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## How Scottish & Newcastle Became the U.K.'s Largest Brewer: A Case of Regulatory Capture?

Firms engage in a multitude of interactions with the external environment, most critically with government and its regulatory agencies. Despite an extensive literature on “regulatory capture,” little attention has been paid to the interactions between merging firms and competition authorities. Yet the possibility of capture exists where there is a recurring series of merger investigations of one firm by the same authority. This analysis of the impact of political influence on the merger history of the brewing firm Scottish & Newcastle extends into a discussion of regulatory capture in the oversight of British brewery mergers during the 1980s and 1990s.

**M**ergers, acquisitions, and hostile bids are a prominent feature of industrial and firm development, providing an important mechanism whereby weak management and faulty corporate strategies are exposed and eliminated. While merger activity can occur at any time, “merger waves” have been evident throughout history, surging most notably after World War II in the United Kingdom in 1953–54, 1959–61, 1968, 1972, 1978–79, and 1984–87.<sup>1</sup> There are several reasons for

<sup>1</sup> Julie Bower relied on data and information from several archives, official Web sites and trade associations while completing her PhD thesis at the University of Warwick. All merger reports are accessible from the Web sites of the Competition Commission ([www.competition-commission.org.uk](http://www.competition-commission.org.uk)), the European Commission ([http://ec.europa.eu/dgs/competition/index\\_en.htm](http://ec.europa.eu/dgs/competition/index_en.htm)), and the Federal Trade Commission ([www.ftc.gov/bc/index.shtml](http://www.ftc.gov/bc/index.shtml)). Antitrust investigation reports on the U.K. brewing industry (1969 and 1989) are available in hard copy from Her Majesty's Stationary Office. Press releases relating to the 1989 antitrust investigation are available on request from the archive of the U.K. government's Department for Business, Innovation and Skills. Firms' annual reports can be accessed from the archives of the London Business School and the University of Strathclyde (Matthew Brown and J. W. Cameron only). Data are also available on request from the British Beer and Pub Association (annual *Statistical Handbook*). Scottish & Newcastle plc kindly sent various items from its firm archive, including copies of listing particulars for all the mergers referred to in this article, in addition to offer and defense documents. Julie Bower also relied on material written during her time as an investment analyst at various City of London investment banks from 1992 to 1999.

the occurrence of mergers in waves: the availability of capital to finance mergers and acquisitions is likely to be cyclical; firms have a natural tendency to copy competitors; and the political climate might favor larger firms that are either international in scope or are more diversified.

In the British alcoholic beverages industry, four merger waves have been identified and discussed in detail by Teresa da Silva Lopes.<sup>2</sup> Terry R. Gourvish and Richard G. Wilson note the decisive period of change in British brewing brought about by merger activity from 1959 to 1961.<sup>3</sup> It was largely from this merger wave that what became known as the “Big Six” vertically integrated brewer-retailers emerged. Allied Breweries, the forerunner of the international spirits firm Allied Domecq, was formed in 1961 from the merger of three independent firms: Ind Coope of Burton-on-Trent, Tetley Walker of Leeds, and Ansells of Birmingham. Scottish & Newcastle emerged from the 1960 merger of two family businesses, Scottish Brewers Ltd. and the Newcastle Breweries Ltd.<sup>4</sup> Bass Brewers emerged somewhat later, in 1967, through the merger of Bass, Mitchells and Butlers Ltd. and Charrington United Breweries.<sup>5</sup>

While 1972 witnessed a change of ownership for two of the Big Six (Imperial Group, the parent of Imperial Tobacco, bought Courage, and hotel and property conglomerate Grand Metropolitan made a successful hostile bid for Watney Mann), the remainder of the 1970s was a relatively quiet period, when the firms engaged in similar small-scale diversification strategies that encompassed food, spirits, and hotels and leisure acquisitions. However, the 1980s emerged as a particularly acquisitive period for the British alcoholic beverages industry, both domestically and internationally, and was notable for the rise in hostile bids.

In an earlier analysis, Julie Bower showed that hostile bids (where the management of the target firm refuses to cooperate with the bidder firm) were more likely to be referred to the competition authorities than agreed bids (where the managements of the two firms agree on terms before the bid is made public).<sup>6</sup> Further, in U.K. brewing industry bids

<sup>2</sup>Teresa da Silva Lopes, “Brands and the Evolution of Multinationals in Alcoholic Beverages,” *Business History* 44 (July 2002): 1–30, ascribes “merger waves” in the alcoholic beverages industry to a combination of several factors related to the evolution of the industry and also to the strategy of the firms.

<sup>3</sup>Terry R. Gourvish and Richard G. Wilson, *The British Brewing Industry 1830–1980* (Cambridge, U.K., 1994), chart the development of the Big Six national brewer-retailers through a series of mergers of family-owned regional brewers.

<sup>4</sup>Monopolies and Mergers Commission (hereafter, MMC), “Scottish & Newcastle Breweries plc and Matthew Brown plc: A Report on the Proposed Merger,” Cmnd [Command of Her Majesty] 9645 (1985): 15.

<sup>5</sup>A chronology of the key mergers of the Big Six from 1960 is shown in MMC, “Bass plc, Carlsberg A/S and Carlsberg-Tetley plc: A Report on the Merger Situation,” Cm [Command of Her Majesty] 3662 (1997): 141.

<sup>6</sup>Julie Bower, “Strategic Interactions with Competition Authorities in the U.K. Alcoholic Beverages Industry,” PhD thesis, University of Warwick, 2007.

specifically, political influence increased the likelihood that a merger would be referred. Since referral itself often prompted firms to abandon proposed mergers for fear of becoming the subjects of lengthy and costly investigations, would-be acquirers had to adapt their merger strategies accordingly. As a result, agreed bids became the norm, in some cases through merger alliances with competitors solely in order to gain regulatory clearance.<sup>7</sup>

In this article, we describe the emergence of Scottish & Newcastle as the United Kingdom's largest brewer through the landmark acquisition of Courage in 1995 that prompted the subsequent exit from the domestic scene of leading competitors Bass and Whitbread. From its heartland in Scotland and northeast England, Scottish & Newcastle embarked on an aggressive merger strategy to augment its corporate objective of creating national brands. In pursuing this objective, the firm played up the political connections of the company's chief executive, Alick (later Sir Alick) Rankin, to full advantage while dealing with the U.K. merger regime. Without Rankin's strategic foresight and the powerful political influence he wielded as a businessman and leading supporter of the Scottish Conservative Party, it is questionable whether Scottish & Newcastle would have been as successful in implementing its merger growth strategy.

In this analysis of the successful prosecution of Scottish & Newcastle's corporate growth strategy, we focus on the role played by individual manager entrepreneurs in the conduct of mergers. We are guided by investigations of regulatory capture reported in the literature that reveal the degree to which individuals and politically influential organizations have determined the structure and trajectory of the industry and its firms. We argue that conventional tools of economic analysis tend to abstract from the political and cultural forces that underpin the conduct of mergers. A detailed historical analysis is required to understand the factors that shaped the evolution of this major firm and its competitors.<sup>8</sup>

### Regulatory Capture and the Politics of the Public Interest

In the 1960s, the British brewing industry was transformed from a collection of family firms into the national amalgamation of

<sup>7</sup>Typified by Diageo and Pernod Ricard's joint bid for Seagram in 2001.

