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Forbidden City: Launching a Craft Beer in China

In February 2019, despite the cold drizzle spattering his Shanghai office windows, Le Jie felt joy as he read a memo that highlighted Eurasian Brewing Company's (EBC) increase in market share in China in 2018. As vice president of EBC's China and East Asia operations, Le was delighted that these data also showed the average annual revenue growth of his China regional division had been over 15% since he had become vice president in 2010.

Despite these results, Le felt he still had much work to do. He had focused for many years on cutting costs, rationalizing his division's product line, and tightening operations. Now, he was ready to introduce a new craft beer that he believed could significantly increase EBC's market share and profitability in China. Le's plans were being challenged, however, by Vivian Chin, EBC's director of marketing and export sales. She and her staff were rolling out a small-batch craft-type beer that they felt had regional and perhaps even worldwide appeal. And Chin firmly believed there was no room for both new products on the Chinese market.

To resolve this stalemate, Victor Wang, managing director of EBC, had asked to Le to fly to Shanghai to meet Chin and him. Wang wanted Le to feel ownership over key decisions in his region. Yet, he also felt the China subsidiary's actions had to be consistent with EBC's growth strategy. Whatever path was taken, Wang knew this choice would reverberate throughout the company.

Industry Background: Brewing from 7000 BC to Today

Evidence of beer brewing has been found as far back as the Neolithic Age, when the spread of brewing techniques supported the cultural shift that took place when hunter-gatherers built agricultural communities. In the Middle Ages, as monasteries spread through Europe, monks developed small brewing centers through innovations such as using hops as a preservative. Supported by Europe's abundant barley crops, consumption grew, often because beer was safer to

HBS Professor Emeritus Christopher A. Bartlett and Brandeis University Senior Lecturer Carole Carlson prepared this case solely as a basis for class discussion and not as an endorsement, a source of primary data, or an illustration of effective or ineffective management. Although based on real events and despite occasional reference to actual companies, this case is fictitious and any resemblance to actual persons or entities is coincidental.

drink than water. A wide range of regional brewing practices evolved, all based on the availability of local crops, which led to the great diversity of local beer styles available today.

In the 18th and 19th centuries, technical innovations such as the development of hydrometers and other instruments and process advances such as pasteurization and refrigeration converted brewing from a highly variable artisanal craft to a stable production process. Subsequent advances in transportation, packaging, and distribution enabled beer to be produced at scale and distributed to wide geographic areas.

By the 20th century, major breweries had been established in almost every country, albeit with features shaped by history and national differences. In the United States, several agricultural shocks led breweries to produce lighter beers with less grain content than their European counterparts, which remained rooted in their regional histories and brewing traditions. In another source of industry divergence, some European breweries thrived in the early decades of the century while their American counterparts were constrained, first by Prohibition and then by the Great Depression.

Nonetheless, the post–World War II decades saw widespread industry growth. A major change came in the 1980s and 1990s, when Heineken, Carlsberg, Corona, and others began to promote exports as a means of growth. In the process, they created a high-quality worldwide market niche for imported beer. Still, by 1999, while Coke and Pepsi had captured 70% of the soft drink market worldwide, the world's top four brewing companies accounted for only 17% of global beer sales.

All that changed when the new millennium ushered in a rapid series of mergers and acquisitions. By 2018, when annual global beer sales exceeded $700 billion, four players dominated the industry. Anheuser-Busch InBev (AB InBev) was the largest, with a 27% market share and a portfolio of 400 brands, including Beck's, Budweiser, and Stella Artois. In second place was Heineken N.V., with a 13% share of the global market, a stable of 300 brands, and operations in nearly 200 countries. These two giants were followed by Molson Coors, with a 5% share, and Carlsberg Group, with 4%.

Besides accounting for almost half the world's beer volume, these four companies netted 75% of industry profits. Because transportation was a major cost element in a global market, profitability depended on creating strong demand supported by efficient local production. As a result, global brewers began to boost their horizontal consolidation with vertical integration, increasing their value chain investments from agriculture to distribution to retail.

