketplace using each product's price against its primary benefit - the most important product benefit that drives pricing in the market. Since information of each product's actual price in the Japanese beer market is not available, I instead show the average retail price of each category (beer, low-malt beer, new genre) in Exhibit 6-1.

Exhibit 6-1. Price and benefit map - The Japanese beer market (2014)



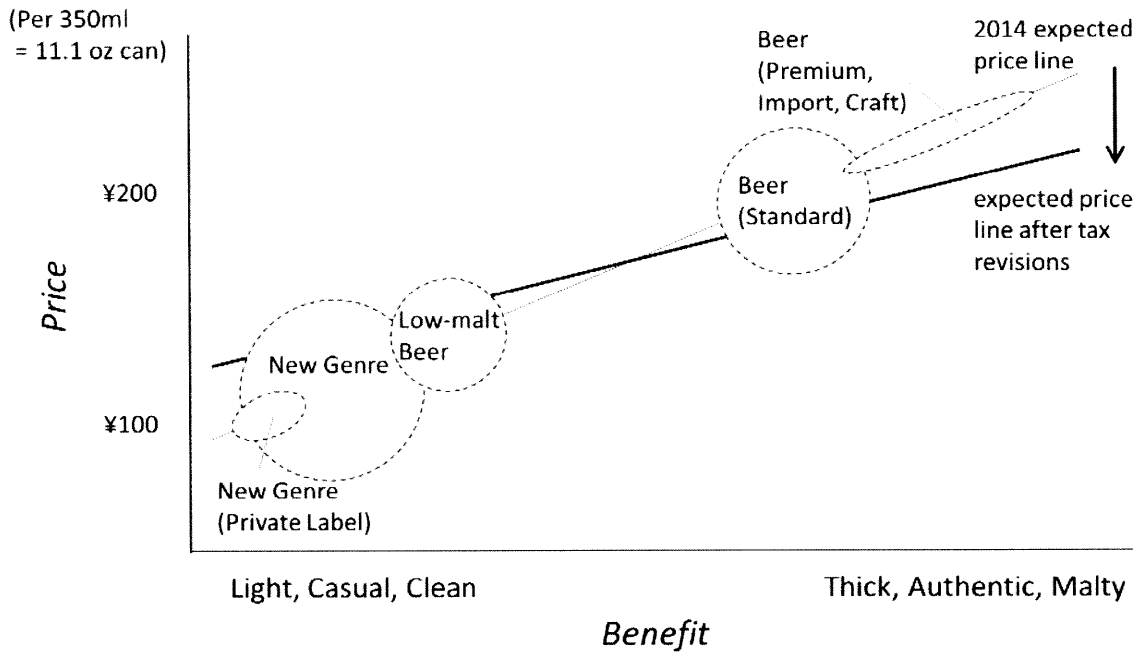
Notes: $1 = approx. ¥120 (as of April 2015)
Source: Research by Kirin

The price-benefit map shown in Exhibit 6-1 is based on the 2014 price range in the Japanese beer market. While the market includes household consumption and consumption in restaurants and bars, here I focus on the former, where consumers select what they drink from a variety of products in the broad price range. For 2014, the rough estimate of household market composition was 33–34% (beer), 19–20% (low-malt beer), and 47–48% (new genre), each of which is represented by the three circles in Exhibit 6-1. The growing segments are craft beer at the upper end of the price range, and imported private-label brands at the lower end—and both of them are still small.

As I have noted before, the content of the Liquor Tax Act revisions is uncertain. I have assumed the most moderate option, where the three categories remain but with a

narrowed tax rate gap between them. Based on this assumption, the most probable *initial* moves by the Big Four would be to narrow the price gap between the three categories to reflect new tax rate, which provides an expected price line with a more gentle slope in the map (see Exhibit 6-2).