<sup>8</sup>Most merger analysis has utilized the axioms of industrial economics. A recent review of competition policy in the U.K. brewing industry by Margaret M. Slade, "Competition Policy Towards Brewing: Rational Response to Market Power or Unwarranted Interference in Efficient Markets?" in *The Economics of Beer* (Oxford, U.K., 2011) is a good example of this approach. The study finds that the remedies adopted by the Monopolies and Mergers Commission during the 1980s for the purpose of generating industry efficiency and benefiting consumers produced questionable results. While acknowledging the strong influence of political lobbying, the study, however, makes no comment on how it affected policy.

brewer-retailers that became known as the Big Six. The legislative changes of the Companies Acts of 1947 and 1948 that made this development possible resulted in requirements for increased accounting disclosure and led to the emergence of a market for corporate control. Prior to this legislation, many firms owed their continued existence to what Steve Toms and Mike Wright describe as weak corporate governance whose ownership characteristics prevented shareholders from exerting influence by means of either voice or exit.<sup>9</sup>

Notwithstanding a more formal competition policy established by the Monopolies and Restrictive Practices Act of 1948, merger regulation in postwar Britain operated within the framework of considerable business lobbying and political bipartisanship.<sup>10</sup> The existence of the “public interest provision” in competition policy that endured until passage of the Enterprise Act of 2002 (which created the independent Competition Commission), gave the Monopolies and Mergers Commission (MMC) the opportunity to consider antitrust infringements and mergers, not only with respect to their likely impact on prices and consumer choice, but also with reference to, for example, employment and support for regional businesses.<sup>11</sup> The MMC operated de facto as a government-directed agent. The provisions of the Fair Trading Act of 1973 allowed the secretary of state (for trade and industry) both to refer a merger to the MMC and to overrule its findings. The Act gave legitimacy to business lobbying and special-interest pleading whose intensity was nowhere more apparent than in the defenses mounted against hostile bids.

In considering how individual management entrepreneurs might seek to influence the operation of competition policy, research in economics on the phenomenon known as “regulatory capture” (which in broad terms describes how individual regulators cease to act independently, as defined by their official remit, and act in favor of the firms they are tasked with regulating) offers some relevant insights. Existing literature has tended to focus on the operations of utility companies, whose activities and performance carry significant public good implications. The managers of utility firms meet regularly with their regulatory agency counterparts to discuss all aspects of their industry’s operations, including pricing strategies. These repeated interactions between regulators and firms create the pretext for capture. During periods of

<sup>9</sup> Steve Toms and Mike Wright, “Corporate Governance, Strategy and Structure in British Business History, 1950–2000,” *Business History* 44 (July 2002): 91–124.

<sup>10</sup> For the development of U.K. competition policy, see Stephen Wilks, *In the Public Interest: Competition Policy and the Monopolies and Mergers Commission* (Manchester, U.K., 1999).

<sup>11</sup> The Competition Commission Web site sets out the current role of the various regulatory bodies and the law that relates to antitrust and merger provision in the U.K.

intense merger-and-acquisition activity, or when an industry has been the subject of a series of antitrust inquiries, there are similarly repeated interactions between regulators and firms.

Early theories of regulatory capture were established by the economist George Stigler and then developed further by the legal scholar Richard Posner to describe, in its simplest form, the idea that regulators could be swayed by “special interests.”<sup>12</sup> Stigler’s analysis concerned the degree of regulatory favors granted to U.S. railroad companies by different states between 1932 and 1933. Posner presented additional evidence of the influence of interest-group pressures on the structure and procedures of regulation from his investigation of public utility and common-carrier regulations.

A notable enhancement to the debate on regulatory capture was made by the economists Jean-Jacques Laffont and Jean Tirole, who analyzed capture in an “agency-theoretic framework.” The authors highlighted various ways in which interest groups (and firms) have the means to influence public decision makers, ranging from monetary bribes to future employment for commissioners and agency staff (the “revolving door” phenomenon).<sup>13</sup> Their model of the interactions of firms and agencies with the U.S. Congress considers the regulation of a natural monopoly, as observed in many utility industries, where the legal structure governs the firm’s rate of return and price. Similarly, economist David Martimort developed a dynamic “game-theory” model to explain how capture evolved both across different regulatory agencies and within specific agencies over time. He argued that while agencies start out to protect the public interest, they frequently become inefficient, bureaucratized, and eager to please private interests.<sup>14</sup>

Political economist Ernesto Dal Bó considered a narrower definition of regulatory capture, as the process through which regulated monopolies end up “manipulating” the state agencies that are supposed to control them.<sup>15</sup> He pointed out that although most of the literature has

<sup>12</sup> George J. Stigler, “The Theory of Economic Regulation,” *Bell Journal of Economics and Management Science* 2 (Spring 1971): 3–21, proposes as a general hypothesis that every industry with enough political power to utilize the state will seek to control entry and retard the rate of growth of new firms. Richard A. Posner, “Theories of Economic Regulation,” *Bell Journal of Economics and Management Science* 5 (Autumn 1974): 335–58, distinguishes the “public interest” theory as a response to the demand from the public that markets work efficiently and fairly from a second “capture” theory that is “espoused by an odd mixture of welfare state liberals, muckrakers, Marxists and free-market economists.”

<sup>13</sup> Jean-Jacques Laffont and Jean Tirole, “The Politics of Government Decision-Making: A Theory of Regulatory Capture,” *Quarterly Journal of Economics* 106 (Nov. 1991): 1089–127.

<sup>14</sup> David Martimort, “The Life Cycle of Regulatory Agencies: Dynamic Capture and Transaction Costs,” *Review of Economic Studies* 66 (1999): 929–47, conjectures that capture is enforced through repeated interactions.

<sup>15</sup> Ernesto Dal Bó, “Regulatory Capture: A Review,” *Oxford Review of Economic Policy* 22, no. 2 (2006): 203–25, discusses political influence in the U.S. telecommunications industry.

focused on utility regulation, a literature on political influence has grown alongside it, although empirical evidence for a link between political influence and regulatory outcomes has remained scarce. While there may be no deliberate attempts to manipulate regulation for agency or industry gain in the manner described by Laffont and Tirole, even regulators with the best intentions come to see issues through the same lens as the industry and firms presenting them with information. As British economist John Kay recently characterized these interactions, the most common form of regulatory capture is “honest and may be characterized as intellectual capture.”<sup>16</sup>

Outside of these informative insights, there have been few attempts to consider the nature of the reciprocal exchanges between firms and the authorities that oversee antitrust and merger policy. Although at first sight it might appear illogical to consider these interactions in the context of regulatory capture, it is the case that some nonutility industries, such as the U.K. supermarket retailers, have been subjects of a series of antitrust inquiries. Moreover, in industries characterized by intense merger-and-acquisition activity, one or more firms may be the subject of repeated merger inquiries by the same regulators. Previous analysis of the connection between merger activity and political influence has focused on studies that utilize cross-sectional datasets, where data are investigated for a collection of firms at a single point in time rather than historically, and therefore have not provided the type of longitudinal evidence that is needed to investigate either the possibility of capture in these processes or the critical role of specific entrepreneurs.

In a controversial analysis of U.S. merger practices, Malcolm Coate, Richard Higgins, and Fred McChesney used internal Federal Trade Commission (FTC) files on challenged horizontal mergers in order to test the hypothesis that U.S. antitrust rulings were politically driven.<sup>17</sup> They concluded that pressure from politicians (who tend to favor merger challenges in order to prevent companies from leaving their jurisdictions) increased the likelihood that the FTC would question proposed mergers. Thus, their findings indicated that politics, at least in the 1980s, shaped what had traditionally been viewed as an “independent” merger policy regime.

<sup>16</sup> John Kay, “Better a Distant Judge Than a Pliant Regulator,” *Financial Times*, Nov. 3, 2010.

<sup>17</sup> Malcolm B. Coate, Richard S. Higgins, and Fred S. McChesney, “Bureaucracy and Politics in FTC Merger Challenges,” *Journal of Law and Economics* 33 (Oct. 1990): 463–82. This paper, co-authored by economist Fred McChesney and two former employees of the Federal Trade Commission, made use of non-public information taken from internal FTC files and was obliged to carry a disclaimer stating that the FTC Bureau of Economics had major disagreements with the methodology, analysis, inferences, and conclusions contained in the paper.

