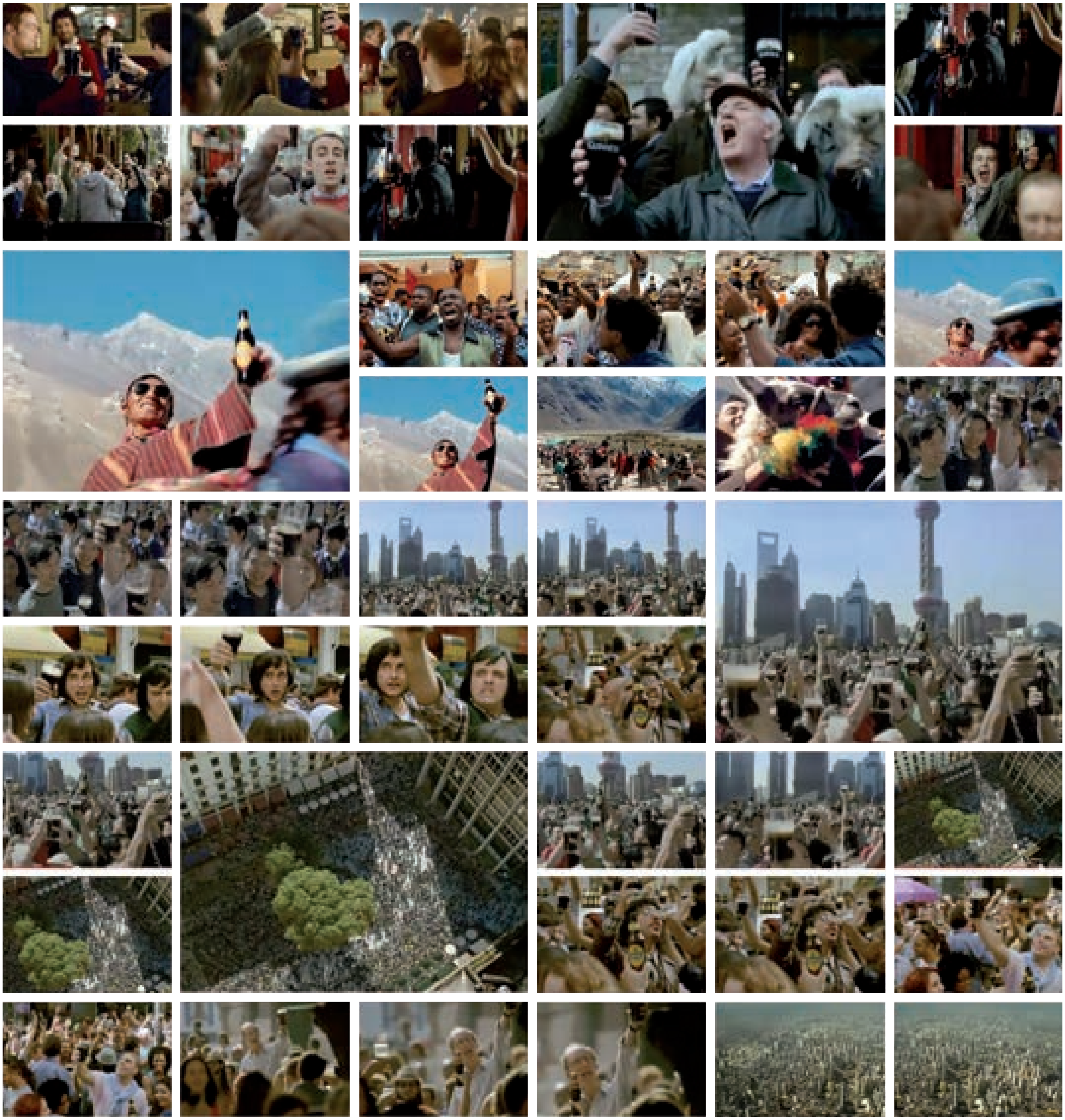
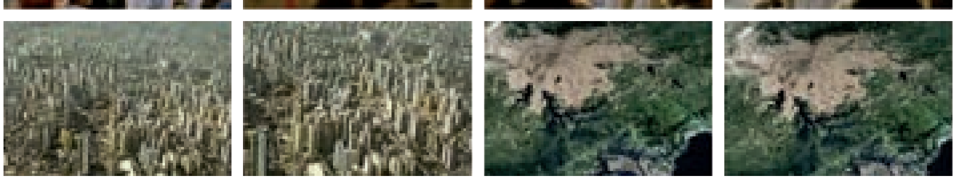




Shots from a 2009 Guinness television commercial featuring an international toast to "Arthur's Day," which marked the 250th anniversary of Arthur Guinness signing a 9,000-year lease on the company's "home" brewery at St. James's Gate, Dublin. The ad for the Diageo brand starts in Dublin and moves around the world – to Africa, Chile, Brazil and China.

