Economic Perspective 1

THE CHANGING FACE OF SCOTCH

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Despite being the most "Scottish" of products, relatively little of the whisky distilled in this country is produced by companies ultimately controlled from within Scotland. What is more, the externally-controlled sector expanded significantly during the 1970s in a manner unseen since the arrival of the North American distilling giants in the immediate post-war years, once again raising the spectre of foreign domination of our (original) national drink.

Two problems bedevil analysis of ownership and control in the whisky industry. The first is the complex pattern of ownership, with a network of distilling, blending and broking companies intertwined with holding and shell companies, all of which serve to obscure the location of control. This can be an interesting exercise in its own right, revealing some unlikely combinations such as aerospace group Hawker Siddeley's 75% interest in six Scottish distilleries. However, even tracing the ownership history of the companies does not give the full picture of changes in the pattern of ownership. The distilleries themselves frequently change hands, one result of the product being unusually location-specific. It takes many years for whisky from an individual distillery to develop a distinctive and acceptable flavour, which goes a long way to enhancing its value to its owner, and makes acquisition of an established distillery a much more attractive proposition to a potential incomer than a "greenfield" investment.

The second problem lies in deciding whether a company is Scottish. Registration in Edinburgh provides only the roughest of guides, and the definition adopted here is location of ultimate control; thus a Glasgow-based company acquired by a London-based holding company is deemed to have been externally acquired even where the degree of day-to-day control exercised by the acquirer appears minimal. By this definition the largest firm in the industry, Distillers Company, would not be regarded as Scottish, despite its decentralised management structure.

In sharp contrast to the 1960s, when ownership remained fairly steady, between 1971 and 1981 twenty of Scotland's 117 malt whisky distilleries passed out of Scottish ownership. (The figure of 117 refers to workable rather than working distilleries. Several have been mothballed). This reduced the proportion of Scottish-controlled distilleries - and employment - from 38% to 21%; English companies control just over half the distilleries and employment, the remainder being foreign controlled, mainly from North America. These changes are outlined below.

Even this table does not fully illustrate the extent of the whisky merry-go-round **within** the externally-controlled sector. In 1975 Long John International moved from US to English ownership, as did Littlemill Distillery Company last year. To complicate matters further, Bladnoch Distillery was recently acquired by Arthur Bell & Sons, thus reverting to Scottish control.

The reasons for the rush of takeover activity are not difficult to trace. Whisky

SCOTCH WHISKY COMPANIES EXTERNALLY ACQUIRED 1971-81			
Year	Acquired Company	Ultimate Acquired	No.of Distills.
1971	Littlemill Distillery Co.	Barton Brands (US)	2
1972	Tullibardine Distillery Co.	Carlton Industries (UK)	1
1972	Deanston Distillers	Carlton Industries (UK)	1
1973	MacNab Distilleries	Distilerias-y-Crienza (Spain)	1
1973	Bladnoch Distillery	Publicker Industies (US)	1
1974	S Campbell & Son	Pernod-Ricard (France)	1
1976	Wm Teacher & Sons	Allied Breweries (UK)	2
1978	The Glenlivet Distillers	Seagram (Canada)	5
1979	Whyte & Mackay Distillers	Lonrho (UK)	3
1981	Glenturret Distillery	Cointreau (France)	1

Note: In addition to the above, two malt distilleries moved out of Scottish ownership during this time without the acquisition of a Scottish company.

was very much a boom product until the late 1970's, one of the few indigenous Scottish industries in which it was possible to invest profitably. Most of the acquirers already had some experience of distilling or some related area of activity and saw the opportunity to move in on the prestigious part of the distilling world. During that decade's headlong rush to cope with the world's apparently insatiable appetite for Scotch, distilling capacity rose by over 50%. As late as 1978 the NEDC Distilling Sector Working Group was forecasting an annual rise in world sales of Scotch whisky of 4.4% into the 1990s; between the year of the forecast and 1982 sales actually fell by a total of 8%. It is easy, but unfair, to accuse the distillers of being wildly over-optimistic in their forecasts. Even in periods of relative economic stability they have a difficult job forecasting demand anything from three to ten or more years in advance, and few could have foreseen a recession of such length and severity coupled with the collapse of several major markets, the most notable being South America.

As well as being a profitable investment during most of the 1970s, the industry was characterised by several ripe takeover targets. Several companies, including some quoted ones, paid the price for being too long family controlled, and found themselves in a position in which adherence to the family name had little usefulness other than some romantic attachments. Frequently the only means of obtaining the funds necessary for expansion - or survival - was by being acquired, so that the strategy became one of damage minimisation by the selection of and approach to a suitable partner, precisely the tactic adopted by at least three of the companies in the table above.