Between 2013 and 2018, however, growth stagnated, particularly in the United States and Europe, where consumer tastes continued a shift to wine and distilled spirits. To maintain profit margins, many global players increased their focus on premium products. But in this segment, they were challenged by emerging craft-beer brewers producing small-scale offerings that consumers found more interesting and authentic than traditional high-end brews. In response, global beer companies began acquiring craft brewers and producing their own "craft-style" beers.[1]

In a parallel growth strategy, the major players also turned their attention to growth opportunities in Asia, Latin America, and Eastern Europe. One market that drew all global competitors' attention was China, which had emerged as the world's largest beer market by volume.

[1] Craft beer is defined by the Brewers Association as beer produced by breweries that are small (annual production of 6 million barrels or fewer) and independent (less than 25% owned or controlled by a large beverage company). In practice, many beers that are marketed as craft do not meet this definition, however, and the term often is used to describe beers that are innovative or distinctive in style or quality.

The Beer Industry in China: An Awakening Giant

As the world's largest beer producer, China accounted for 23% of global volume in 2017—twice the output of the number two producer, the United States. Led by traditional local breweries that made inexpensive pale lagers, China's beer market had grown rapidly from 1985 to 2015. This growth was driven by an increase in per capita consumption from 3 liters to 30 liters during this period. But growth had recently stalled. In 2015, strict government curbs on outdoor drinking, a crackdown on drunk driving, and successive years of bad summer weather led to consumption declines between 2015 and 2017, which led to a 1.5% drop in industry revenues in 2016.

This slowdown was met with concern by companies that assumed they had diversified away from slow-growth markets. They were reminded of the painful experiences of foreign companies in China in the mid-1990s, when they found that their investments in cutting-edge technology and trendy branding did not offset the strength of existing local brands, buyers' price sensitivity, or the arcane distribution system. Many had been forced to exit, selling their facilities at fire-sale prices.

Furthermore, all newcomers were tested by entrenched local competitors. The largest was China Resources (CR), whose Snow Beer was an inexpensive brew that was the best-selling beer brand in the world despite being sold only in China. CR had a 26% market share, followed by Tsingtao, with 17%, and Beijing Yanjing, with 10%. Among the foreign companies, AB InBev claimed 16%, while Carlsberg had a 5% share. Other smaller players accounted for the remainder.

Though the China beer market had historically been dominated by locally produced, low-priced pale lagers such as Snow, Tsingtao, Yanjing, and Harbin, this popularly priced segment was mature and was forecast to grow more slowly than higher-priced segments. Representing 21% of production by volume, the segment accounted for only 15% by value. By contrast, the more expensive domestic and imported premium brands that sold at much higher price points accounted for 61% of China's $79 billion beer market. Consumers of these beers were typically high-income urban dwellers.

At the very top end was the even faster growing super-premium segment, which accounted for 24% of the market by value. However, brands in this segment were increasingly competing with pub-sold craft beers. By 2018, more than 1,000 craft breweries had opened in China, including Beijing's Great Leap Brewing and Shanghai's Boxing Cat Brewery. These newcomers had introduced brews using diverse local ingredients such as tea, chrysanthemums, and chili peppers. An emerging beer culture, particularly visible in larger cities, was driven by affluent young patrons and evolving tastes. Yet while craft beer sales had increased by more than 40% between 2015 and 2018 and were predicted to increase 120% between 2018 and 2022, they still represented only 5% of the super-premium segment and just 1% of China's total beer sales. To some foreign brewers, this emerging market trend was reminiscent of recent changes they had seen in their home markets, where craft beers had captured significant market share from premium and super-premium brands.

Foreign beer companies knew of these changes in the Chinese beer market, but many remained unsure about how to respond. Although total beer consumption by volume was projected to decline slightly from 2019 to 2023, industry revenues were expected to grow. The projected growth was driven by a forecast shift from mass-market brews to premium beers due to the rapid growth of affluent Chinese consumers, particularly those in the younger demographic who represented the core target consumers for beer companies. But with memories of the miscalculations of the mid-1990s still in mind, many foreign brewers were approaching the market cautiously.

Eurasian Brewing Company: Birth of a New Company

EBC was created through the 2011 merger of two companies. The Indochina Beverage Group (IBG) was an old-line Singapore-based brewer, bottler, and distributor of a range of mostly premium beer and soft drink brands that focused on Southeast Asian markets. Its merger partner, Dragon Spring Brewery (DSB), was a young Chinese company that had started as a provincial brewery selling low-priced beer to its local market before expanding nationally and eventually extending its operations into several East Asian countries. The headquarters of the merged EBC organization was in Singapore at a site IBG had occupied since its founding in 1912.