CHEERS! SLÁINTE! KAMPAI! ŞEREFE!...

by Kim Fletcher, Brunswick, London

A national drink can carry nearly as much cultural significance as a language. As Diageo's experience shows, when entering a new drinks market it pays to respect tradition, find suitable partners and tread lightly

Of course he knew it was a big deal, but it wasn't until he arrived for a holiday break in Kaş on Turkey's Mediterranean coast, that Ian Wright realized just how popular a brand Diageo had acquired. The name of the country's giant spirits company, Mey Içki, was everywhere he looked. "Every table, every café and bar, the name was right in front of you on the salt and pepper pots," says Wright, Corporate Relations Director at Diageo, the world's biggest spirits company. "You couldn't have a cup of coffee without seeing it."

Diageo paid £1.3bn ($2.1bn) for Mey Içki, giving the London-based drinks business control of up to 80 per cent of the world market for raki, an aniseed-flavored spirit. The case for buying into Turkey was compelling: a fast growing economy with an increasingly affluent middle class. The deal delivered not only a new portfolio of brands, but also access to a distribution network and potential new customers for Diageo's existing brands.

"The demographics work for us," explains Wright. "We have critical mass – a large cohort of people at the legal drinking age, moving into the markets we are interested in, buying local spirits."

Given the long history of raki in Turkey, these new customers are unlikely to move straight to Diageo's Johnnie Walker Scotch Whisky, Smirnoff vodka or Tanqueray gin, but they are increasingly likely to try them. Now, whatever they drink, there's a good chance it will be a Diageo brand. "All around the world," explains Wright, "there tends to be a mainstream and a premium component in the drinks market. As the middle classes expand, we see increasing play for premium brands and we expect that to extend further so that premium is playing at scale."

The Turkish acquisition is the latest and the biggest of a series of deals designed to stimulate the growth that Diageo seeks in order to compensate for more difficult trading conditions in the mature markets of Europe and North America.

Paul Walsh, Diageo's chief executive, has predicted that the company will generate half its sales from emerging markets within the next three to five years. That growth will come partly from increasing sales – the Chinese, for example, are conducting a passionate love affair with Johnnie Walker while Guinness is already well established in Africa – and partly from acquisitions.

All businesses are, of course, interested in the most promising of the emerging markets: whether it is the BRICs (Brazil, Russia, India and China), the EAGLEs (Emerging and Growth Leading Economies), or the CIVETS (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa) – pick whichever acronym you like – but not many have identified as clear a strategy as Diageo in terms of how to approach and develop a market presence.

The starting point is knowledge of the markets – and a clear communication of the values that Diageo will bring. Wright rattles off the drinking habits of the world with the expertise of a cocktail barman. "There's still great variation. The Mexicans, of course, are very fond of tequila; the Chinese like baijiu; the Koreans are big on soju. You go into a supermarket in Russia and you are just overwhelmed by the shelves of different types of vodka on sale. India is pretty much whiskey and beer; Africa is beer; Brazil goes for cachaça..."

Baijiu, which is distilled from sorghum, and soju, a starch-based spirit that is sweeter than vodka, are unfamiliar to most Western drinkers. Cachaça, a kind of rum fermented from sugar cane, appears internationally but makes most sales at home in Brazil. The popularity of tequila has grown, but globalization has not yet ended long-standing national tastes. They may have made big inroads, but whiskey, gin and vodka have not conquered the world.

The Diageo approach gives the company the opportunity to benefit from local sales, from enhanced distribution of its own brands or from both, as with the purchase of Mey Içki.

The company will look at different models – partnership, joint venture or acquisition – and in some countries the best relationship may be a traditional distribution deal. But increasingly, Diageo is looking for a closer relationship that involves a stake in manufacturing.

In China, Diageo has a minority stake that could become a controlling one. In India, where it has a subsidiary, there are plans to launch some local brands. It has stakes in breweries in Kenya and Nigeria, and in the Ron Zacapa brand of rum in Guatemala, not to mention a strategic partnership with Hanoi Liquor Joint Stock Company (Halico), the largest branded spirits distiller in Vietnam. With Halico, the plan is to support the Vodka Hanoi brand with sales initiatives and logistics expertise, while using Halico's local network to promote sales of Johnnie Walker Scotch Whisky, Smirnoff and Baileys. There is also a winery in Argentina, a cachaça distillery in Brazil and a steady stream of other possibilities.