A similarly thought-provoking analysis of European mergers, by academic economists Nihat Aktas, Eric de Bodt, and Richard Roll, concluded that European merger policy was protectionist, as it was designed to protect “privileged” firms.<sup>18</sup> Their empirical analysis of 290 proposed mergers screened by the European regulatory authorities in the 1990s showed that intervention was more likely when a leading European firm’s market position would be challenged by an acquiring entity from outside the European Union. This result is supported in a similar economic study by Patrice Bougette and Stéphane Turolla of 229 European mergers between 1990 and 2005, which found that the type of merger remedy proposed (behavioral or structural) differed, depending on the firm’s industry, the country, and the identity of the European commissioner at the time.<sup>19</sup>

Considering the possibility of capture during merger transactions allows for the possibility that influential entrepreneurs could develop competitive advantages for their firms relative to others within their industry. There are examples in the business history literature of such relations between entrepreneurs and government agencies. For example, as part of their extensive historical analysis of the Anglo-Dutch multinational food and toiletries producer and distributor Unilever, Geoffrey Jones and Peter Miskell uncovered evidence of the firm’s lobbying and political influence in the early days of the European Union.<sup>20</sup> Although Unilever did not fund political parties directly, it did provide financial support to campaigns that supported entry in countries seeking to join the Union. Moreover, they pointed out that one of the firm’s chairmen, Paul Rijkens, was the only entrepreneurial figure to have regularly engaged in high-level meetings with the political establishment of the European Commission in those early years. It was likely no coincidence that efforts to introduce a tax on vegetable oil, which would have narrowed the price differential with butter, did not survive the opposition of the Unilever-funded margarine lobby and of various consumer groups.

In the U.K. brewing industry, the nickname “the Beerage” (“beer” plus “peerage”) encapsulates the lobbying power and political influence of the leading firms, reflecting the honors bestowed on the family-led firms of the nineteenth century, and alluding to the political funding by the brewers in return for favorable treatment through the licensing

<sup>18</sup> Nihat Aktas, Eric de Bodt, and Richard Roll, “Is European M&A Regulation Protectionist?” *Economic Journal* 117 (July 2007): 1096–121.

<sup>19</sup> Patrice Bougette and Stéphane Turolla, “Merger Remedies at the European Commission: A Multinomial Logit Analysis,” *MPRA* [Munich Personal RePEc Archive] paper 2461 (Apr. 2007).

<sup>20</sup> Geoffrey Jones and Peter Miskell, “European Integration and Corporate Restructuring: The Strategy of Unilever c.1957–c.1990,” *Economic History Review* 58, no. 1 (2005): 113–39.

system. Following passage of the Licensing Act of 1872 by Prime Minister Gladstone's Liberal government, which restricted opening times of public houses and regulated the content of beer, the beer barons switched their allegiance to the Conservative Party. The barons remained closely aligned with the Conservatives until the 1990s, by which time the political power base of the Beerage was concentrated heavily in the hands of the large brewer-retailers. Even recent discussions in Parliament point to the long and enduring history of the Beerage in the British political system. In a House of Lords debate in 2005, Liberal peer Lord McNally made this comment:

It is a funny old world; it is about 100 years since that great Liberal, Sir Winston Churchill, accused the Conservative Party of drawing a brewer's dray across the road of progress. Of course at that time the Conservative Benches in this House were known collectively as the Beerage. Today, it is the Labour Party that is the brewer's friend.<sup>21</sup>

Political donations from the Beerage to the Conservative Party lasted well into the 1990s.<sup>22</sup> In addition, the large brewers had an influential voice within the Brewers' Society, the industry-funded lobbying group that represented their collective interests. While the Brewers' Society represented the interests of seventy-seven member firms, the membership of its governing council was such that the group known as the Big Seven brewers—Allied-Lyons, Bass, Courage, Guinness, Scottish & Newcastle, Whitbread, and Watney Mann—had a permanent majority.<sup>23</sup> The Brewers' Society was described by the MMC during the 1989 "Beer Orders" investigation as "formidably effective in championing its members' interests."<sup>24</sup>

That the political power of Scottish & Newcastle transcended even the general lobbying power of the industry is evident from its merger history, which featured the critical role played by its chief executive officer, Alick Rankin. The recent review of the business history literature

<sup>21</sup> Lords Hansard, 14 Nov. 2005, column 904. [Hansard is the written record of U.K. Parliamentary debate, either from the House of Commons or the House of Lords].

<sup>22</sup> For example, donations from Allied-Lyons to the Conservative Party in 1991 amounted to £110,000, those of Scottish & Newcastle were £50,000 in 1997, and those of Whitbread were £15,000 in 1990. Donations ceased after those years.

<sup>23</sup> See MMC, "The Supply of Beer: A Report on the Supply of Beer for Retail Sale in the United Kingdom," Cm 654 (1989): 111–12, for details about the members of the Brewers Society and its conduct in the inquiry. Following an intense lobbying campaign, the Brewers Society was credited with forcing the government to partially back down ("Decision on Beer Orders," DTI [Department of Trade and Industry] Press Notice 89/745).

<sup>24</sup> Hansard, 15 Feb. 1995. In a debate on extending Sunday trading hours, Donald Anderson, Labour MP for Swansea, East made this comment: "the brewers were becoming pretty unhappy with the performance of what they deemed to be their Government, and the Government hoped to win back the support of the brewers, which, after all, had provided 10 per cent of Conservative party funds at the previous general election."



by Geoffrey Jones and R. Daniel Wadhvani has opened the possibility of debate about the role of individuals in politics and regulatory conduct. In our consideration, the actions of businessmen like Alick Rankin and his adversary, Elders IXL's John Elliott, in the bitter fight for Scottish & Newcastle during regulatory negotiations are examples of professional managers operating as modern entrepreneurs in the sense discussed by historians Teresa da Silva Lopes and Mark Casson.<sup>25</sup> These managers are the agents who act as conduits between their firms' various stakeholders and the external environment.

Alick Rankin's role in navigating Scottish & Newcastle through its transformation from a regional to an international brewer supplies the template for the firm's success in implementing its subsequent mergers. Scottish & Newcastle's corporate evolution illustrates how political acumen, combined with a grasp of the regulatory framework, conferred a competitive advantage—albeit one that was ultimately transitory—on this firm in a consolidating industry. The management of Scottish & Newcastle adapted to the changing economic and political environment in a manner that enabled the firm to eclipse its major competitors.

### Scottish & Newcastle: Developing a Growth Strategy Based on Mergers

At the time of the publication of the first antitrust investigation into the U.K. brewing industry in 1969, the Big Six major brewer-retailers accounted for nearly 70 percent of British beer production. (See Table 1.) Together with Guinness (a major Anglo-Irish brewer, but unlike the other majors, one that did not own a tied pub estate), these seven firms (the Big Seven) dominated the British brewing industry. As one of the smaller of the Big Six brewer-retailers, Scottish & Newcastle controlled a limited estate of tied houses (retailing outlets that the brewer either owned directly or controlled through a tenancy agreement), owing to the larger incidence of free-trade sales that traditionally characterized the Scottish beer market.

<sup>25</sup> Geoffrey Jones and R. Daniel Wadhvani, "Entrepreneurship and Business History: Renewing the Research Agenda," Harvard Business School working paper 07-007 (2006), conclude that there are opportunities for advancing understanding of the historical role of culture and values on entrepreneurial behavior and the role of institutions in economic growth by exploring the precise relation between institutions and entrepreneurs. Teresa da Silva Lopes and Mark Casson, "Entrepreneurship and the Development of Global Brands," *Business History Review* 81 (Winter 2007): 651–80, distinguish between a "traditional" entrepreneur that flourished in the late-nineteenth and early-twentieth centuries and an "expanded" version of an entrepreneur that emerged in the mid-twentieth century, when professional managers were recruited to manage firms that now relied on external shareholders for capital.

