Diageo was formed in 1997 through the merger of Guinness and Grand Metropolitan. Both companies were themselves products of earlier mergers – Guinness had famously acquired Distillers in 1986 while Grand Metropolitan had diversified from its origins as a hotel chain into spirits (IDV), food (Pillsbury), restaurants (Burger King) and pubs.

As with most mergers, the initial changes were relatively superficial. Executives argued for the synergies between the various businesses but the only real integration occurred between the spirits businesses of the two companies. Fairly quickly, however, a more focused strategy emerged. When Seagrams announced the sale of its spirits and wine business, Diageo quickly moved in to pick up as many brands it could (competition rules prevented a complete acquisition). Pillsbury and Burger King were sold off. And the Guinness business was integrated into the global spirits organisation.

The premium drinks strategy

The purpose of all these changes was to make Diageo the world’s leading premium drinks company. During the post-merger integration, CEO John McGrath and his executive team had honed in on their real strength: the ability to build a premium consumer brand and leverage it on a global basis. They built a sophisticated methodology – the “Diageo way of brand building” – based around insights into their consumers’ needs. They identified a set of global priority brands (for example, Smirnoff, Baileys) for managing on a world-wide basis. And they developed a unique organisation structure in which country operations were organised according to their expertise and potential.

There were four “lead” markets (the UK, the US, Ireland and Spain) that were expected to take leadership roles in developing new brands, 14 “key” markets where Diageo already had a strong position, and then a larger group of “venture” markets in which there was a “tight focus on fewer brands, using a more flexible model”. The theory was that brands would be developed in the lead markets and then rolled out quickly on a global basis through the key and venture markets.

The enormous success of Smirnoff Ice has validated the Diageo model. Under new CEO Paul Walsh (pictured above) Diageo has invested heavily in “ready-to-drink” (RTD) brands including Smirnoff Ice. These were initially aimed at the female pub-goer who did not like beer but then increasingly targeted towards male drinkers.

Smirnoff Ice was launched in 1998 in the UK and once it was proven there it was rolled out over the next two years to a further 15 countries, with total sales so far in excess of 1.5 billion bottles. And not only is Smirnoff Ice a big seller in its own right, it also has two very attractive side-benefits: it helps to invigorate the core Smirnoff brand and it takes market share away from beer. For the global beer companies like Heineken and Interbrew, Diageo is suddenly a serious threat.

The lesson

Diageo provides a clear example of a company that understands and leverages its core competence. Rather than pursue multiple strategic thrusts at the time of the merger, the company put its faith in its ability to build global drinks brands and it created an organisation that allowed it to extract value from that ability. In a difficult market, Diageo still managed nine per cent organic growth over the last 12 months, and it looks well set for further growth as it launches new RTD products such as J&B Twist.

Case prepared by Julian Birkinshaw