Exhibit 6-2. Price and benefit map - The Japanese beer market (2014 vs. after tax revisions)



Notes: $1 = approx. ¥120 (as of April 2015)

There could be two significant *subsequent* moves as a result of the new price line. One is further growth of the high-priced beer segment (including craft beer) because it would be offered at a more affordable price if the revised act lowers the tax rate of the beer category. The other is potential competition in the *current* price range of the new genre category. Exhibit 6-2 shows there would be a large empty space at the current new genre position if its tax rate increases, thereby raising the average price throughout the category.

Some aggressive companies might move back into the white space as low-end competitors, even at the expense of their margin, in order to erode the market share of other new genre products that may move into upper price range—which is precisely the deterioration trap.

While these two moves are complete opposites, they are not surprising because the increasing trend of polarization in consumption patterns is found in many Japanese markets due to growing income disparity. In addition, both ends of the price range are where signs of player dispersion have already surfaced. I believe Kirin should prioritize its resource allocation to deal with these two probable scenarios. I also believe it should adopt the "*escape*" strategy along the lines of PepsiCo, which would limit fighting in certain market segments while maintaining a certain level of market position for Kirin.

Regarding the move at the upper end of the price range, Kirin should achieve a leading position. The key is aggressive expansion of the segment, which is still small although growing rapidly. Here Kirin could adopt the "*create and focus*" strategy, similar to BBC, as a complement to the "*escape and focus*" strategy. The point of BBC's strategy is that it explosively expanded the U.S. craft beer segment by driving strategic proliferation and developing a larger platform. While I have refrained from discussing specific designs for applying the BBC approach to the Japanese beer market, the important points of that strategy are to emphasize flexibility rather than cost efficiency and to connect networks effectively within the supply chain or between the supply chain and consumers. This approach could not only help Kirin differentiate itself in the market but also increase the customers' perception of beer value, as they could enjoy a variety of innovative offerings which have not existed in the Japanese market to date.

How should Kirin cope with the probable proliferation trap at the lower end the price range? D'Aveni argues that the key decision to be made when a company faces the proliferation trap is "whether to fight or flee," adding:

> Winning the fight depends on the resources you have to throw at the battle relative to the low-end competitor. If you are hopelessly outmatched, then the choice may be to flee if sidestepping is feasible. If you are evenly matched or have an advantage, then containing or undermining the discounter becomes more possible.[45]

Despite the fact that Kirin is second to the leading competitor Asahi, Kirin holds the number one brand in the new genre category, Kirin Nodogoshi. Thus, if Kirin can intensively allocate its resources to the new genre category as well, it should not flee but fight because it will never be outmatched by any competitor that attempts to set a trap. Again, refraining from discussing specific tactics, I believe there are three critical points to dealing with the trap:

(1) Kirin should not set a deterioration trap because such a move would lower its profitability in new genre category

(2) Kirin should take necessary measures immediately after any sign of a trap surfaces in order to prevent the low-end competitor from gaining market power.

(3) Kirin should enhance its cost efficiencies in the field if the company does enter the same segment as the low-end competitor.

6.4 ORGANIZATIONAL ENVIRONMENT

A desirable organizational environment should be built with a long-term perspective, despite the fact that this runs contrary to the business strategy I am suggesting. The first

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[45] D'Aveni, *Beating the Commodity Trap,* 43.

focus should be on what kind of organizational environment Kirin should build in order to establish long-term competitive advantages, and then incorporate a discussion on required capabilities to support the mid-term business strategy described in the previous section.

