Scenario-based strategies for Carlsberg in China

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Agenda

1. Company overview
2. Carlsberg’s operations in China
3. Problem identification
4. China’s geopolitical landscape
5. Chinese beer market
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8. Conclusion

Carlsberg Group

"Probably the best beer in the world"

Background

- Founded in 1847 by J.C. Jacobsen, emphasizing quality, research, and community service
- Celebrated 175th anniversary in 2022
- Over 140 beer brands including flagship beers Carlsberg Pilsner and Tuborg, premium 1664 Blanc, alcohol-free options, and regional specialty beers
- Global workforce of around 40,000
- Brands enjoyed in over 150 markets; diversified presence in Western Europe, Asia, and Central & Eastern Europe

Sustainability

- Enhanced ESG programme: Together Towards ZERO and Beyond (TTZAB)
- Goal to achieve net-zero carbon emissions by 2040 and improve water efficiency by 2030

Strategic operations

- Launched SAIL'27 to boost portfolio, market presence, operations, and culture
- Aims for top-line revenue growth and bottom-line profitability through this strategy

11.5bn
OPERATING PROFIT (DKK)

70.3bn
REVENUE (DKK)

Carlsberg’s current operations in China

History and growth in China

Carlsberg's relationship with China began in 1876 with its first beer export there. In 2002, the company significantly invested in China's western regions, aligning with the country’s Western Development Strategy. Carlsberg China has grown to become the fifth-largest beer company in China.

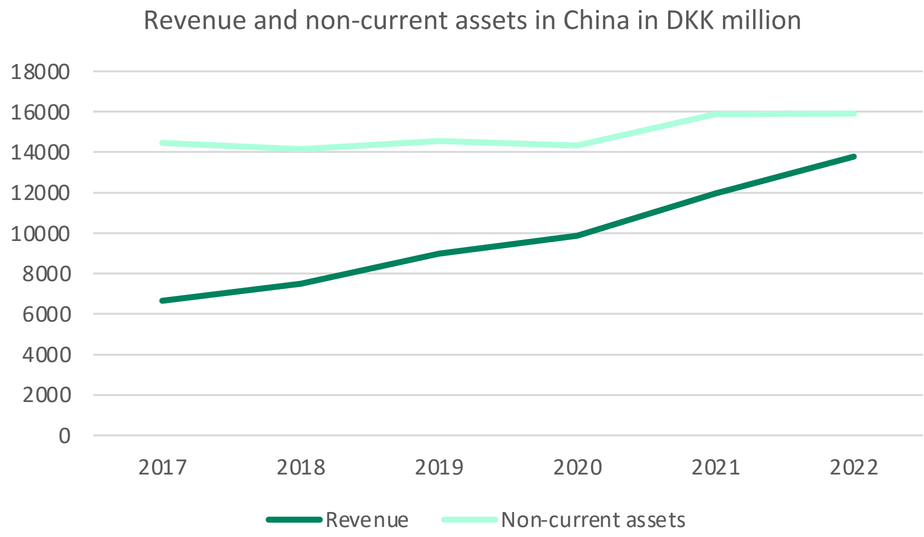
Future outlook in China

Carlsberg foresees significant growth opportunities in China. The company plans to leverage its mix of international premium and strong local brands to expand further. Carlsberg will focus on a 'big city' approach and aims to enhance its presence in emerging retail channels, including e-commerce and modern off-trade.

Key facts

- Breweries: 26
- Market position: 5th
- Chongqing Brewery Company (CBC) serves as the operational platform in China
- Carlsberg China features a "6+6" brand portfolio with 6 international premium brands and 6 local brands
- In 2021, Carlsberg's sales volume growth in China was threefold compared to the overall Chinese beer industry
- Operations are recovering from the Covid-19 pandemic

Strong revenue development



Problem identification

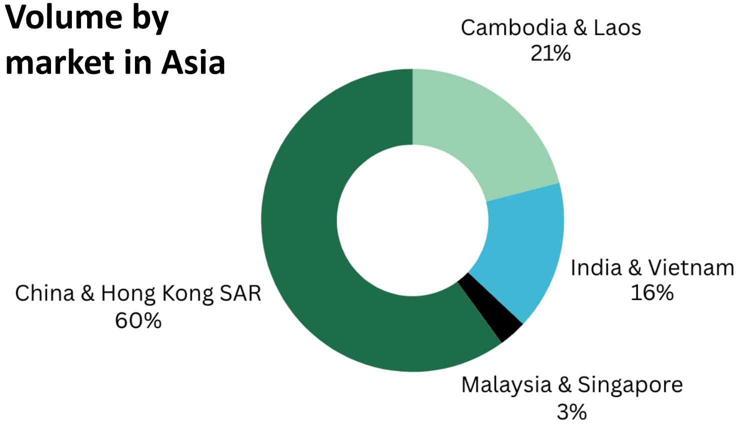
Key considerations

Attractive Chinese brewing market: The Chinese brewing industry is expected to reach a value of US$151 billion by 2026, driven by a growing middle class, urbanization, and a shift in consumer preferences towards premium and craft beers.