IBG's major growth spurt began in 1932, when it secured bottling rights for Coca-Cola in Singapore and Malaysia. In 1948, IBG opened a brewery, leveraging its beverage distribution power to become a major local beer producer. Starting in the 1960s, IBG began expanding in Southeast Asia through both organic growth and acquisitions. It built positions in Malaysia, Thailand, Vietnam, Cambodia, and Indonesia mostly by acquiring local beer brands in premium segments. In the early 1990s, IBG divested its soft drink division, including bottling operations that had occupied valuable real estate in central Singapore. It used this cash windfall to expand its beer distribution and acquire brewing operations to Australia, New Zealand, Japan, Hong Kong, the Philippines, and other Pacific region markets. Despite its traditional roots, IBG was respected for its marketing capabilities and well known for its aggressive cost-cutting and rough-and-tumble corporate culture.

In contrast to its partner's long history, DSB was founded in 1983 as Long-quan Brewery in Liaoning province in northeastern China. It had grown by acquiring other small beer companies in its region before expanding beyond its home province to secure breweries in Dongguan, Nanjing, and Harbin. In 2005, DSB formed an alliance with Denmark's Carlsberg group, and under its new English name of Dragon Spring Brewery, began acquiring and modernizing small breweries in South Korea, Macau, Taiwan, and Hong Kong. By the time of the merger, DSB owned 12 breweries in China and another five in East Asia. While several of its brands were in the premium segment, the bulk of DSB's business was concentrated in the popularly and lower-priced parts of the market.

In discussing how he integrated DSB and IBG, Victor Wang emphasized three action items:

> First, we wanted to focus on our cost structure to gain post-merger efficiencies. Second, we had to identify managers who could keep expenses down while not sacrificing top-line growth. Finally, we had to assess our best expansion opportunities. South Asia met this final objective, and since it was already our most profitable region, we decided it was the best place to grow.

By the end of the merger, ex–IBG executives occupied most of EBC's leadership roles. This included Vivian Chin, whom Wang regarded as a key appointment when he named her EBC's director of marketing and export sales. Chin had run IBG's export division since 2002 and had been credited with leading IBG's successful expansion into the Pacific region. Her new role extended her responsibility to include the China and East Asia markets that DSB had previously run.

EBC in China: Strengthening Foundations

In 2012, Wang began to focus on DSB's former operations. He was delighted to find that Le Jie, DSB's managing director at the time of the merger, was leading a turnaround. With over a decade of industry experience in the region, Le was a Hong Kong native who had obtained his MBA at Harvard Business School. After five years in various roles at the multinational beverage company Diageo, in 2006 he was recruited by DSB to be its China sales manager. Just two years later, he was named the

China country manager, and when deteriorating results led to his boss's dismissal in 2010, Le was promoted to managing director, responsible for all DSB's China and offshore operations. **Exhibit 1** shows the profit statements for both EBC and its Chinese subsidiary.

Well before the merger, DSB's China business had faced major challenges. Despite having well-run bottling facilities, its marketing had been uneven at best. DSB's profitability was compromised by a market position that straddled low-quality local brews on one side and global premium brands on the other. For years, with its margins squeezed by mass-market price competition, DSB had been prevented from investing in its small range of premium products. At the same time, the company faced supply chain issues in a constrained Chinese market, particularly in sourcing high-grade malted barley, a vital ingredient to ensure the quality of premium brands.