Michael A. Cusumano advocates six principles (*platforms*, *services*, *capabilities*, *pull*, *scope*, and *flexibility*), which he argues are essential to the effective management of strategy and innovation over long periods of time, compared to older or narrower views of competitive advantage (see Exhibit 6-3).[46]

Based on Exhibit 6-3, it is probably safe to say that not only the Japanese Big Four (including Kirin) but also most of large beer companies in the world, have managed their businesses based primarily on the "*product level*" model; They focus on product strategy and marketing and their products basically do not require complementary services, with some exceptions such as offerings at restaurants. A most of their beer products are pilsner type, which is suitable for large-scale production, so differentiation relies on brand image rather than the product itself. Also, the distribution channel from breweries to consumers is long. These product and industry characteristics have been driving beer companies to compete by streamlining their production process, developing a distribution network to the mass market, and boosting consumer demands through advertising, promotion, and price. While every major brewery is keen to develop capabilities to manage this kind of traditional business model, their ability to re-create competitive advantages would vary greatly from company to company.

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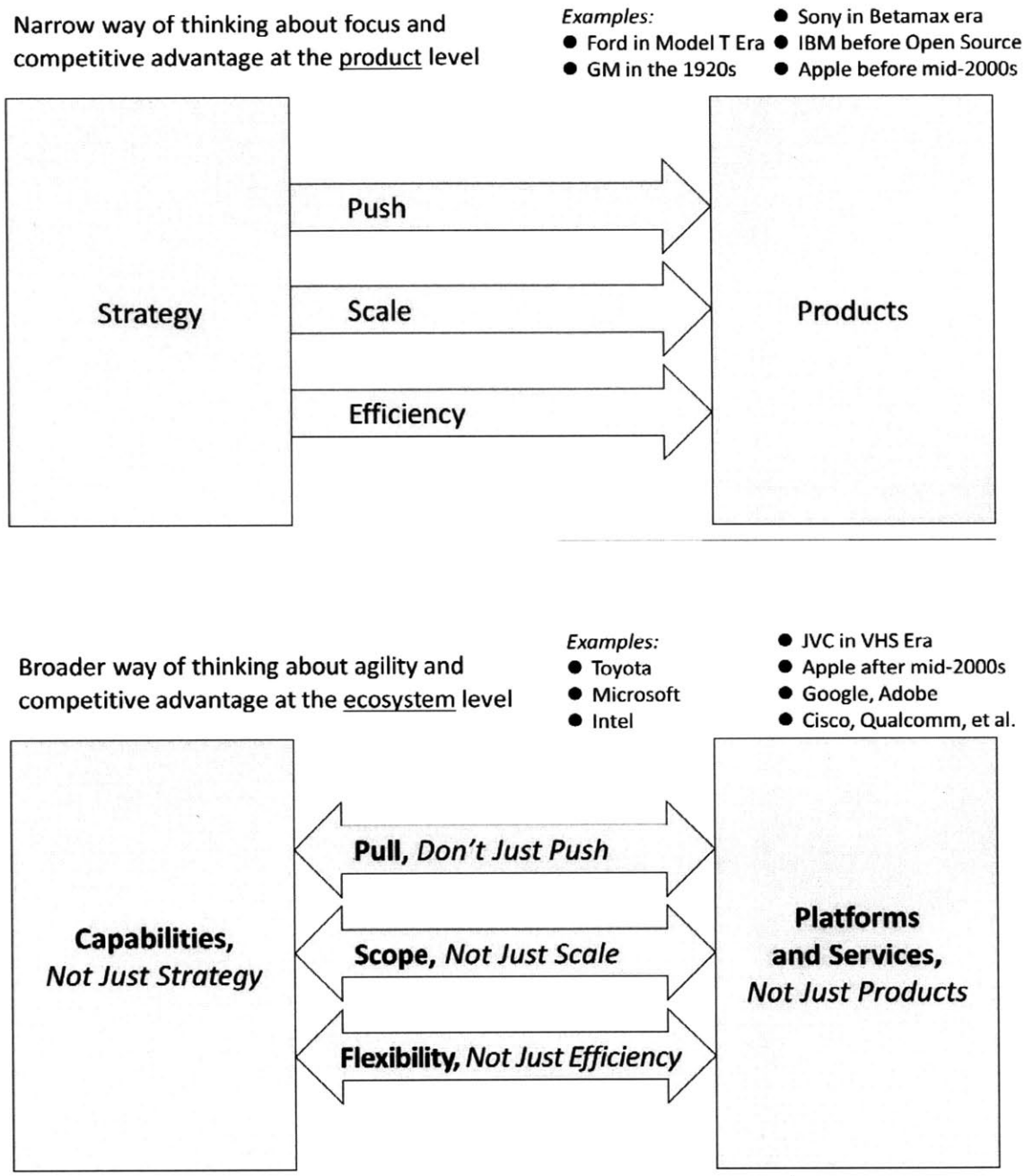
[46] Michael A. Cusumano, *Staying Power: Six Enduring Principles for Managing Strategy and Innovation in an Uncertain World* (Oxford, UK: Oxford University Press, 2010), 10-12.