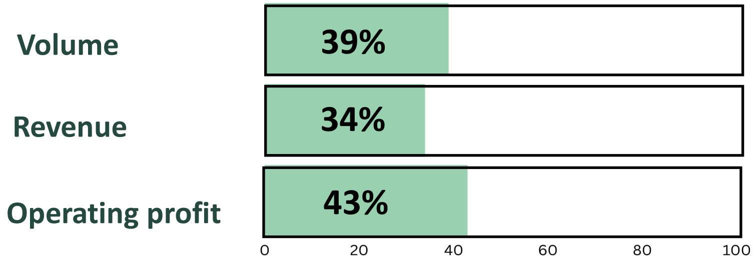
Political situation: Geopolitical uncertainties in the Chinese brewing market arise from shifting trade policies and diplomatic relations, which can affect raw material imports and export dynamics, with implications for investment and production costs.

Impact of Russian aggression: Carlsberg faced significant geopolitical challenges from the war in Ukraine, leading to the divestiture of its Russian operations and a goodwill impairment of DKK 700 million in March 2022.

Volume by market in Asia



Share of regions



How the developments in the Chinese brewing market impact Carlsberg's operations in China, and what are the best strategies to the evolving environment?

China’s geopolitical landscape

Carlsberg Group

China's ascent as a global economic and military power is underscored by its ambitious trade initiatives and expanding international business engagements. Its dynamic yet contentious relationship with the United States spans trade, technology, and security, while its assertive stance on Taiwan shapes its regional and global diplomatic interactions.

- **Decoupling for self-reliance:** China's "Made in China 2025" and dual circulation strategies aim for technological self-reliance and domestic innovation
- **Economic diversification & currency Internationalization:** Diversifying its economy and promoting the CNY's global role are central to China's strategy to reduce Western financial system dependency
- **Domestic market & technological independence:** Boosting local consumption and tech development is key to China's market resilience and tech independence

- **Navigating shifting alliances & friendshoring:** China adapts to new trade realities and friendshoring by diversifying partnerships and recalibrating supply chains
- **Trade dynamics & diplomatic engagement:** Faced with trade disputes and shifting Western policies, China is reinforcing its diplomatic ties and advocating for an international order that suits its interests
- **Global tech dominance & standards:** To counter Western tech decoupling, China aims to establish its own global tech standards and secure market influence

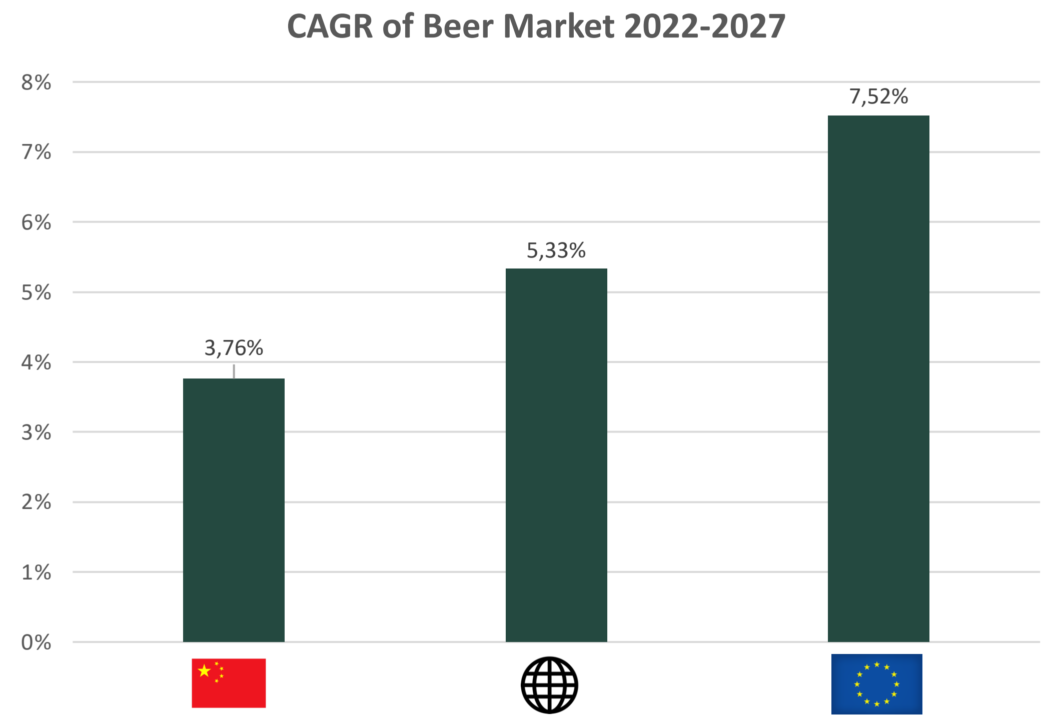
Chinese beer market

Key facts

China is the world's leading beer market. In 2022 beer revenues in China accounted for 121.4 mil. USD.

Expected CAGR 2022-2027 is 3.76% compared to global CAGR of 5.33%.

Fast growth of craft beer in China. Craft beer is popular especially in Tier 1 cities because of its higher prices..