Table 1  
The Principal U.K. Brewers in 1967

<i>Firm</i>	<i>Production (m barrels)</i>	<i>Market Share (%)</i>
Bass Charrington	5.64	18.1
Allied Breweries	4.83	15.5
Whitbread	3.46	11.1
Watney Mann	2.94	9.4
Scottish & Newcastle	2.51	8.0
Courage Barclay & Simonds	1.78	5.7
Total "Big Six"	21.16	67.8
Arthur Guinness	1.53	4.9
Next 11 brewers	4.46	14.3
Final 93 brewers	4.06	13.0
Total U.K.	31.20	100.0

Source: Monopolies Commission, "Beer: A Report on the Supply of Beer," 1969.

The market shares of the leading brewers reflected their regional strengths, as only a handful of beer brands, such as Guinness, bottled Bass, and Worthington, could be considered "national."<sup>26</sup> This was the period prior to the emergence of lager as an important beer category in England and Wales. Regional taste preferences, coupled with the difficulties in transporting draft ales, had limited the scope for developing national brands; in total, there were still around three thousand different brands in the late 1960s.

In a definitive historical analysis of the U.K. beer market, Gourvish and Wilson ascribe the factors leading to the series of regional mergers that created the Big Six as a combination of "defensive anxiety . . . and the search for national status through the acquisition of retail outlets. Emulation of others was also important."<sup>27</sup> Moreover, the arrival of new entrants, both from overseas (the aggressive Canadian United Breweries, controlled by E. P. Taylor) and at home (property developer Charles Clore's failed 1959 hostile bid for Watney Mann), the latter attracted by perceived underperforming assets in key city centers, reminded the U.K.'s foremost brewers of the need to protect and expand their bases.

<sup>26</sup> MMC, "Beer: A Report on the Supply of Beer," HC [House of Commons] 216 (1969): 7, cites Mr. J. A. P. Charrington, president of Bass Charrington, in the *Times*, 22 Apr. 1968, in ascribing regional taste preferences that underpinned the regional nature of the U.K. brewing industry.

<sup>27</sup> Gourvish and Wilson, *The British Brewing Industry*.

During the 1960s, complaints of anticompetitive behavior began to surface in the industry in response to the powerful market positions of the major brewers. With the exception of Guinness, these firms had vertically integrated businesses that encompassed brewing, wholesaling, and retailing. The MMC report identified adverse public interest issues growing out of the industry's vertically integrated structure and the national brewers' collective power. In the early 1970s, only two outsiders managed to enter the industry (Imperial Group and Grand Metropolitan), which they accomplished by acquiring two of the Big Six brewer-retailers. Any ambition to embark on a merger was limited by the prospect of further antitrust pressure, with the result that only piecemeal consolidation of small family brewers occurred at this time.<sup>28</sup> The larger brewers were content to follow the corporate growth trend that prevailed in Britain during the 1970s, which entailed diversifying into other business sectors, such as food manufacturing, retailing, and leisure.

For its own part, Scottish & Newcastle pursued an organic growth strategy during the 1970s, designed to extend its base in Scotland and the Northeast of England southward. The strategy was initially successful, but as beer consumption declined nationally during the recession of the late 1970s, rival brewers responded aggressively, and Scottish & Newcastle's beer sales also declined.<sup>29</sup> Thus, as the 1980s progressed, the firm abandoned its organic approach to growth and adopted a strategy of acquisition while continuing to work toward its aim of becoming a fully fledged national brewer. (The main merger events in the history of Scottish & Newcastle prior to 1995, and the Courage acquisition, are shown in Table 2.)

The transformation of Scottish & Newcastle into the United Kingdom's leading brewer was largely propelled by the elevation of Alick Rankin to the role of chief executive officer in 1983. Rankin held this position until 1989, when he became group chairman, combining that role with other external appointments, such as chair of the Brewers' Society. Rankin's impact was "rapid and profound": the firm's shift toward acquisitive growth commenced in 1984 with negotiations to acquire the Hartlepool-based company J. W. Cameron, the ailing brewing subsidiary of industrial conglomerate Ellerman Group, which controlled 460 public houses and owned the Lion Brewery.<sup>30</sup> Surprisingly, however, this initial attempt to grow through acquisition was referred to the MMC and

<sup>28</sup>Price Commission, "Beer Prices and Margins," report no. 31 (1977), points to the adverse effect on beer prices of a combination of high concentration and vertical integration in the brewing industry, reinforced by restrictive licensing laws.

<sup>29</sup>In MMC, "Scottish & Newcastle Breweries plc and Matthew Brown plc" (1985): 16; Scottish & Newcastle's 1985 beer sales being some 20 percent below their 1975–76 peak.

<sup>30</sup>"Obituary: Sir Alick Rankin," *Independent*, 6 Aug. 1999.

Table 2  
Scottish & Newcastle: Brewery Mergers, 1984–1995

<i>Year</i>	<i>Event</i>
1984	Acquisition of JW Cameron abandoned following referral to MMC
1985	Launched hostile bid for Matthew Brown
1986	Acquired Home Brewery for £123m
1987	Acquired Matthew Brown for £118m
1988	Received hostile approach from Elders IXL, owner of Courage
1989	Elders IXL hostile bid for S&N blocked by MMC
1993	Acquired Chef & Brewer managed pub estate for £628.5m from Grand Metropolitan
1995	Acquired Courage for £430m (included Foster's European distribution rights)

Source: Scottish & Newcastle; Julie Bower, "Strategic Interactions with Competition Authorities in the U.K. Alcoholic Beverages Industry," PhD thesis, University of Warwick, 2007; prices paid were actual at the time of the acquisition.

subsequently abandoned by Rankin. Given the relatively small sizes of both firms and the limited geographic overlap in the pub estates, the reasons for the bid's referral are unclear. According to one view, lobbying by the Campaign for Real Ale (CAMRA), an independent, voluntary organization that champions the rights of consumers in relation to the U.K. and European beer and drinks industry, was a decisive factor in the decision.<sup>31</sup>

Informed by the failure of its first notable acquisition attempt, Scottish & Newcastle announced a hostile bid for the Lancashire-based firm of Matthew Brown in March 1985. Matthew Brown was one of the larger and more successful of the regional brewers that had grown by acquisition in northwest England, eventually extending eastward into Yorkshire with the acquisition of Theakston. Its assets comprised four breweries and 525 tied public houses. The offer document to Matthew Brown's shareholders reveals that Scottish & Newcastle, which had already amassed a 13 percent shareholding in its target, warned that regional brewers like Matthew Brown would find it increasingly difficult to survive on their own in the fiercely competitive domestic beer market. In the document, Scottish & Newcastle argued that the merger would offer new commercial opportunities to Matthew Brown that would guarantee its future.

This acquisition was also referred to the MMC on April 24, 1985. Scottish & Newcastle argued that integration with Matthew Brown presented a means of strengthening its ability to compete more effectively

<sup>31</sup> See Campaign for Real Ale [CAMRA], *Opening Times*, no. 139 (2009): 6.

with the other five national brewer-retailers, in addition to the regional brewers. The national brewer-retailers each controlled between 5,000 and 7,000 tied outlets, whereas Scottish & Newcastle controlled a mere 1,450 and Matthew Brown owned 525. Although its size and demonstrated ability to compete successfully in the free trade gave the firm a competitive advantage over the nationals, Scottish & Newcastle pleaded to the MMC that it needed both to establish a larger platform in the Northwest and in Yorkshire and to gain access to Matthew Brown's English heritage ale brands, in order to strengthen its own ale portfolio.