Exhibit 6-3. The six enduring principles and competitive advantage



Source: Cusumano (2010), modified by thesis author.

As discussed in Chapter 3, Kirin is re-creating its organizational capabilities corresponding to changes in external environment, such as the rise of competitors, the shift of dominant power in the supply chain, and the transformation of consumption patterns. Some efforts were successful, others were not. The overall results may not be satisfactory even from the viewpoint of market share, but Kirin has managed to survive so far—within the traditional beer business model.

However, this business model could be exposed to significant external changes in the future. For instance, what if consumers take drastic action to seek a different type of beer because they are bored with the stereotype pilsner beer? What if consumers pay no attention to TV ads? What if consumers decide to do all their beer shopping via the Internet rather than going to a store? What if consumers find little value in the large company brands? These possibilities are not just theoretical; they are already taking place in some advanced countries, and signs are surfacing in Japan as well. These fundamental changes in consumer behavior clearly come, at least in part, from today's IT society, where consumers can easily find enormous information at any time and at no cost. This means that even the beer industry's traditional business model, which has always seemed immune from the high-tech economy, could undergo a huge transformation because of IT. In response, consumer products companies (including beer companies) need to become directly involved with changing and diversifying their consumer bases, not just through distribution or mass media, but in every market or segment where they compete. This broad perspective makes Cusumano's six principles—which he considers to be fundamental to a model of competitive advantage at the "*ecosystem*" level—entirely relevant to the beer industry.

While these six principles will provide Kirin with a number of thought-provoking viewpoints, it is impossible to reform such a large organization at once from all of those six angles. Where Kirin should begin? I believe "*flexibility*" is the first priority. While Cusumano points out that flexibility includes various dimensions (manufacturing, product development, strategy, and entrepreneurship),[47] I believe *flexibility in a chosen strategy* is critical in the case of Kirin. Although Kirin has undertaken a variety of organizational climate reforms, a highly structured and centralized culture persists. A rigid planning and resource allocation system requires managers and employees to adhere to their initial plans and targets. Organizational segmentation in recent years has resulted in complicated operating processes and ineffective inter-organizational communication.

An effective way to overcome these organizational obstacles, which prevent flexibility in a firm's strategy would be—as PepsiCo did with its diversification strategy—to further decentralize Kirin's entire organization so that each business unit can re-create its business strategies and management plans flexibly and with agility to enable it to respond to market changes. At the same time, it should be noted that decentralization without economies of scope yields no added value for a group of companies, as the case of PepsiCo pointed out. Kirin should develop an effective inter-organizational collaboration system that enable it to not only share between the different lines of business but also share within the same line of business, which Cusumano emphasizes.[48] In this regard, there is much Kirin could do in the way of reviewing the functions of its holding companies in Japan, as well as a detailed review of the current balanced scorecard system, which pays great attention to

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[47] Cusumano, *Staying Power,* 256.

[48] Cusumano, *Staying Power,* 205.

vertical strategic and planning linkages within the group but very little attention to horizontal linkages.