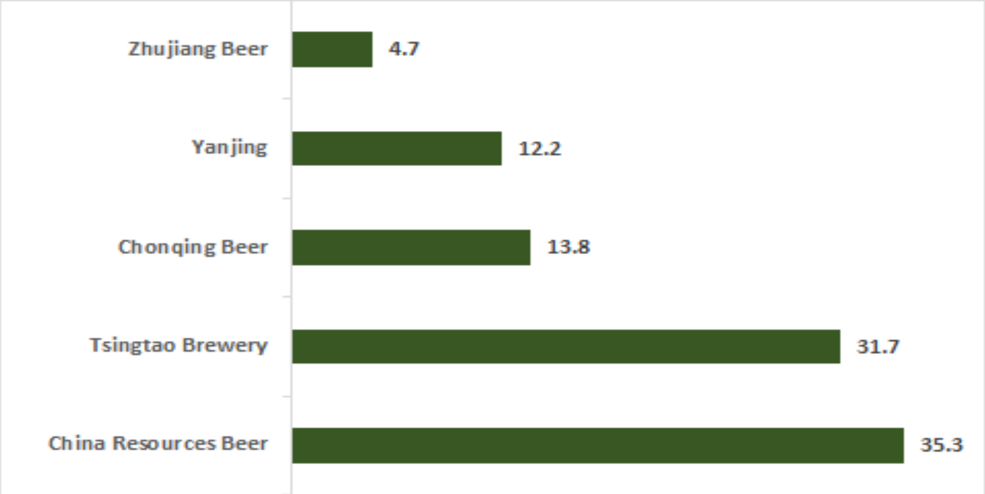


Chinese beer market is expected to grow slower than European and global market in coming years. Despite this fact, it remains very attractive for brewing companies.

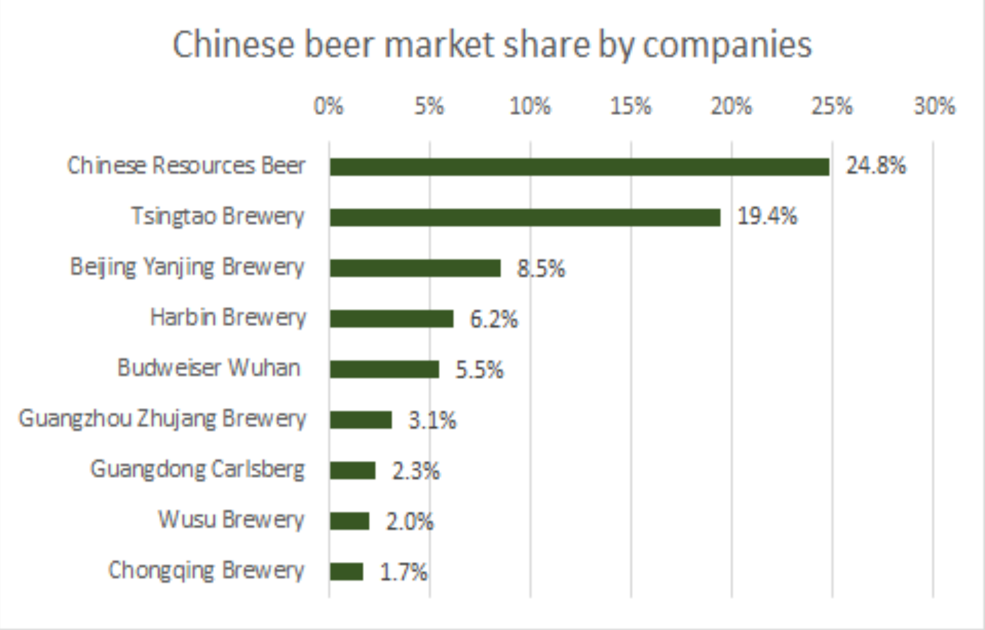
Foreign and domestic competition in China

Competition

- **Very strong position of local companies** in Chinese market, owning the majority of market share.
- Domestic beer brands in China benefit from superior base markets, geographically distinct branding, and better local **consumer loyalty**.
- In 2022, the revenue of the brand **Budweiser** beer alone generated nearly **RMB 7 billion** (USD 974 million), establishing itself as one of the leading brands in the market.
- **Heineken** entered the Chinese beer market back in **1983**,the company took a significant step by buying **40%** of CR's stakes as part of a partnership
- In the first half of 2022, Heineken registered **double-digit growth**, thanks in part to CR Beer's youth-oriented marketing strategies



Revenue of Chinese beer companies (2022) Billion RMB



Scenarios

1. **Changing environment & consumer preferences**

The expansion of the middle class in China has led to changing preferences

2. **Chinese market losing attractivity**

Growth of Chinese beer market will not meet expectations

3. **Escalation of geopolitical tensions**

The US-China relationship deteriorates and global economic instability significantly impacts Carlsberg

Changing environment & consumer preferences

Changing environment & consumer preferences

Demand Shift

- The **expansion** of the **middle class** in China has led to increased **disposable income** for households
- This creates a **snowball effect** on every industry including the beer market

- As a result, consumers have **more purchasing power**
- Consumers become more inclined to spend on **lifestyle products**
- Changing consumer preferences

Government Legislations

- Chinese Government initiatives and regulations started to **promote responsible drinking**
- China issued legislation on reducing the import tariff of daily consumer goods

- Growing awareness of health and wellness
- Increased interest in **low-alcohol** or **non-alcoholic beer** options

Trend of CSR

- China increased its interdependency on resources to around **10%** of its need
- Today, many global beer brands are increasingly recognizing the importance of CSR

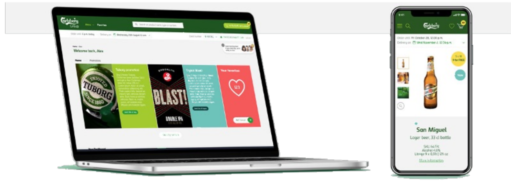
- Natural and agricultural resources became more important for the government

Changing environment & consumer preferences

"Brewing for a better today and tomorrow".