Significantly, the proposal had the backing of the Industry Department of Scotland, a government department, which stated its belief that the ability of a rejuvenated Scottish & Newcastle to become more competitive with its main rivals would be in the interests of both the industry and consumers. The Scottish officials were of the opinion that any adverse effect on employment resulting from brewery closures would be brief and should be weighed against the longer-term prospects for growth and prosperity that the merged entity would offer.<sup>32</sup> Scottish political interests strongly supported a Scottish firm's effort to compete on a level playing field with its English rivals. Indeed, in a speech to the Scottish Conservative Conference in 1984, Prime Minister Margaret Thatcher made special reference to the secretary of state for Scotland at the time, stating, "Nobody stands up for Scotland more than George Younger."<sup>33</sup> George (later Viscount) Younger was descended from the famous brewing families of William Younger and William McEwan that formed the Scottish half of Scottish & Newcastle. Other government departments declined invitations to make representations about the merger, including the Ministry of Agriculture, Fisheries and Food (the sponsoring department for the brewing industry), the Home Office, and Her Majesty's Customs and Excise. The Department of Employment merely stated that the prospect of increased unemployment did not of itself warrant finding against the merger proposal.

In reviewing the possible impact of this merger, the MMC was particularly concerned about how it would affect regional competition. Once free-trade outlets with exclusive supply contracts were included in the analysis, the commission argued that the firms' joint market share in North and West Cumbria would rise from just under a third to around 50 percent. However, while the MMC considered this prospect problematic, it ultimately accepted the argument put forward by Scottish &

<sup>32</sup> While many third parties were against the merger, in particular those representing interests in the Northwest, others including two Newcastle MPs held supporting views. MMC, "Scottish & Newcastle Breweries plc and Matthew Brown plc," 56–57.

<sup>33</sup> Margaret Thatcher Foundation, Margaret Thatcher's speech to the Scottish Conservative Conference, 11 May 1984.

Newcastle that the issue of increased share would be offset by the relative ease with which free-trade contractors would be able to switch suppliers.<sup>34</sup>

In its concluding remarks, the MMC summarized the public interest arguments that had been addressed in the case, issuing pointers on how subsequent mergers might be considered. Referring to earlier findings by the Price Commission that the existing combination of high concentration and vertical integration in the brewing industry had made new entry difficult, the MMC noted that the objective of enhancing competition among national tied estate brewers was a pressing matter of public interest. The proposed merger was therefore approved on the grounds that it would assist the ability of Scottish & Newcastle to compete with the other Big Six national brewer-retailers.<sup>35</sup>

A strong emotional consideration in MMC investigations at this time was the prospect that mergers would have an impact on local employment opportunities. Drawing on the public interest provision, Matthew Brown's advisers had argued vociferously that, if the bid proceeded, jobs would be lost across the region as a result of some or all of its breweries being closed. In its submission to the MMC, Scottish & Newcastle gave assurances "categorically, publicly, and in writing that without any question whatsoever the Blackburn and Masham breweries [of Matthew Brown] are sacrosanct for continued brewing purposes."<sup>36</sup> No such assurances were given, however, on the Cumbrian-based breweries at Carlisle and Workington that employed collectively some 170 people.<sup>37</sup> Although the bid was cleared in November 1985, it took more than a year of negotiations between the parties before the deal was consummated in early 1987. The long drawn-out acquisition of Matthew Brown represented for Alick Rankin and his team a unique learning experience, as it enabled them to become familiar with the merger policies that were in place at the time and with the mechanism of fighting a hostile bid in the public eye. The experience had been an opportunity for the management to present and argue its case to the MMC—that the

<sup>34</sup>The traditional vertically integrated structure of the U.K. beer market was underpinned by a property tie. The brewers owned licensed premises, both managed and tenanted, where only their brands were sold. However, a major part of the free trade was also tied to the large national brewers by way of loans, often at levels considerably below market interest rates in return for various buying obligations.

<sup>35</sup>MMC, "Scottish & Newcastle Breweries plc and Matthew Brown plc," 64.

<sup>36</sup>*Ibid.*, 66.

<sup>37</sup>In an Adjournment debate, Jack Straw, Labour MP for Blackburn, pointed to the "flagrant breach of categorical undertakings to keep open the Blackburn brewery given by Scottish & Newcastle to the Monopolies and Mergers Commission in 1985 and repeated on many subsequent occasions in 1987, 1988 and 1989. The question raised by Scottish & Newcastle's conduct is identical to that which arose in the takeover of Distillers by Guinness." *Hansard*, 22 Nov. 1990.

U.K. beer market needed a strengthened free trade-oriented supplier like Scottish & Newcastle as a counterforce to the major national vertically integrated brewers—and gave the firm the chance to garner general pointers from the regulators on how to apply the public interest provision in future brewery mergers. How far the firm had honed these crucial skills was put to the test two years later, when the Australian company, Elders IXL, sought to strengthen its base in the United Kingdom ahead of staging an assault on mainland Europe.

### Regulatory Capture and the Entry of Elders IXL into the U.K. Market

In 1983, Elders IXL, one of Australia's largest firms, entered its domestic brewing industry via the acquisition of Carlton United Breweries (CUB), producer of Foster's lager and one of the country's duopoly brewers, representing a market share of 47 percent. Elders' ambitious management, led by former McKinsey management consultant John Elliott, believed that the U.K. beer market was ripe for rationalization.<sup>38</sup> He recognized that the beer industry was becoming increasingly international and sought to use Britain as the platform for expanding into Europe. In October 1985, Elders IXL launched a hostile bid for the diversified British brewing firm Allied-Lyons. Elders' bid was referred to the MMC on December 5, 1985, by Secretary of State for Trade and Industry Leon Brittan, who was concerned, rather unusually, that the bidder's use of substantial financial leverage was a matter of public interest. Although the bid was eventually cleared by the MMC in September 1986, the lengthy inquiry gave Allied-Lyons' management enough time to embark on its own "poison pill" acquisition strategy. Allied initiated its plan by buying control of the major Canadian spirits firm Hiram Walker and then wooing City financial analysts with an invitation to visit—on a specially chartered Concorde flight—its newly acquired North American operations.<sup>39</sup> The combination of the time delay, the strong City backing, and the increased size and complexity of the Allied-Lyons enterprise were more than sufficient to dissuade Elders IXL from continuing its approach, notwithstanding the bid's eventual clearance by the MMC.

Unwilling to be diverted from its U.K. and European strategic objectives, in November 1986 Elders IXL bid successfully in the auction

<sup>38</sup>Sir Alick Rankin's obituary noted that Elders IXL was "not conspicuously constrained by the finer points of British market etiquette." *Independent*, 6 Aug. 1999.

<sup>39</sup>"Drinks analysts wistfully recall the heady 1980s when Allied Domecq hired Concorde for a week, and flew them all to whisky distilleries in Scotland, Canada, America and France; 'I think that marked the peak,' says one." *Telegraph*, 24 June 2000.

for the brewing firm Courage, which had become available as an orphan asset following Hanson Trust's acquisition of Imperial Tobacco.<sup>40</sup> With the takeover of Courage completed, Elders IXL contacted Scottish & Newcastle to propose forming a national distribution system, motivated by consideration of the complementary nature of Courage's southern-based brewing and pub estate and the northern focus of Scottish & Newcastle's assets. The debate extended to an agreed merger of the two beer businesses under Scottish & Newcastle's control. However, in an attempt to speed the transaction, Elders IXL began to buy shares in Scottish & Newcastle. The two companies held further rounds of meetings, during which time Elders' management further increased its firm's shareholding in Scottish & Newcastle. When no agreement was reached between the parties, Elders launched a £1.6 billion hostile bid on October 17, 1988.

The Elders bid for Scottish & Newcastle was referred to the MMC on November 9, 1988. Two days earlier, Scottish & Newcastle had published its defense document, in which it pointed to an "already overgeared" Elders IXL balance sheet—the reason for the secretary of state's decision to refer Elders' earlier hostile bid for Allied-Lyons—and stated, "Courage is now poorly positioned for the future. It is trying to buy the success that it will find hard to achieve through organic growth."<sup>41</sup> The true irony of these arguments only became apparent seven years later, when Scottish & Newcastle directly acquired Courage.