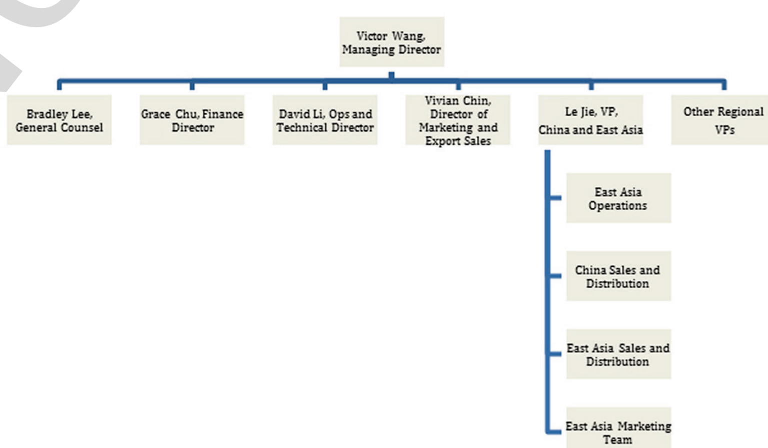
Since 2010, Le had dedicated himself to cutting costs, securing the supply chain, and boosting revenues. This last objective involved eliminating some lower-priced brands while establishing a stronger marketing presence in major cities. While reorienting the strategy toward higher-margin, faster-growing premium segments, Le had also replaced most of DSB's marketing group. A more disciplined pricing and discount structure, renegotiated supply chain contracts, and personnel layoffs followed. Together, these initiatives had an immediate impact on profitability. It was a huge job, but progress had been encouraging. Sales in China had resumed healthy growth and profits had been restored by 2012. More recently, since taking responsibility for DSB's international operations, Le had also initiated a similar turnaround strategy in the troubled Korean operation.

Developing the Headquarters-Subsidiary Relationship.

Despite EBC's official ethos of decentralization, many former DSB employees believed EBC's executive team inserted itself into decisions about East Asia markets that it barely understood. This tension could be seen in the evolving relationship between Le and Chin, whose respect for each other's abilities was overshadowed by their wariness of each other's motives.

To reduce this tension, Wang decided Le would report to him about the division's profitability and growth. Yet he was clear that he did not intend to resolve every dispute between Le and Chin about marketing and branding. "Le's performance suggested he could grow his division further," said Wang. "The friction between Chin and him can benefit both of them because it will force them to sharpen and defend their ideas." See **Figure 1** for EBC's organizational chart.

Figure 1 EBC Organizational Chart



Becoming a Global Beverage Company

In recent decades, as European and American beer companies had expanded into China, Korea, Thailand, and other Asian markets, competitive pressures on companies like IBC and DSB increased. Soon after the merger, Wang and Chin decided they needed to respond. They started envisaging EBC not as just a "quality local beer producer" but as a "global beverage company" with the marketing expertise, brand recognition, and distribution muscle to respond to the incursion by accessing markets worldwide. Because Asian brewers had been slow to follow the export leads of Heineken, Carlsberg, Corona, and others since the 1980s, Wang and Chin believed an opportunity existed to build premium Asian beer brands that could achieve significant regional and global exports.

Wang explained the logic behind EBC's strategy of pan-Asian and worldwide expansion driven by a global branding strategy: "As a late mover, we have some advantages. First, we're located in one of the largest and fastest-growing markets in the world and have deep experience creating products for Asian consumers. Second, because we aren't bound by the traditions and legal constraints facing foreign brewers, we can respond to local tastes and preferences instead of imposing European or American beer concepts on our markets. And finally, our scale and experience allow us to be both a high-quality and a low-cost producer—skills that will help us leapfrog into Western markets."

Within EBC, there was consensus about the appeal of Wang's long-term vision, but opinions about how to achieve it—and how quickly it could be achieved—varied greatly. Chin and her team felt headquarters had to lead brand strategy while local managers focused on implementation.

In contrast, Le and his team tried to convince Chin that, unlike most of her other markets in South Asia and the Pacific, where mainstream and premium-branded products were dominant, China was still a popular-price market where few large brands were well established or highly regarded. Small local or regional breweries were still strong, particularly in the retail channel. Le argued,

> EBC has all the required capabilities to be the leading brand in China, but that effort will bear fruit only after we establish distribution and nurture relationships with resellers. We must thus expand this capability to set ourselves up for future opportunities. Then, after the market becomes more receptive to higher-priced segments and becomes more brand-driven, marketing assumes a more prominent role.

Wang remarked, "This debate was inevitable, especially given the legacies of DSB and IBG. Although it seemed painful sometimes, it has made us a stronger company."

New Directions: A Great Leap Forward

Following the strategy Le had implemented in the core market, his team pruned popular low-cost brands, focused on premium products, and drove production costs down in the China region's offshore markets. As profits improved, the company invested in marketing, distribution, and promotion budgets for its premium brands. By 2018, all East Asian operations except those in Korea were profitable. While the China market was dominated by a few large companies, particularly China Resources and AB InBev, Le had expanded EBC's sales from 289 million SGD to 382 million SGD, while lifting net profit from 8% to 16% of sales. (In 2016, 1.38 SGD = 1USD.) By 2018, China operations accounted for one-third of EBC's income and almost half the company's after-tax profits.