Sail'27 "Big-city Approach"

- Capitalize on the growth of **e-commerce** in China by expanding online presence
- Establish partnerships with popular e-commerce platforms or create a dedicated online store to reach a broader consumer base
- Use **clout influencers** to promote the online platform and new campaigns by social media platforms to tiptoe around the ad restriction laws in China.

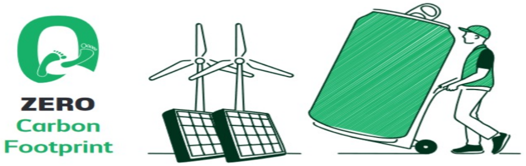


Promote Non-Alcoholic Beer

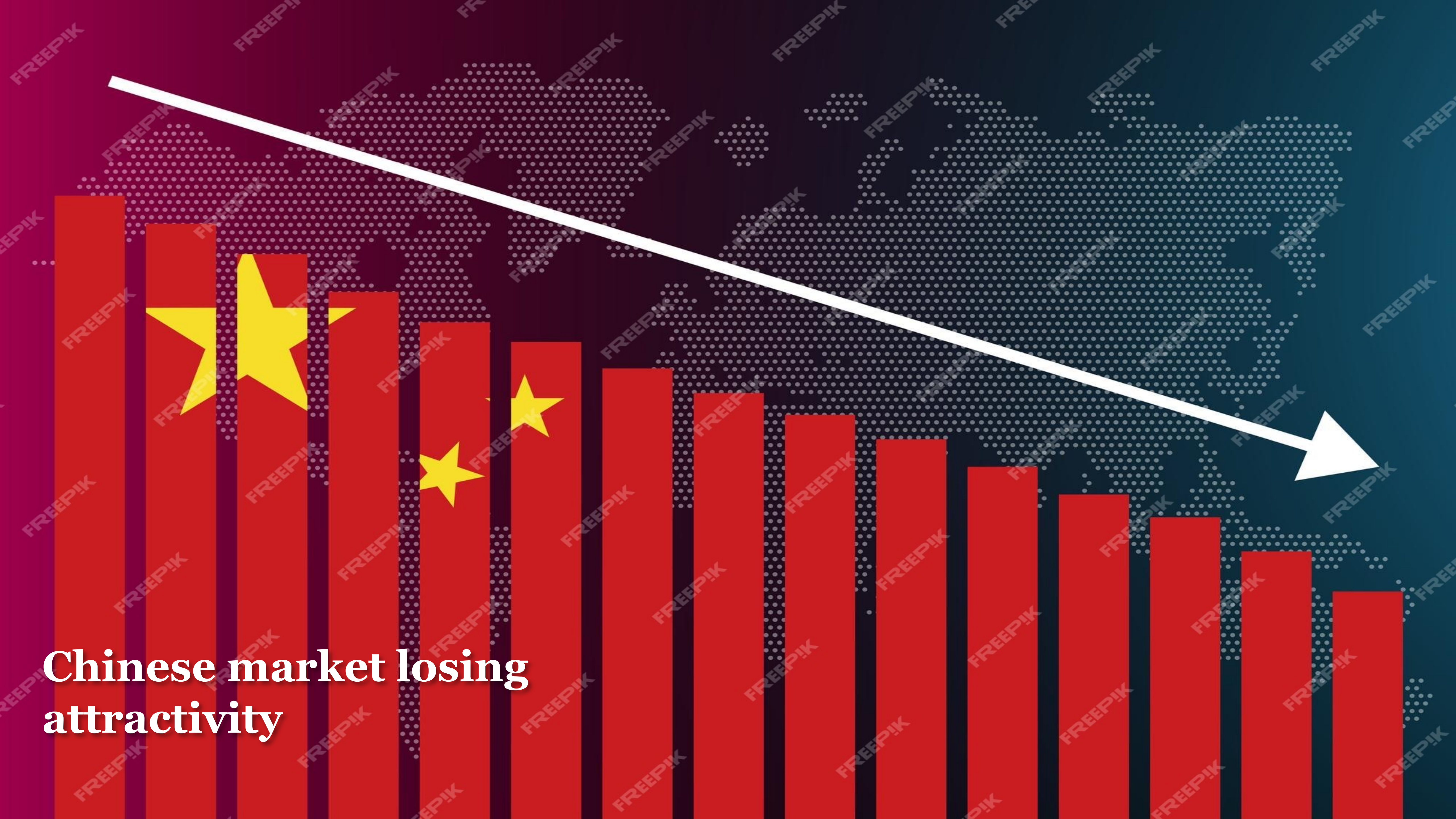
- **Sponsorship** initiatives with sports activities such as table tennis tournaments and promote Carlsberg's non-alcoholic beer (Heineken□ Formula1)
- Target for **35%** of our brews to be low or no-alcohol by **2030.**
- Correspond to Carlsberg's **CSR** initiatives

Together Towards ZERO and Beyond.