Scottish & Newcastle's auditor, Arthur Young, provided a detailed balance-sheet analysis of Elders IXL, supporting the view that the bid amounted to a highly leveraged deal that should be referred, and possibly blocked. The defense document was bolstered by helpful comments from the City and from leading newspapers. The *Financial Times* concluded, "The deal is a straight forward financial manoeuvre."<sup>42</sup> Scottish & Newcastle mustered support from all official quarters in its defense. Supportive submissions to the inquiry were made by the Industrial Department of Scotland, the Scottish Development Agency, Scottish Financial Enterprise, Scottish Trades Union Congress and various regional chapters of trade unions, the Bank of Scotland, and a host of Scottish MPs spanning all political parties. The Scottish Council on Alcohol recorded its view that the social awareness shown by Scottish & Newcastle regarding the alcohol abuse debate might be "jeopardized if the merger proceeded" (thereby suggesting that the Australian firm had less social

<sup>40</sup> Imperial bought Courage in 1972 as part of its strategy of diversifying away from tobacco.

<sup>41</sup> "Scottish & Newcastle Breweries plc Support a Successful Company—Reject the Elders Offers," [Scottish & Newcastle defense document] 7 Nov. 1988, 3.

<sup>42</sup> The Lex Column, *Financial Times*, 12 May 1988, 5.



awareness).<sup>43</sup> Against this array of forces, the Bank of England made a written submission stating that neither the financing of Elders IXL nor the resulting merged entity raised material concerns about either competition or the public interest.

The actions of Elders IXL directed toward the U.K. Takeover Code were aggressive by British standards. On the morning of the referral, Elders bought more shares in the stock market, increasing its holding in Scottish & Newcastle almost to 24 percent. This action prompted Secretary of State for Trade and Industry Lord Young to take the unprecedented step of ordering a freeze of the shareholding and limiting Elders' voting rights to 15 percent of the equity. Elders justified its actions on the basis that they were designed to stop Scottish & Newcastle from instigating an Allied-style "poison pill" strategy during the course of the MMC investigation. Moreover, Elders claimed that its actions did not breach the Substantial Acquisition Rules of the Fair Trading Act. Nonetheless, during the course of Elders' bid, Scottish & Newcastle spent £115 million to acquire the Pontin's holiday park business. The Pontin's management team later recalled, "Scottish & Newcastle were under threat from Elders IXL, which had launched a bid and S&N wanted to buy a U.K. leisure business. . . . It was a sort of poison pill."<sup>44</sup>

The MMC concluded that the merger of Elders IXL and Scottish & Newcastle would undermine the public interest, on the grounds that it would lead to the loss of the independence of one of the major suppliers to the market. The decision, which emphasized mainly the competition in free-trade pubs (i.e., pubs *not* tied to a brewer), was made despite written submission by the two major supermarket groups, Tesco and Sainsbury, that no such adverse consumer impact would result from the merger. The commission's reason for blocking the merger is significant on two counts. First, during the MMC inquiry into the Matthew Brown merger bid, Scottish & Newcastle had itself argued successfully that free-trade supply contracts were irrelevant because those contracts readily changed hands. Second, by the mid-1980s, sales in the take-home trade, which was increasingly dominated by the supermarkets, represented more than 15 percent of the total beer market, a figure that approximately equaled the business conducted by free-trade pubs.<sup>45</sup> Elders IXL's unsuccessful hostile bid for Scottish & Newcastle in 1989 coincided with the publication of the MMC's detailed multiyear investigation of competition in the U.K. beer market, which culminated in

<sup>43</sup> MMC, "Elders IXL Ltd. and Scottish & Newcastle Breweries plc: A Report on the Merger Situations," Cm 654 (1989): 94.

<sup>44</sup> Parr is taking another punt on Pontin's', *Daily Telegraph*, 30 Mar. 2008, 2.

<sup>45</sup> MMC, "The Supply of Beer" (1989): 31.

what became known as the Beer Orders. In its investigation, the MMC concluded that a complex monopoly favored brewers that owned tied houses, or who had loan-tied agreements (at reduced interest rates) with free houses, restricting the growth of brewers without tied estates. The MMC recommended that a ceiling of two thousand tied on-license outlets should be placed on any one brewery group, and that loan tying should be eliminated in order to “restore a substantial measure of genuine freedom to the ‘free’ trade.”<sup>46</sup>

The decision to block the Elders IXL bid was published on March 8, 1989, in the same month as the publication of the antitrust enquiry. Members of the Elders IXL investigation team at the MMC, while acknowledging that they had been given an advance copy of the antitrust report, stated that they had reached their decision on the merger based only on the evidence in front of it. Yet the degree of industry lobbying and political intervention that occurred over the course of the Beer Orders enquiry was clearly extensive, making it difficult to imagine that the Elders bid inquiry operated in a vacuum, unaffected by political considerations. Had the MMC decided not to recommend that the merger be blocked, it is likely that the secretary of state could have been persuaded to countermand its decision, given the powerful political connections of Alick Rankin (and his team) to important players in the Conservative Party.

In response to the MMC’s ruling against its bid for Scottish & Newcastle, Elders’ management issued general criticisms of the British brewing industry’s restrictive structure and operation and suggested that the industry was subject to an unwarranted degree of political interest. The managers stated their opinion that the industry “attracted an unusual amount of sentimental interest which should not be confused with genuine public interest issues. . . . [and] was highly regulated and very ‘political.’”<sup>47</sup>

Both the relative market shares, shown in Table 3, and the falling trend in beer consumption patterns in the United Kingdom implied that rationalization of supply through merger activity would become an economic inevitability. Annual U.K. beer consumption peaked at forty-two million barrels in 1979 and then declined to thirty-five million barrels by the end of the 1990s.<sup>48</sup> The Brewers’ Society pointed to “substantial excess capacity for ale production and substantial new investment in lager production facilities.”<sup>49</sup> Estimates from within the

<sup>46</sup> *Ibid.*, 5.

<sup>47</sup> MMC, “Elders IXL Ltd. and Scottish & Newcastle Breweries plc,” 63–64.

<sup>48</sup> Bower, “Strategic Interactions,” shows U.K. beer consumption from 1899 to 2004 in Table 2.3.

<sup>49</sup> MMC, “The Supply of Beer,” 118.

Table 3  
The Principal Producers of Beer in 1985

Brewer	Production (m barrels)	Market Share (%)
Bass	8.4	22.9
Allied-Lyons	4.7	12.8
Whitbread	4.0	11.0
Scottish & Newcastle	3.9	10.6
Watney (Grand Met)	3.2	8.8
Courage (Elders)	3.2	8.7
Total Big Six	27.3	74.8
Total U.K.	36.6	100.0

Source: Monopolies and Mergers Commission, "The Supply of Beer: A Report on the Supply of Beer for Retail Sale in the United Kingdom," 1989.

industry suggested that overcapacity in U.K. brewing exceeded ten million barrels at the time of the Beer Orders enquiry.<sup>50</sup> The ongoing shift in consumption from traditional ale to lager underpinned the arguments for rationalizing capacity and consequently for consolidation among existing firms.

The political pressures that advanced a decision to block the Elders bid were laid bare in retrospective accounts of the episode. In mourning the demise of Scottish & Newcastle, which occurred in 2007, the *Herald Scotland* commented as follows:

In constructing a defence of his company, Rankin played a political blinder. First, despite some rather flimsy evidence on market overlap between S&N and Courage . . . he succeeded in getting the Elders bid referred. . . . There were suggestions at the time that Buck House [Buckingham Palace] had dropped a few supportive hints in appropriate ears.<sup>51</sup>

The article went on to discuss the close link between Scottish & Newcastle and the Conservative Party in Scotland and to explore the firm's status as that nation's largest manufacturing company.

The ability of Scottish & Newcastle to invoke the right of the political (Conservative Party) machine to interfere directly in regulatory outcomes is well documented. The nature of the relations between the MMC and the secretary of state in the U.K. merger regime of the 1980s and

<sup>50</sup> MMC, "Elders IXL Ltd. and Grand Metropolitan plc: A Report on the Merger Situations," Cm 1227 (1990): 11–12, gives estimates of capacity utilization for the major U.K. brewers.