How welcome is Diageo as it seeks opportunities in emerging markets? Is it seen as a foreign predator, a threat to local culture? Do consumers fear an attempt to impose international brands? Ian Wright pauses to consider the question. "They do see a degree of things as British," he says. The primary listing for Diageo's shares is London, though around half the shareholders are outside the UK, with a large portion in the US. So, it is an international company with roots firmly in the British Isles.

The task, Wright explains, is clear communication with all the relevant stakeholders, particularly the local affiliate. "The first thing is the partner," Wright says. "Whatever form the partnership may take, we start with having a partner who is prepared to work with us, who can see the value in working together."

Firms in the drinks industry are often still family-owned. "It's really important that we can build up trust," says Wright. "They want to know that we can enhance the brand and protect the family legacy." A recent example of the process is Ketel One vodka, a business started in the Netherlands in 1691 by the Nolet family. The first step was a joint venture between Nolet Group and Diageo in 2008, with Diageo taking control a year later.

"This way of doing business is actually part of our heritage. If we look at those great Scotch whisky names – Haig, Buchanan, Walker – they were all family businesses. And of course there was a Mr Tanqueray and a Mr Gordon," Wright says.

Diageo – bottoms up

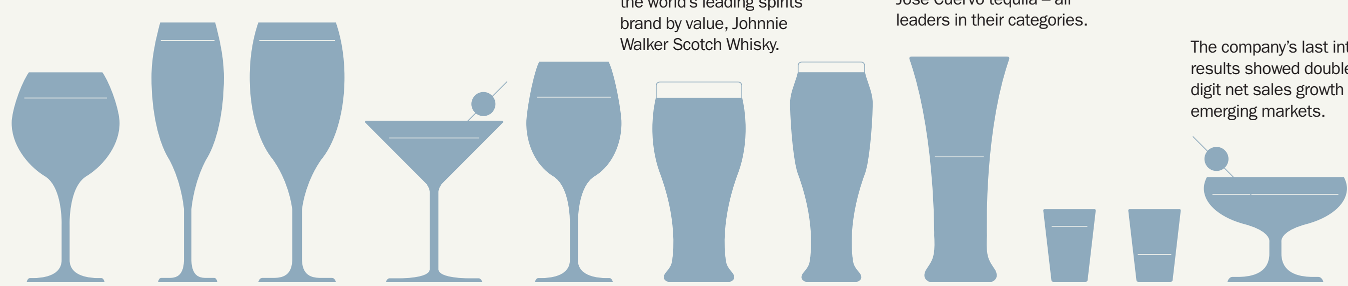
The 1997 merger of Guinness and Grand Metropolitan created Diageo, the world's leading premium drinks business.

Diageo trades in around 180 markets around the world and employs more than 20,000 people in its offices and factories.

The company produces eight of the world's 20 top spirit brands (by volume), including the world's leading spirits brand by value, Johnnie Walker Scotch Whisky.

Diageo brands include Smirnoff vodka, Guinness stout, Bailey's liqueur and Jose Cuervo tequila – all leaders in their categories.

The company's last interim results showed double-digit net sales growth in emerging markets.



Diageo also must be comfortable with potential partners. "Compliance issues are very important to us. We have to have partners who will work in a way that conforms with all international requirements," Wright says. "The game doesn't start if we don't think we have that. We've walked away from acquisitions where we didn't believe we could get that degree of transparency."

The dealings with government are also of crucial importance, including conforming to competition and other market rules, though it can extend beyond that. "Sometimes these things are just to do with competition," Wright says. "In other situations there may be talks about investment in local communities, other forms of social activity, involvement in campaigns and education around responsible drinking. We're currently one of the bidders for a brewery in Ethiopia, for example, and it's not just a question of who comes up with the most money."

> *"In Turkey, they've been drinking raki for hundreds of years. Getting all that heritage out and just selling Johnnie Walker Scotch, it's just not going to happen"*
>
> *Paul Walsh*
> *Chief Executive, Diageo*

There is also work to be done with supplier networks. Will those sorghum and wheat and barley farmers, those sugar cane growers and bottle makers who have worked with the existing business continue to work with Diageo? "There are relatively few suppliers of the ingredients in a market and they always have the option of working with other players," says Wright. "We try and secure suppliers from within the country and we are keen to find ways of involving them more in the production process and in issues such as sustainability."

It is important, too, to understand the distribution networks. In older markets, typically around 60 per cent of Diageo's sales is to the "off-trade" – supermarkets, liquor stores – with the rest to the "on-trade" – bars, restaurants, hotels. Those proportions may be reversed in developing markets, which are less consistent and where sales outlets may be owned by the government. Wright cites India as an example of the difference. "You have a high-end premium market for international brands in the big hotels of cities such as Delhi and Mumbai. But the vast majority of sales come in other cities selling more standard products, such as VAT 69 whisky." Last year Diageo relaunched and repackaged VAT 69 to make further inroads in the Indian market.