At the same time, Le had been working on supply chain issues, particularly as concerns grew about the quality of local barley, the key ingredient in beer's malting process. With huge regional differences in soils, climate, and agricultural practices, China's barley quality was highly variable, an issue that was not a major concern for cheaper brews produced for local markets. But to ensure that his premium products were produced to a consistent quality standard across regions, Le contacted Euromalt, a German barley cooperative with worldwide operations. The company had a Chinese malting plant with a 50,000-ton capacity, built specifically to produce malt for the local operations of a German brewing group. Although its malts were more expensive than those from existing sources, Le was impressed by both the quality and the wide range that Euromalt offered. In 2012, he entered into a joint venture with Euromalt, making it a key part of his plans to move upmarket.

However, in 2015 Euromalt faced financial difficulties that forced it to renegotiate its supply contracts. The subsequent significant cost increase had a major impact on the East Asia division's bottom line—and on Le's reputation as a negotiator. The task of developing secondary malt sources with quality product and stable pricing consumed much of his time in 2015, a problem exacerbated by Le's unwillingness to delegate this work to others. Wang had often urged him to hire and delegate to more capable people, but Le had trouble finding subordinates he trusted.

It was against this backdrop that Wang considered Le's 2016 recommendation to acquire Emperor Holdings, one of South Korea's three domestic brewers. The South Korean market was large: sales in 2015 were $2 billion. More than 90% of beer consumed was locally produced, but import sales were growing rapidly from their small base. Though the two largest competitors had been brewing beer in Korea since the 1920s, Emperor was a relative newcomer, having been founded in 1990.

Among educated consumers, Korean beer was regarded as dull and characterless, its insipid taste the result of Koreans' use of rice instead of malted barley. As imported beers began taking market share, the Korean government faced pressure to reduce regulations inhibiting the growth of small-scale breweries. A 2015 reform allowed microbreweries to distribute their products to restaurants and pubs. The expectation was that distribution to wholesalers and grocery retailers would follow. Le felt that while the two larger competitors would have difficulty responding to these changes, Emperor had an opportunity to enhance its image and profitability by increasing demand for quality niche beers. Acknowledging the risk that Korea's growing microbrew industry might disrupt this strategy, Le argued that Emperor's scale would give it both the cost advantage and the financial resources to launch premium offerings that could nurture and exploit shifting consumer tastes.

While concerned about Le's ability to stay on top of his multiple priorities, Wang approved the acquisition. When the deal closed in early 2017, the CEO advised his younger colleague to add talented staff to ensure the venture's success. While privately recognizing the acquisition's risks, Wang wanted to signal that successful entrepreneurial managers would be supported in EBC.

The Final Decision: Which Brand?

In late 2018, a new point of tension materialized between Le and Chin. For years, Le had been following the emergence of craft brewing products in China, systematically tracking their growing success and influence in the premium and super-premium segments. He observed:

> It used to be that a Heineken or a Miller could waltz into China and gain share as a high-end brand because of their European or American image. But our market has shifted radically, and now high-end Chinese craft brews like Boxing Cat and Great Leap are taking market share. It's just like the United States in the 1990s, when a wave of craft beers transformed the taste and image of American beer. The large breweries misjudged the trend, and in a classic case of disruption, the microbreweries snuck up and stole a

> huge share of the high-end market. That's what China is poised to do now, and the recent success of Chinese craft brewers is evidence of that.

Along with his local marketing team, Le had been developing a concept for this segment under the umbrella brand Forbidden City, a name referencing an imperial palace constructed during the 15th century. The team proposed to market the product only in China using an airplane- and airman-themed visual image. Initial product concept testing had verified the brand's appeal as well as its positive impact on the image of EBC's other brands.

Le planned to set up two small-run brewing operations, one near Beijing and another in Shanghai. Both would produce only Forbidden City, and each would be co-located with a pub and a retail store. He hoped to receive a waiver from a Chinese government regulation on minimum bottling requirements, a rule designed to favor large producers. If that was denied, his backup plan was to produce Forbidden City as a craft beer in existing EBC domestic breweries.