<sup>51</sup> "Who Will Toast Victory in the Brewing Beer Wars," *Herald Scotland*, 19 Oct. 2007.

1990s suggests extensive political influence over the MMC's enquiries; the secretary's overriding authority gave him enough leeway to influence the MMC's deliberations and indirectly leading to capture. However, even if this were not the case, it is possible to conjecture that by the time Scottish & Newcastle appeared before the MMC with its defense against the Elders hostile bid, it had, at the very least, gained a better understanding of how the inquiry would proceed and of which arguments would find favor with the MMC. In all, the history of Scottish & Newcastle's merger-based growth strategy appears to offer a clear example of the process of intellectual capture as postulated by Kay.

### Postscript: The 1995 Courage Reverse Merger

Having escaped the clutches of Elders IXL, Scottish & Newcastle was in the fortunate and unique position among the Big Six of not having an estate of tied houses that was sufficiently large to require divestment in order to comply with the terms of the Beer Orders. Since the Beer Orders were undermining the vertically integrated structure of the U.K. brewing market, the remaining members of the Big Six were forced to consider alternative options for their British operations.<sup>52</sup> Having undergone two failed mergers, it is not surprising that Courage's parent, Elders IXL, was an early mover in developing a new beer strategy. On March 12, 1990, Elders IXL and Grand Met (its U.K. beer distribution partner) announced their agreement to swap brewing and pub assets through a complex three-stage process.<sup>53</sup> The following year, Allied-Lyons announced that it was merging its U.K. brewing operations with those of Carlsberg AS to form Carlsberg-Tetley Ltd. Both deals were designed to improve brewing efficiency at a time when beer consumption was declining, particularly in the pub trade.<sup>54</sup>

As the 1990s progressed, both Allied-Lyons and Grand Met saw their futures moving into the international spirits industry. Whitbread

<sup>52</sup>Terry R. Gourvish, "Mergers and the British Brewing Industry," in *Management and Business in Britain and France* (1995), eds. Y. Cassis, F. Crouzet, and T.R. Gourvish, Clarendon Press, U.K., refers to a market strategy for all the major brewers, except Guinness, that from 1880 to 1900 was based on the acquisition of existing firms to build vertically integrated structures.

<sup>53</sup>Courage acquired the brewing assets of Grand Met. Grand Met took a 50 percent shareholding in the Courage tenanted pub operation, renamed Inntrepreneur Estates Ltd. (IEL), and injected its 3,565 tenanted pubs. Both the wholly owned Grand Met-managed pubs and IEL signed ten-year exclusive supply contracts to Courage, subsequently revised to five years to comply with EU law.

<sup>54</sup>In MMC, "Elders IXL Ltd. and Grand Metropolitan Plc" (1990): 35-36, Courage gave evidence of readily attainable efficiencies. In MMC, "Allied-Lyons plc and Carlsberg A/S: A Report on the Proposed Joint Venture," Cm 2029 (1992): 44, there is broad agreement with Courage on the strong buying power of the multiple grocers and the potential for considerable efficiency savings in both beer production and distribution.

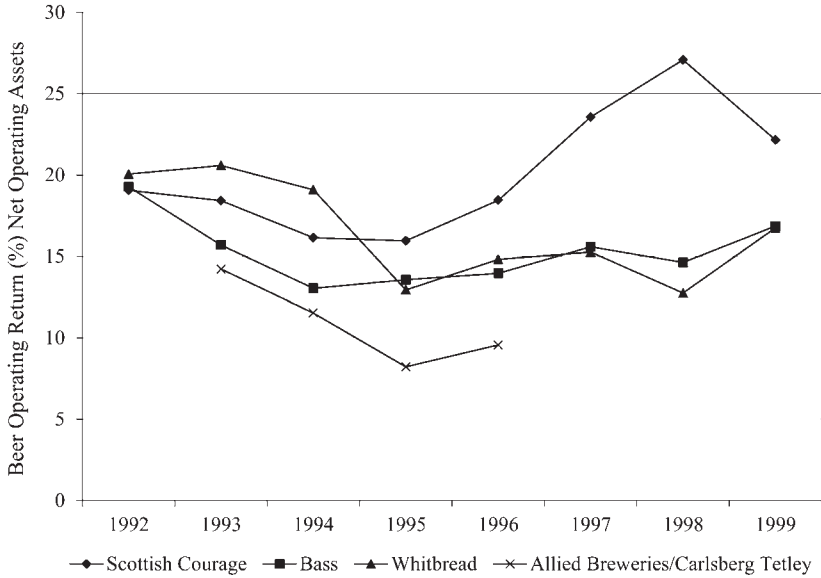


Figure 1. Operating returns of major U.K. brewer-retailers. (Source: Julie Bower, “Strategic Interactions with Competition Authorities in the U.K. Alcoholic Beverages Industry,” PhD thesis, University of Warwick 2007, Figure 5.2, compiled from published financial data in annual reports and accounts of Allied Domecq, Bass, Scottish & Newcastle and Whitbread, 1990–2000.)

and Bass, both confident in their competitive advantage in the United Kingdom, made no move to consolidate their operations, either in brewing or retailing, ignoring the efforts of countless corporate financiers. In fact, the need for further consolidation in brewing was becoming evident from the operating return trajectory of the industry’s major brewer-retailers during the 1990s. (See Figure 1.)<sup>55</sup>

On May 18, 1995, Scottish & Newcastle made the surprise announcement that it had agreed to buy Courage from Fosters Group, the renamed Elders IXL, for £425 million. Through this acquisition, Scottish & Newcastle gained not only the brewing rights to Foster’s in Britain and continental Europe but also, crucially, leadership of the U.K. brewing market. With close to a 30 percent market share, it was seven percentage points higher than the long-term market leader Bass, and it

<sup>55</sup> Figure 1 depicts the Big Six at the time of the 1995 merger of Scottish & Newcastle and Courage. In aggregate they accounted for approximately 80 percent of U.K. production. Guinness was categorized separately, in “Brewers without Tied Estate” in the 1989 MMC inquiry, which, in aggregate, accounted for 8 percent of U.K. production and is omitted from this chart; it was not a vertically integrated U.K. brewer and its major focus was outside the U.K.

had also acquired some of Britain's leading beer brands and most efficient breweries.<sup>56</sup> The management team, now led by Brian Stewart, with Sir Alick Rankin as chairman, outlined the rationale for the acquisition as essentially one of geographic expansion: the acquisition of a "complementary portfolio of national and regional brands," coupled with opportunities for establishing cost leadership through "substantial operating economies of scale."<sup>57</sup> In reality, having acquired the Chef & Brewer pub chain from Grand Met some two years earlier as a platform for growth in London and the Southeast, Scottish & Newcastle recognized not only the significance of the Courage brands that supplied that estate but also, de facto, the weakness of its own existing brand portfolio to supply the pubs when the Courage supply contract expired in March 1995.<sup>58</sup>

From the outset, the management of Scottish & Newcastle was confident that the merger would proceed unchallenged on the basis of "soundings" that had been taken from the Office of Fair Trading.<sup>59</sup> The merger was duly transacted as planned, without a referral for MMC investigation, notwithstanding its breach of the 25 percent market-share threshold. With the Conservative Party's term in office coming to an end in May 1997, a Scottish firm that had previously fared well in the competition policy sphere was, perhaps, the only big brewer that was sufficiently bold—and well connected—to attempt to breach the horizontal market share "rule." Various debates in the House of Commons made it clear that a future Labour government would offer few favors, either to Scottish & Newcastle or to the Beerage in general.<sup>60</sup> The threat to the industry of a more powerful Scottish & Newcastle forced an almost immediate reappraisal of strategies at the remaining national brewer retailers. As the regulatory regime seemed prepared to entertain greater horizontal integration, complete dismantling of the vertical tie now seemed a realistic prospect. With the benefit of hindsight, the challenge became to conduct transactions while the Conservatives were still in office.