- Engage with local communities through **corporate social responsibility** initiatives and gain loyalty
- **Educate consumers** about the varieties to promote responsible consumption
- Collaborating with universities to **innovate sustainable brewing.**
- MNEs 'impact' on sustainable development framework **(Kolk, 2016)**



By leveraging e-commerce, the company can reach a wider audience. Promoting non-alcoholic beer aligns with evolving consumer preferences. Simultaneously, engaging in CSR initiatives allows Carlsberg to build brand loyalty within local communities. A holistic approach integrating these strategies positions Carlsberg to establish a stronger foothold and navigate the evolving market in China.



Chinese market losing attractivity

Scenario 2 – Chinese market losing attractivity

	Lower growth	Increased protectionism	Craft beer popularity
?	• Similarly to Russia, Chinese beer market will grow slower than expected. • Instead of predicted growth of 3.8%, Chinese beer market will only grow by 2.5-3%.	• Raising consumers' preference for domestic products in China. • Lower prices and government's campaigns for supporting the consumption of local products.	• Craft beer popularity will grow very fast in China. • Small breweries will establish themselves as an important power within the market. • Craft beer will remain popular mainly in Tier 1 cities because of its price.
	• Slower revenue growth in China leading to lower attractiveness compared to other markets all over the world.	• Loss of market share in international premium brands. We assume that local brands will not be harmed in this scenario.	• Carlsberg’s competition in premium market segment will rise. • Carlsberg will lose some of its market share in its most important segment of premium beer.

Strategy 2 – Preserving the market share

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Orientation on local brands

- Carlsberg's premium brands might face a **threat from domestic producers and craft beer**,
- They should concentrate more on their 6 non-premium local brands, **reducing their business scope in China.**
- This would be the **strategy of retrenchment (**Wenzel, Stanske & Lieberman, 2020).

Lower tier cities

- Premium brands are mostly popular in Tier 1 cities, non-premium ones are consumed mainly in lower tier cities.
- When shifting the focus to non-premium brands, **Carlsberg could gain market share in lower tier cities**, in exchange for losing some in Tier 1.
- When executed well, this strategy should ensure at least **preserving their current market share in China.**

Observing other options

- If Chinese market would not turn out as profitable as expected, Carlsberg should not invest so much in China.
- In this scenario, there is still **no need to exit Chinese market.**
- Carlsberg should be **observing other, more profitable markets** where they could enter, or improve their position.

If the Chinese beer market would not grow as fast as expected, Carlsberg should still remain in the market, but should only try to preserve their position. They should focus more on their local non-premium brands to dilute the potential risk of losing market share in premium market segment. If this situation continues, Carlsberg should be observing other markets than China and try to grow elsewhere.

Escalation of geopolitical tensions

Scenario 3 – Escalation of geopolitical tensions

	US-China	Supranational challenges	Military action
?	• US-China political tensions escalate • US and China impose heavy tariffs on key industries	• China breaches international agreements, e.g. cybersecurity, increased arming of North Korea • Supranational organizations imposing sanctions • Re-evaluation and disruption of bilateral relationships	• China's "unification" of territories with the mainland, using force if necessary • China increases military action in surrounding areas, creating a blockade around Taiwan • US increases its military presence in the region

Impact (US-China and Supranational challenges):

- Market uncertainty
- Challenges to source raw materials
- Reduced consumer spending
- Currency risk
- Sanctions increase costs and lead to challenges in supply chain management
- Brand perception
- Cybersecurity risk

Impact (Military action):

- Global economic instability
- Supply chain disruption
- New regulations and trade barriers
- Negative sentiment toward brands highly dependent on China

Strategy 3 - Scaling down and exiting China

Risk assessment

- The third scenario highlights volatility in the external environment of Carlsberg
- **High geopolitical risk** for Carlsberg in China, assessed with De Villa's (2023) framework
- Localized production and **low dependency on the parent company** (Meyer and Estrin, 2023)

Gradual scale down

- **Gradually minimize operations** in China
- Discontinuing the sale of international premium brands
- Licensing operations to a local company to retain a level of control
- **Shifting production** or distribution **to other markets in Asia** where Carlsberg faces fewer geopolitical risks

Complete exit and sale of assets

- **Quick action is needed to reduce financial losses** during geopolitical disruptions
- Hesitation amplifies financial and operational risks, as seen in the case of Russia
- Selling assets, such as breweries or distribution networks, to local companies or international buyers
- **Clear communication** with stakeholders is essential during scale-downs

With US-China tensions and global instability, Carlsberg's strategy should include reassessing resource dependencies, scaling back in volatile regions, relocating production within Asia, and potentially selling or licensing assets to reduce financial impact while protecting its brand, with a complete withdrawal from China if Taiwan would be invaded.