This proposal immediately ran afoul of the global marketing team in Singapore. After a year of secret planning, Chin's team had recently concluded a successful Singapore test market of Wild Dog, a craft-style beer. They were now in final discussions to launch it as a pan-Asian brand with the potential for global distribution. Though Wild Dog's marketing campaign would present it as a premium craft-type beer, EBC would brew it in small batches at its existing large-scale breweries.

Chin said, "The brand name 'Wild Dog' was well received in focus groups. Its edgy, masculine vibe is backed by marketing themes centered on manliness and virility." Targeting affluent, young to middle-aged males, EBC's marketing team believed this brand image would clearly differentiate it from the fashionable and elite positioning of most American and European brands. "Our Singapore launch showed favorable results, and early market tests in Kuala Lumpur and Manila suggest it could succeed in those markets too," said Chin. "We now feel we could give Tsingtao a run for its money in the international market with a more modern and compelling Asian-sourced brand."

Because of her commitment to Wild Dog, Chin was quite negative when Le's team presented its Forbidden City proposal to Singapore management. She said its launch would confuse EBC distributors in China since it would appeal to the same customers as Wild Dog, and at a similar price point.

Le pushed back. Responding to Chin's insistence that the Forbidden City proposal be shelved, he countered,

> Our markets don't need another faux craft beer. Wild Dog won't convey the same authenticity as Forbidden City. And its introduction won't convince my team that there's support for the innovation needed to propel the company forward in one of its most critical markets. We believe the market is ready for a strong brand that builds on national pride.

In response, Chin claimed that recent news confirming Heineken's agreement to buy 40% of CR for $3.1 billion underscored the need for EBC to have a global marketing strategy rather than a local plan. But Le responded that Chin should be more concerned about a different local industry deal. He argued that AB InBev's recent purchase of the Chinese microbrewery Boxing Cat suggested that the big global players recognized that launching their own craft beers in China would be difficult.

As Chin concluded the meeting, she insisted that EBC must have an integrated brand strategy, rather than respond with products for each of its respective markets. She said, "The only way EBC can benefit from being a global company is to act like one. We must pursue brands that have widespread appeal and enable us to coordinate our marketing campaigns across markets."

Le accepted that Wild Dog's early success in Singapore and promising rollouts elsewhere probably had led EBC's senior management to see it as both a budding pan-Asian opportunity and a potential global brand. But he also knew that given how committed his local team was to Forbidden City, a product that they felt was creative, innovative, and attuned to their local market., he needed to respond to Chin's challenge: "You don't know the China market like I do," he said. "If we are to grow, we need to nurture new channels and experiment with different marketing models." The exchange ended awkwardly; both Le and Chin knew that Victor Wang would need to be involved.

As Wang planned for his meeting with Chin and Le, he recognized that both their arguments had merit. As he began to write up a meeting agenda, he wondered how to resolve this dispute.

Exhibit 1 EBC and EBC China Profit Statements

EBC Profit Statement: 2015–2018 (in thousands of Singapore $)

	2015	*2016*	*2017*	*2018*
Revenues	963,001	970,234	1,015,961	1,075,855
Cost of sales	542,535	507,766	558,290	600,125
Gross profit	420,466	462,468	457,671	475,730
Operating expenses				
Distribution	79,392	86,673	93,394	101,137
Marketing	134,272	146,931	145,496	140,027
Administration	68,538	67,154	69,199	70,414
Profit before taxes	138,264	161,710	149,582	164,152
Taxes	27,653	32,342	29,917	32,830
Profit after taxes	110,611	129,368	119,665	131,322

EBC China Operations Profit Statement: 2015–2018 (in thousands of Singapore $)

Revenues	288,900	310,475	347,186	381,992
Cost of sales	157,228	169,584	185,181	197,574
Gross profit	131,672	140,891	162,005	184,418
Operating expenses**				
Distribution	23,112	24,838	25,889	26,730
Marketing	34,668	40,362	48,326	51,079
Administration	18,779	20,181	22,437	24,029
Profit before taxes	55,113	55,510	65,353	82,580
Taxes	14,779	13,877	16,338	20,645
Profit after taxes	40,334	41,633	49,015	61,935

* Average annual SGD/USD exchange rate: 2015: $1 USD = SGD 0.728; 2016: $1 USD = SGD 0.724; 2017: $1 USD = SGD 0.725; 2018: $1 USD = SGD 0.724.

** Includes share of allocated corporate overhead.