If Kirin develops enhanced flexibility in its strategy, as Cusumano suggests, it will give the company an opportunity to evolve *capabilities* and to implement *pull* and *scope* concepts.[49] At the same time, however, Cusumano points out that these principles require a company to repeat a process of trial, error, and experimentation,[50] which is not easy for a large organization, and even more so for Kirin, which has strong failure-averse culture.

I believe the best solution is to create small independent business units within the group. In this regard, the high-priced beer business, including craft beer which I discussed in the mid-term business strategy, seems to be a good candidate because this emerging segment is full of new trends and customer preferences with which Kirin is so far unfamiliar. An independent unit could try various ways of communication with consumers, gain new knowledge and insight into consumer interests other than price, and incorporate these new ideas into the processes of production and sales. This initiative would also have the secondary benefit that small independent organizations would help Kirin train younger managerial talent effectively.

Three organizational points should be noted here; (1) Kirin management has to allow this small unit to implement trial, error, and experimentation. (2) Kirin has to avoid applying the same metrics as the parent's to evaluate the subsidiary unit's performance because the unit should be allowed to pursue different strategies, capabilities, and processes, and to create an organizational climate separate from that of the parent business. (3) Even though the unit is a subsidiary under the larger group, as discussed in the BBC case, the unit would

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[49] Cusumano, *Staying Power,* 249.

[50] Cusumano, *Staying Power,* 277.

also require an experienced leader who is highly familiar with its respective industry structures. This kind of leader would enable the unit to fully use the insights gained from experimentations in its business and that person could give feedback effectively to the parent based on the understanding of the large organization's contexts. Kirin has just begun its craft beer business with an independent subsidiary. I hope this initiative helps Kirin form new strategies and organizational environment.

Kirin has a lot of valuable capabilities and assets—excellent product quality, R&D capabilities, customer-oriented style, emphasis on human resources development and work environment, and brilliant people who support these capabilities and assets—which characterize many Japanese companies as well, and would definitely contribute to re-creating Kirin's competitive advantages. I hope Kirin takes full advantage of these unique capabilities and assets and becomes a firm with a hard-to-imitate process of continuously reinventing itself.

CONCLUSION

This thesis explored Kirin's future business strategy and organizational environment in the Japanese beer market, where decline and commoditization are advancing simultaneously, and industry structure and consumer behaviors are changing. A summary of my recommendation is as follows;

1) Business strategy side: I recommend that Kirin adopt the "*escape and diversify*" approach as its core business strategy because the Japanese beer market is likely to face further decline and product proliferation in the future, which would make the "fight and dominate" strategy less effective. As a mid-term strategy, Kirin should prioritize its resource allocation in two growing segments: the upper end and the lower end of a possible new price range, which could greatly affect the competitive landscape in the beer market after the expected liquor tax revisions. Each of these two segments requires a different strategic approach. At the upper end of the price range, Kirin should adopt the "*create and focus*" strategy as a complement to the "escape and diversify" strategy in order to aggressively expand the segment. At the lower end, Kirin should react quickly and remain persistent in efforts not to be caught in the possible deterioration trap. With regard to "*diversify*," Kirin should aim to expand into businesses where it can manage feasible economies of scope in Japan.
2) Organizational environment side: I recommend that Kirin shape its organizational environment based on a long-term perspective so that the company not only executes specific strategies but also continuously re-creates its competitive advantages by

adapting flexibly to various changes in external conditions. The following three points are apparently critical:

- Enhance *flexibility* in its strategy, which requires Kirin to build a more decentralized and agile organization. This point is also consistent with the capabilities required for the suggested "escape and diversify" strategy.
- Diversification requires an effective management system that enables Kirin to pursue *economies of scope*, which is also necessary for decentralization to yield added value for a group of companies.
- In order to continuously evolve *capabilities*, Kirin should build an organization open to trial, error, and experimentation. I believe allowing an independent small organization to work on innovation would be the most effective way.