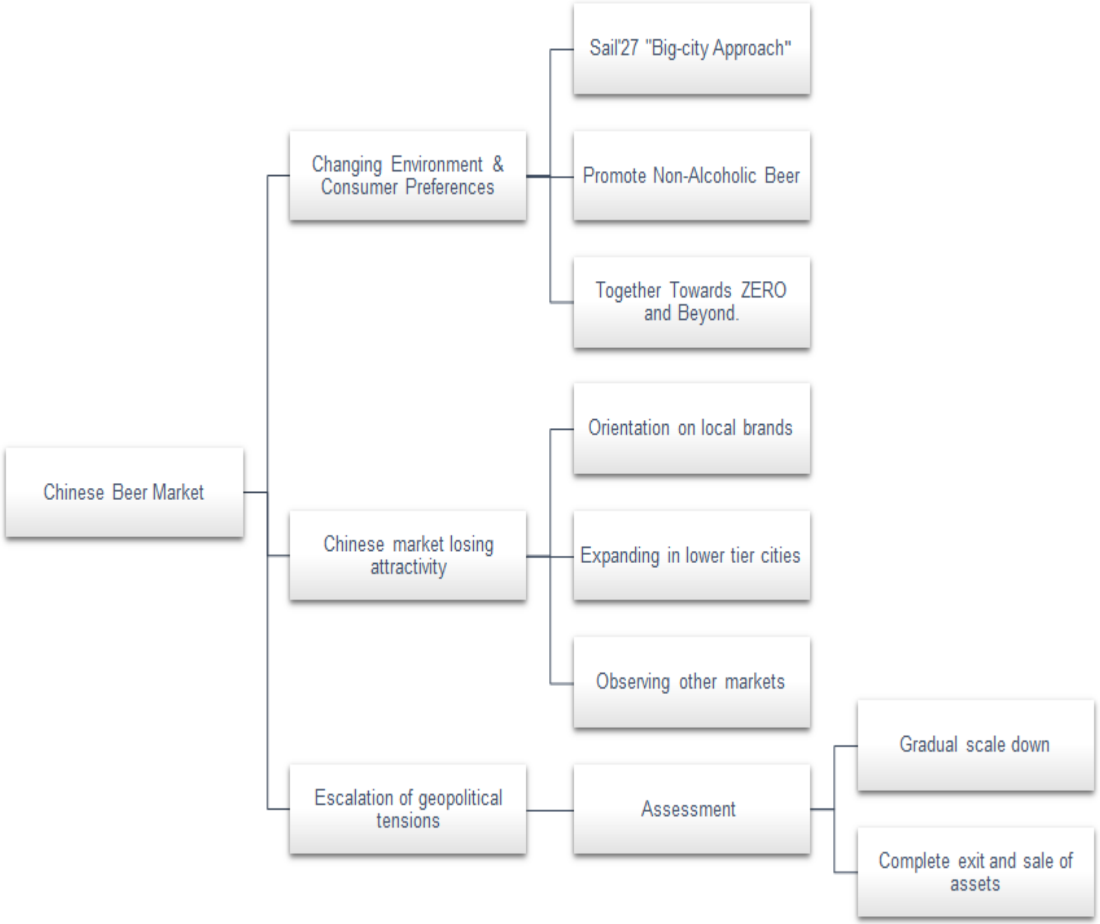
Recommendation & Conclusion

Recommendations

1. Our suggestion prioritizes embracing e-commerce, concurrently advocating for non-alcoholic beverages in tandem with regulatory compliance, while emphasizing the significance of Corporate Social Responsibility (CSR) initiatives.

2. If Chinese beer market would not grow as fast as expected, strategy of retrenchment should be chosen, preserving the market share by focusing on local non-premium brands.

3. In the event of escalating US-China political tensions resulting in substantial tariffs, our recommendation would involve swift action to gradually scale down operations in China, coupled with the proactive development of a comprehensive exit strategy.



Each scenario and its corresponding strategies are designed to provide a comprehensive understanding and proactive approach to the multifaceted nature of the beer market in China.

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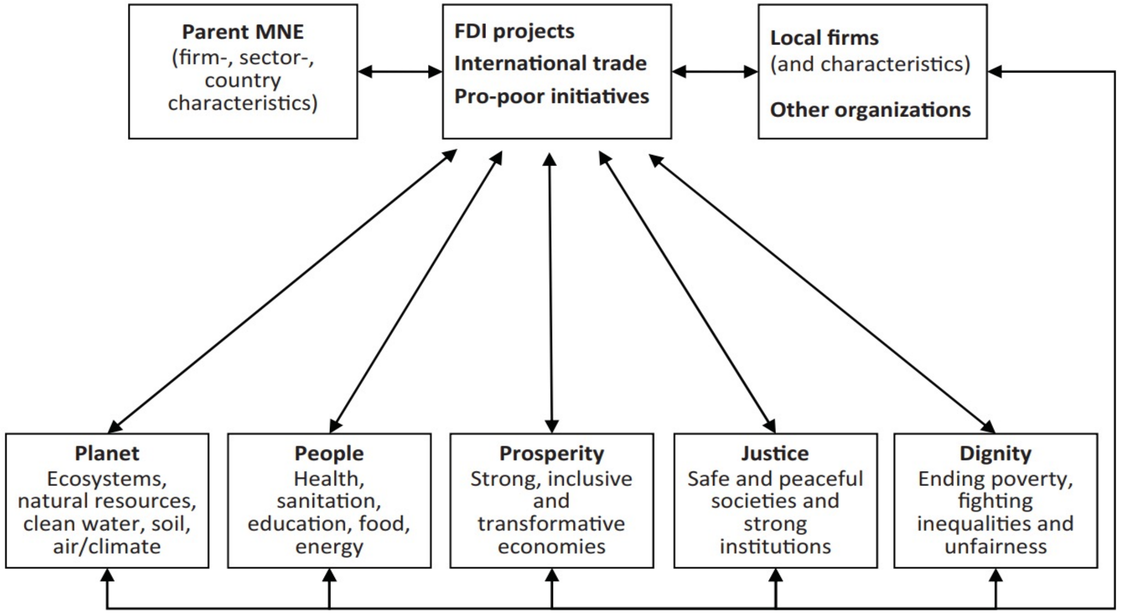
Carlsberg's impact on sustainable development (Scenario 1)