Diageo will not enter a market without understanding its structure and the social implications of its arrival. A prerequisite is that local consumers must have some appetite for Western influence. They must be open to trying international brands, though that is not the same as having a desire to abandon local brands.

CEO Paul Walsh explained the position to Reuters earlier this year. "In Turkey they drink raki. They've been drinking it for hundreds of years. Anybody who thinks you're suddenly going to get all that heritage out and just sell Johnnie Walker Scotch, it's just

not going to happen," he said. So, Diageo doesn't expect to take over with its own brands, and it does need to communicate that clearly. If consumers felt Diageo was coming in to replace local spirits with Western brands, they might revolt.

For Ian Wright, it is vital to show respect for national social and economic values and customs and, in the case of acquisition, to reassure all audiences that there will be no attempt to Westernize favorite products. The plan, rather, will be to find a bigger, international audience for them. "You've got to be extremely careful and win acceptance for the total business picture," Wright says. "The economics may have to be softened; we may take a longer term view of synergies. We have to show respect and that we are in this for the long term. One of the ways we try to do that is by encouraging local investors to have a piece of the action."

Fortunately, Diageo has experience of dealing with such sensitivities back in its home market. "What we are doing isn't so different from when we moved into Scottish whisky distillers," says Wright. "It was important that they knew we would be good stewards. Or, think of Guinness: how would it have played in Ireland if they thought there was any danger to that great national brand?"

Doing business in emerging markets is rarely straightforward and requires patience, especially in the world of food and drink with its inherent cultural sensitivities.

China is particularly protective of its home-grown industries. Last year, for example, China's regulators rejected a $2.4bn bid by The Coca-Cola Company for Huiyuan Juice, one of China's best-known soft drinks makers.

Diageo is still awaiting regulatory approval for its offer to take indirect control of the Chinese drinks group Sichuan Swellfun, which produces baijiu under the Shui Jing Fang brand.

Earlier this year, Vince Cable, the UK Business Secretary, discussed the Diageo deal with the Chinese. The outcome remains uncertain, but they did agree a deal to prevent Chinese distillers calling their products "Scotch whisky," a move that could help Scotland to double exports to China – currently worth around $90m – over the next five years.

This is familiar ground to Diageo, which has built up a huge base of knowledge about local operating conditions as it has grown around the world. Wright says the company has learned the importance of using that knowledge. "We've had our moments, but overall we've been very sensitive to local cultures. You have to take each country as an individual case," he says. "You can't wing it in this situation. You've got to have real knowledge of the countries you're going into, the stakeholders you need to reach, and understand the communications required to reach them."

Once you understand the history and tradition of raki, you are well placed to teach the pleasures of Scotch whisky.

Kim Fletcher is a Partner in Brunswick's London office. He was previously Managing Director of Brunswick's sister company, Trinity Management Communications, and has a background in UK national newspapers.

Whisk(e)y galore

The origins of the word whisky are uncontroversial. According to The Scotch Whisky Association, it comes from the Gaelic *uisge beatha*, or *usquebaugh*, meaning water of life.

The spelling of the word is another matter. For those unfamiliar with the debate, *New York Times* food and wine critic Eric Asimov summed it up perfectly in a column: "Whiskey is a word with an alternative spelling, whisky. Or maybe it's the other way around."

Asimov had written a story about the spirit and he – or his editors – had followed *The New York Times'* spelling style (above right).

whiskey(s). The general term covers bourbon, rye, Scotch and other liquors distilled from a mash of grain. For consistency, use this spelling even for liquors (typically Scotch) labeled *whisky*.

But "clearly, definitively, and somewhat aggressively, people from Scotland and many fans of Scotch have informed me of their preference for whisky over whiskey," complained Asimov.

He turned to Jesse Sheidlower of the Oxford English Dictionary for a second opinion, who took a different view. "This isn't a case where a small group of fanatics are insisting on some highly personal interpretation of an issue that is not adhered to by anyone outside their cult. It's almost universally the case that the word is spelled 'whisky' in Scotland and Canada, and 'whiskey' elsewhere."

So what do the Scotch – sorry Scots – think about all this? The Scotch Whisky Association is refreshingly reasonable: "Most well-known dictionaries give both spellings." But it has a much bigger annoyance to tackle, namely the use of the word "Scotch" on products that aren't. "Scotch whisky is defined in UK law, and also protected at European Union and World Trade Organization level as a recognized 'geographical indication,'" it warns imposters.

But in terms of style it would prefer that you dropped that "e."

This article has adopted the style of "whiskey" as the generic but dropped the "e" for Scotch whisky.