This thesis is about one company, Kirin. However, writing the thesis made me think deeply about the challenges that face many Japanese companies in circumstances similar to those confronting Kirin. Here are some of my thoughts.

The current recession in Japan has lasted for more than 20 years, and in the midst of shrinking market share due to a decline in demand and a younger population, many Japanese companies have undertaken desperate measures to mitigate the business downturn and loss of revenue. Some released new products; others dropped prices, restructured, introduced a pay-for-performance system, focused just on their core business, expanded overseas, and/or switched to another business that held promise of greater growth. All of these options are reasonable in such a harsh economic condition, and Kirin, too, adopted some of them in order to cope with increasing competition and to help the business survive into the future.

At the same time, however, many of these efforts were motivated by the prospect of immediate and visible performance improvement. This could be attributed to growing pressure for short-term profits from the capital market, which only increased following the collapse of the mutual shareholding system in Japan. These circumstances discouraged companies from prioritizing efforts of re-creating competitive advantages in anticipation of long-term future changes in the market because this kind of efforts take a long time and are less visible to external stakeholders. I believe this often-accepted organizational mindset facilitated myopic and homogeneous competition in the declining market, and resulted in increasing commoditization; it was a vicious cycle that would not end well.

Having an awareness of these problems already in my mind, I learned the following lessons during the process of writing the thesis.

1) It is important to keep a broad perspective as a firm determines multiple strategy options in anticipation of a future market environment. Consumer products companies in particular, including Kirin, tend to emphasize a specific product brand strategy during the process of developing an overall business strategy. While I fully appreciate the importance of a brand strategy, it will not work effectively unless it is positioned in a well-designed "big picture" of a larger business strategy based on cool-headed observations of the external environment.
2) In this regard, applying D'Aveni's frameworks (i.e., classified commoditization patterns and suggested practical strategic options) to Kirin, as well as the three case studies (Coke, PepsiCo, BBC), helped me think about strategy from a wide-ranging and panoramic view of industry structure, which made me take a step back from the current homogeneous competition in the Japanese beer market.

3) Business strategy is closely linked to the organizational environment, and no strategy has a prepared organization ready in advance. Every firm executes its strategy more or less in parallel, by trial and error, while developing a required or desirable organizational environment. Through my research on Kirin, the three case studies, and discussions with my thesis advisor, I realized that a firm should be careful about the following two points.
    - Strategy and organization should to be aligned, but not perfectly. If a firm pays little or no attention to the linkage between the two, organization development easily loses its direction and can sometimes even impede strategy.
    - On the other hand, if a firm makes the linkage between strategy and organization too tight, future flexibility can be lost.
4) An organizational environment generally can be divided into two parts – "hardware" (i.e., institutional design such as organizational structure and incentive system) and "software" (i.e., capabilities). While it is often the case that companies jump directly from business strategy to the more visible "hardware" part, the most important element is the less visible "software" part. Institutional design should be developed so as to enhance or protect capabilities. Otherwise inappropriate "hardware" can diminish or, worse still, kill the "software."
5) Rather than designing a specific strategy, a company should emphasize cultivating internal capabilities in order to flexibly review a strategy and re-create competitive advantages in response to external changes. I found Cusumano's six principles especially thought-provoking in the light of possible long-term shifts in Japanese consumer behavior—even though, at first glance, they did not seem applicable to the beer industry. Industry structure, business model, brand, and strength—factors that

dependably brought great success in the past—each can change sooner or later. It seems obvious, but is hard to remember. A company should always be conscious of that fact, reinvent itself flexibly as external conditions change, and develop an organizational framework that enables such a reinvention. It is perhaps the most difficult challenge, but it is absolutely a prerequisite for any firm that hopes to endure for the long-term.

Not just decline and commoditization, but also a variety of existing external changes are occurring continuously in the Japanese market. I believe Kirin can turn the situation it faces now into an opportunity to design a distinctive strategy and develop unique capabilities that will help the firm become and remain a genuinely global enterprise.

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