A. Kolk/Journal of World Business 51 (2016) 23–34



This preliminary framework aims to provide a comprehensive lens through which to analyze Carlsberg's activities and impact on sustainable development in China and gain a deeper understanding of the company's sustainability efforts and their influence on the Chinese socio-economic and environmental landscape.

- **Environmental Impact Assessment:**
  - Evaluate Carlsberg's ecological footprint in China, focusing on resource usage, emissions, waste management, and any initiatives for environmental conservation or sustainability.
- **Social and Community Engagement:**
  - Assess Carlsberg's involvement and impact on local communities, including employment generation, social welfare programs, cultural initiatives, and contributions to community development.
- **Market Contribution and Sustainable Practices:**
  - Examine Carlsberg's market influence in China concerning responsible marketing practices, product innovation toward sustainability, and consumer education on responsible consumption.
- **Pro-Poor Initiatives and Development Programs:**
  - Investigate any specific initiatives aimed at socio-economic upliftment, particularly focused on the underprivileged or marginalized sections of society, aligning with pro-poor strategies.
- **Policy Alignment and Compliance:**
  - Evaluate Carlsberg's alignment with local regulations, industry standards, and its commitment to sustainable development goals (SDGs) set by international bodies or agreements.

Analysis of strategic response to crisis (Scenario 2)

Strategic response	Description
RETRENCHMENT	Refers to firms cutting back on activities and resources in a bid to conserve what's left. It's a defensive strategy, often associated with reducing costs, divestments, and narrowing down the scope of business operations.
PERSEVERING	Firms choosing this approach stay the course despite the challenges. They maintain their current strategies, continue with the same business model, and hope that the external environment will improve or stabilize.
INNOVATING	Firms pivot their strategy or operations in response to the crisis. This could involve venturing into new business models, introducing novel products or services, or adapting the current offerings to fit the changing circumstances.
EXIT	Indicates the discontinuation of a firm's business activities in response to a crisis. It can be due to the belief that other responses will not aid survival or can be a strategic choice from the outset. Exits can sometimes pave the way for strategic renewals or new ventures.

Wenzel, Stanske & Lieberman (2020)

In scenario 2, **retrenchment** can be done by narrowing the focus from both, premium and non-premium brands to mostly non-premium local Chinese brands. This strategy should be able to defend Carlsberg's market share in China. **We think this is the strategy Carlsberg should choose when dealing with harder market conditions in China described in scenario 2.**

Persevering strategy in scenario 2 would mean still focusing on both premium and non-premium brands, trying to gain market share in China and operate still without many changes. We think that this strategy would be similar to what Carlsberg has been doing in Russia and we think this strategy would be too risky if scenario 2 happened.

Innovating in scenario 2 could be done by introducing new types of beer to catch up with craft breweries and other competitors in premium segment, offering the consumers new tastes. Although this strategy could be successful, we still think that Carlsberg would need to invest heavily to implement this strategy. We consider such investment as too risky in slowly growing market with many political uncertainties.

In scenario 2, we do not think that **exiting** the Chinese market would be a good step for Carlsberg. China would be still the biggest beer market in the world and too important for Carlsberg to exit. We consider the exit strategy as a last resort in case of geopolitical events with strong negative impact.

Assessment of geopolitical risk for Carlsberg (Scenario 3)

The geopolitical risk for Carlsberg in China is overall very high, as seen from De Villa's (2023) framework. This is due to the authoritarian government and geopolitical tensions in China. Risks relate to possible territorial disputes, trade wars, policy changes, regulatory compliance, and potential state interference. Because of the localized production process, resource dependency from other subsidiaries is rather low. Carlsberg's stakeholders in China may face pressures from local sentiments and directives, while stakeholders in Western countries could be influenced by global perceptions.

Levels of Analysis	Factors	Levels of Risk					Challenges/ Opportunities	Strategies
		Very Low 0-20	Low 21-40	Moderate 41-60	High 61-80	Very High 81-100		
Supranational level	1. Ability of supranational organizations to mediate and resolve political tensions between countries					X		
International level	2. Political relations between countries					X		
	3. Dependence between countries on natural resources, food supplies, technologies, and others		X					
National level	4. Development by countries of technologies, weapons, or others that can redefine their power and influence					X		
	5. Political orientations and agendas of governments					X		
	6. Business-government relations					X		
Industry level	7. Effects throughout the value chain				X			
	8. Stakeholders					X		
Firm level	9. Types of operations				X			
	10. Political capabilities					X		

Obtained from De Villa (2023). Assessing geopolitical risk: A multi-level approach for top managers of multinationals.