Inevitably the takeover of any Scottish company by outsiders produces the stock response of fear of plant closures and job losses. As indicated earlier, whisky is unique in its location pattern and in the legal requirement that whisky must be distilled in Scotland to be called "Scotch". But this requirement does not apply to the blending and bottling operation which account for 60% of employment in the industry, an area highlighted by the recently-announced decision by Distillers to close two such plants at South Queensferry and Glasgow with the loss of over 700 jobs. In fact there appears to be little evidence of a loss of employment through external acquisition; by and large the acquired companies have experienced a similar employment decrease to that in the industry as a whole, a fall of 20% since the peak of 25,000 in 1978-79, although the long term effects of bulk as opposed to bottled exports remain uncertain.

Three factors combine to make it no coincidence that there has been a lack of major whisky takeovers since 1979. The present recession, making whisky a less profitable investment in the short to medium term, a lack of suitably-sized takeover targets following the numerous takeovers of the previous decade, and the Monopolies Commission's decision in 1980 to block the Hiram Walker bid for Highland Distillers have all played their part. The last factor in particular has served to dampen the ardour of those traditional whisky acquirers, the large North American distillers, and the major English brewers appear disinclined to expand to any significant degree their purchases of the mid-1970s. For future developments in the externally-controlled sector we may have to look to two sets of actors who have as yet played only a supporting role in the drama.

Europe

Although still tiny, the European presence in Scotch whisky is nevertheless growing. Five malt whisky distilleries are now controlled by European companies, the first acquired as recently as 1972 by Omnia-Limbourg, a front company for Martini Rossi. Since that time Pernod-Ricard and Cointreau of France and DYC of Spain have moved in, albeit on a modest scale.

For some of the European incomers direct investment in whisky comes after years of activity as overseas agents for Scotch whisky distillers and blenders. For those inexperienced in the art and peculiarities of whisky such investment can be a trying experience; unlike some other spirits Scotch requires a great deal of care in distillation and blending, and the cost of maturing a good whisky for at least three years can be considerable. Nevertheless, the European presence seems here to stay, as the recent purchase by Pernod-Ricard of a second distillery (Edradour in Perthshire) would indicate.

The question remains whether the Europeans will feel sufficiently confident to move into whisky in a big way. They undoubtedly have the financial resources to do so; one European company reputedly gave serious thought to buying Long John International before that company was acquired by Whitbread. However, judging by past behaviour the signs are that at least until the market for whisky picks up European control will expand distillery by distillery rather than by the acquisition of a major whisky company.

A Hint of Eastern Promise?

The jokers in the pack remain the Japanese. There has in the past been limited direct investment in Scotch from Japan, giants Suntory holding a 12% stake in the Glenlivet Distillers before the takeover by Seagram. Suntory may well have coveted ownership of the most prestigious name in the business, but as yet the Japanese have shied clear of buying either a distillery or a distilling company. Perhaps they feel that this most traditional of industries is not yet ready for the full blast of Japanese efficiency, or are simply sensitive to the strength of feeling which such a move would invoke. However, a more likely explanation is that the Japanese do not yet feel that such a major step is necessary.

Japanese direct foreign investment in Britain and Europe has traditionally been defensive in character, notably where an important market is threatened by barriers to trade; in the case of whisky they may feel obliged to act to protect an important source of supply. At least in the foreseeable future Japan has a vested interest in the continuance of bulk malt whisky exports from Scotland which can be admixed with local produce to create blended whisky for home consumption and for re-export. In the longer term the strategy may be to gradually promote the Japanese product in its own right in important export markets like Australia without reference to its Scotch content, allowing an eventual reduction in the use of Scotch malt whisky.

In Scotland the question of bulk exports remains vexed. Supporters argue that it is an important export earner which means that exporting companies can provide more jobs. Opponents claim that the practice allows otherwise inferior foreign blends to be sufficiently improved to compete in world markets with blended Scotch, that it ultimately threatens blending and bottling operation in Scotland which provide so many jobs, and that it is akin to selling the birthright of the genuine article. Pressure to restrict voluntary exports has come from a variety of sources, including non-bulk exporting companies, trade unions, and the NEDC. Such appeals to consider the future of the industry have so far produced from the pro-bulk lobby a terse restatement of Keynes' famous comment on the long run, perhaps understandable in an era of shrinking world markets. Should this attitude change, however, and voluntary restriction of bulk exports become a real possibility, we may experience yet another Japanese dawn raid.