<sup>56</sup> The acquisition gave Scottish & Newcastle two of the U.K.'s leading beer brands, Foster's and John Smith's, that collectively accounted for nearly 30 percent of Courage's volume. Foster's was the second largest lager brand in the U.K. The deal also added modern and relatively more efficient plants at Reading and Tadcaster to add to the existing brewery and then state-of-the-art canning line in Edinburgh.

<sup>57</sup> "Scottish & Newcastle plc Proposed Acquisition of the Courage Business and Rights Issue," Listing Particulars document (1995): 8.

<sup>58</sup> "Scottish & Newcastle plc: Proposed Acquisition of the Chef & Brewer Estate and Rights Issue," Listing Particulars document (1993): 4.

<sup>59</sup> Julie Bower attended the analyst briefing on the day of the merger announcement.

<sup>60</sup> Matthew Brown Brewery, Adjournment debate called by Mr Jack Straw, Labour MP for Blackburn, *Hansard*, 22 Nov. 1990.

Bass, the market leader in the United Kingdom since the 1960s, had been pursuing an organic growth strategy for its domestic brewing operation; its market share of 23 percent severely restricted options for growth by acquisition. During the early 1990s, Bass came under strong pressure from its shareholders to simplify its structure and develop a cohesive group strategy for its core businesses of brewing, pub retailing, and hotels. During this debate, it abruptly lost its U.K. market leadership position to Scottish & Newcastle. On August 25, 1996, Bass announced that, conditional on regulatory approval, it was merging its brewing operations with those of Carlsberg-Tetley by acquiring Allied Domecq's 50 percent stake.<sup>61</sup> The proposed merger was referred to the MMC and, in June 1997, given provisional clearance based on a majority decision.<sup>62</sup> However, the publication of the findings corresponded with a change in government, and the new (Labour Party) secretary of state for trade and industry, Margaret Beckett, blocked the merger. Following this decision, Bass embarked on a full-scale restructuring of its portfolio of businesses that led, in 2000, to its exit from U.K. brewing through a £2.3 billion sale to Belgian brewer, Interbrew, owner of the Stella Artois brand.

At the same time, Whitbread was also considering its strategy in light of the new Beer Orders operating environment and in response to the strategic moves of its close competitors. Its survival as a first-division national brewer had long been questioned, largely due to the firm's reliance on the British license agreements for Heineken and Stella Artois. The Whitbread Brewing Company (WBC) was gradually phased down within the group and, in May 1999, Whitbread signaled that it was staking its future firmly on leisure and retailing with the announcement that it had agreed to buy Allied Domecq's U.K. pub and off-license assets for £2.36 billion. Simultaneously, and mindful of regulatory requirements, Whitbread announced that it would divest its brewing operations when the acquisition was completed. Surprisingly, the Office of Fair Trading advised the secretary of state to refer the bid to the MMC's successor, the Competition Commission.<sup>63</sup> Whitbread decided to abandon the acquisition, although it carried through its objective of

<sup>61</sup> Bass Carlsberg Tetley would have created the U.K.'s largest brewer with 37 percent market share of beer production and a tied estate of 4,400 pubs.

<sup>62</sup> MMC, "Bass plc, Carlsberg A/S and Carlsberg-Tetley plc: A Report on the Merger Situation," Cm 3662 (1997): 30, noted that Professor Newbery, while fully accepting the public interest findings, was not persuaded that the proposed remedy would adequately address the substantial increase in market power accruing to BCT.

<sup>63</sup> "The bid by brewery giant Whitbread for the pub and restaurant business of Allied Domecq has suffered a serious setback, after a decision by Trade Secretary Stephen Byers to refer the deal to the Competition Commission," BBC Web site ([www.news.bbc.co.uk/1/hi/business/394496.stm](http://www.news.bbc.co.uk/1/hi/business/394496.stm)), 14 July 1999.

exiting brewing, and, in May 2000, it sold the business to Interbrew for £400 million.

Thus, in its almost effortless acquisition of Courage, Scottish & Newcastle succeeded in carrying through the merger that the MMC's decision to block the Elders IXL bid had prevented in 1989. The move enabled the company to secure a leading position in U.K. brewing, which it would go on to use as the platform for expansion into Europe after 2000. Its victory effectively led to the exit of long-time market leader Bass, and its other key competitor Whitbread, from the industry altogether.

### Conclusions

This analysis paints a stark picture of the ability of Scottish & Newcastle's management team to exploit its political influence and, using its experience of Britain's merger regulation apparatus in the 1980s and 1990s, enable the firm to carry out its expansion strategy. While its successful defense against a hostile approach from Australian conglomerate Elders IXL might have been attributable to the mistakes made by an overly aggressive Elders' management under John Elliott, its avoidance of the provisions of the 1989 Beer Orders may be ascribed to the limit on pub ownership set by the authorities. However, its success in avoiding an investigation when crossing the 25 percent market-share threshold in acquiring Courage is more difficult to explain without recourse to some form of higher level political influence, since a decision to approve the acquisition was made before the MMC's advice was sought. Contemporaneous documents and retrospective accounts all point to the strength of the political connections of Scottish & Newcastle's top manager, Sir Alick Rankin, which transcended even the powerful lobbying of the wider domestic brewing industry. While Sir Alick was no longer directly part of the day-to-day management team, Courage was transacted under his tenure as group chairman, a position that naturally brings individuals into contact with the wider political establishment.

The *Independent* newspaper's obituary of Sir Alick Rankin in 1999 points to the political forces at work behind the scenes:

Elders was a daunting opponent but, to its apparent surprise, it found Rankin's S&N equal to the challenge. In a campaign that was not without subsequent irony, Rankin played the Scottish card to mobilise both public and political opinion in defence of S&N. . . . The episode made Rankin's reputation, and saw him invited on to numerous blue-chip boards. . . . At the same time he was gaining public recognition as a leading light in the ranks of the quangocracy [independent organisations financed by government] which ran



much of public policy in pre-devolution Scotland, and he became a key ally of Scotland's embattled Tory ministers.<sup>64</sup>

Explaining the Scottish & Newcastle case purely by reference to the stated competition rules of the prevailing U.K. merger regime is fraught with difficulty, given the inconsistency of the various rulings that were made over the period. Not only was the role of political influence clearly important—in particular the “special interest pleading” of the Scottish lobby—but also a case can be made for the existence of a form of capture by a politically well-connected firm in its sequential interactions with the British merger regime, enabling it to triumph on several occasions during a period of industry upheaval. A politically well-connected and influential figure supported by a wider special-interest lobby (Scottish business interests) might be optimally situated to learn from the complex axis comprising the government, its regulatory agents, and industry and from the opportunities that it might present.

More than two decades after Casson identified a knowledge gap in his detailed analysis of the entrepreneur, the subject is still open for consideration in the business history literature.<sup>65</sup> Despite a return to longitudinal case studies of firms and industries in both the business history and corporate strategy literature, little scholarly attention has been paid to the impact of political relations and pressures on how mergers and acquisitions influence firm performance and industry structure. As Jones and Wadhvani point out, “There are major opportunities to complement existing research on the role of institutions in economic growth by exploring the relationship between institutions and entrepreneurs.”<sup>66</sup> In this sense, our article links the study of regulatory capture in economics to the study of the entrepreneur's role in order to close the gap in knowledge that exists at the convergence of corporate strategy and the regulatory framework of government. Navigating this interface on behalf of both bidding and target firms would appear to be crucial to the study of corporate growth strategies built on the use of mergers and acquisitions.

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<sup>64</sup>“Obituary: Sir Alick Rankin.”

<sup>65</sup>Mark Casson, *The Entrepreneur: An Economic Theory* (New York, 1982), 9, sets out the dichotomy of neoclassical economic theory and the Austrian school in developing an adequate predictive economic theory of the entrepreneur.

<sup>66</sup>Jones and Wadhvani, “Entrepreneurship and Business History,” 34.

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