Assessing resource dependencies (Scenario 3)

As mentioned by Meyer and Estrin (2023), Carlsberg was one of the MNEs that was successful in building operations that could be run by locals, without depending much on exports or imports as resources were sourced locally and sold to local markets.

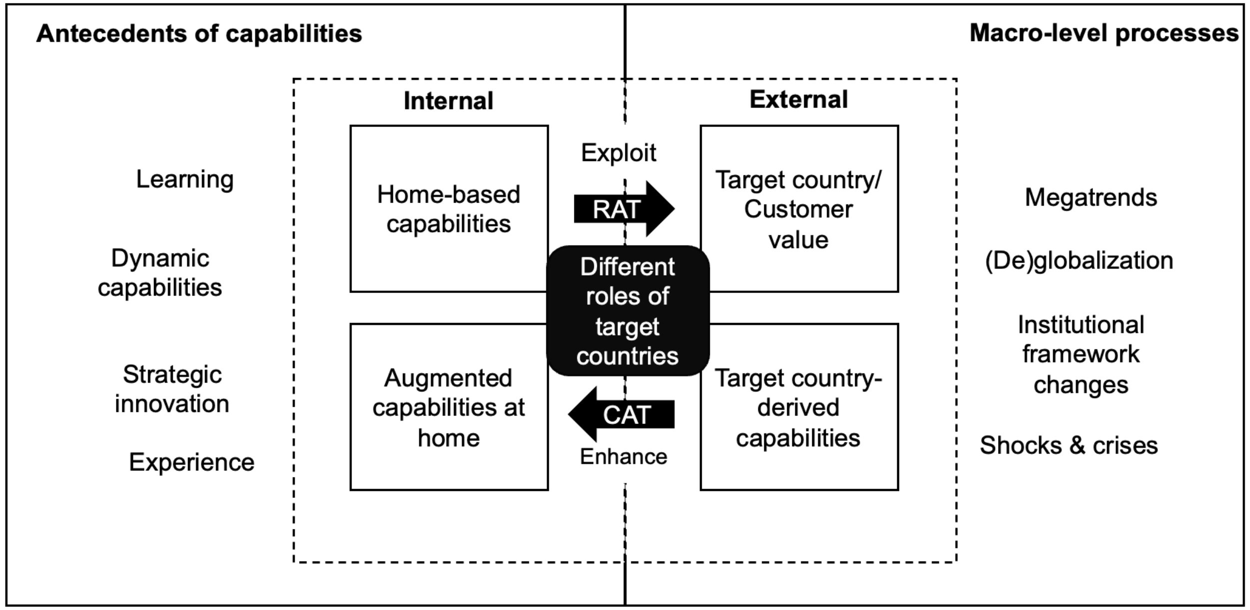
Carlsberg's subsidiaries in China get supplies from regional and national hubs. Production is largely self-sufficient and tailored to local demands, producing and supplying beer primarily for the Chinese market, including mainland China, Hong Kong, and Macau. This operational strategy hints at a low dependency on the parent company for supplying products to other regions, underscoring a localized supply chain approach that focuses on meeting the specific tastes and preferences of the Chinese and nearby markets. This regional focus may help in mitigating risks associated with international logistics and complex global supply chains.

Considering the operations, both the parent's and subsidiary's dependence on each other is low, making the exit by selling the operations feasible, as seen from the resource dependencies matrix by Meyer and Estrin (2023). However, China is the largest market for Carlsberg, and therefore exiting the Chinese market would not only detach a significant revenue stream but also likely lead to dire financial consequences. The losses would not compromise the production capabilities in other regions but would necessitate a substantial strategic and financial reevaluation to mitigate the impact on the global business scale.

		Subsidiary dependence on Parent	
		Low	High
Parent dependence on the subsidiary	High	Exit creates self-harm	Exit results in mutual self-destruction
	Low	Exit by sale of the operational highly feasible	Exit may destroy the local operation

Obtained from Meyer and Estrin (2023). It's hard to say goodbye: Managing disengagement during political disruptions.

Internal and external capabilities (Scenario 3)



Obtained from Niittymies (2023)

Internal

- Home-based capabilities: Carlsberg should assess how geopolitical tensions might affect its ability to leverage its established capabilities in China. It may need to consider strategies for risk mitigation, such as diversifying its supply chain to reduce dependency on any single market
- Augmented capabilities at home: It could be beneficial to enhance crisis management and strategic flexibility to respond quickly to unpredictable changes, such as trade restrictions or sudden shifts in diplomatic relations

External

- Megatrends: Geopolitical tensions often accelerate certain megatrends such as nationalism and protectionism. Carlsberg would need to understand these trends deeply to anticipate and react to the changes in the business environment
- (De)globalization: The company might face increased trade barriers, necessitating a shift towards more localized production and supply chains. It also means understanding and complying with local regulations which might be affected by the geopolitical climate
- Institutional framework changes: Carlsberg should be prepared for sudden changes in the legal and regulatory framework, which can be influenced by geopolitical relations
- Shocks & crises: Geopolitical tensions can lead to economic sanctions, boycotts, or disruptions in the market. Carlsberg would need to have robust contingency plans in place to deal with these eventualities