

Laying Groundwork for Another 100 Years of Growth

– Ready to Spend Over ¥300 Bil. on M&A –

Interviewer: Okabe Hiroshi

Japan's leading beer brewer Kirin Brewery Co., which has marked the 100th anniversary of its founding, established a group holding company, Kirin Holdings Co., in July. The holding company has placed under its wing a number of operating companies for production and sale of various products such as beer, beverages, food and medicine. Kato Kazuyasu, president and chief executive officer (CEO) of Kirin Holdings, carried out the change in the corporate management system in a bid to "lay the groundwork for growth for another 100 years." Japan's domestic beer market is expected to taper off because of a decline in the population. To achieve growth in such a tough business climate, the Kirin Holdings leader envisions a business strategy calling for the company to establish itself as a corporation involved in multiple businesses, not just an all-round maker of alcoholic drinks but a manufacturer making use of its technologies accumulated as a beer brewer for medicine and health and functional foods. Kato plans to invest ¥300 billion in merger and acquisition (M&A) deals in the coming three years to realize the strategy. In an interview with *Japan SPOTLIGHT* magazine, Kato showed his resolve not to stick to the planned amount but to spend more on M&A projects, if necessary.

Photo: Okabe Hiroshi

Aims to Be All-round Maker of Alcoholic Drinks

Domestic shipments of beer and beer-like beverages have continued to decline. The domestic beer market continues to shrink not only due to a decrease in Japan's population but also due to the young generation's shift in preference from beer to other drinks. How do you see the future course of the beer market?

Kato: The size of Japan's beer market is in the trend of leveling off or edging down, indeed. Even though the total market size is leveling off, I believe the share of beer in the market will continue to decline in line with an increase in shipments of beer-like *happoshu* beverages (of lower malt content) and other new-category drinks. Each brewer has put new products into the market in a bid to stop such a market trend. But I believe it's difficult for the beer market to turn the course toward growth.

We need to depart from the traditional management style of relying solely on beer



Kato Kazuyasu, President and CEO, Kirin Holdings Co.

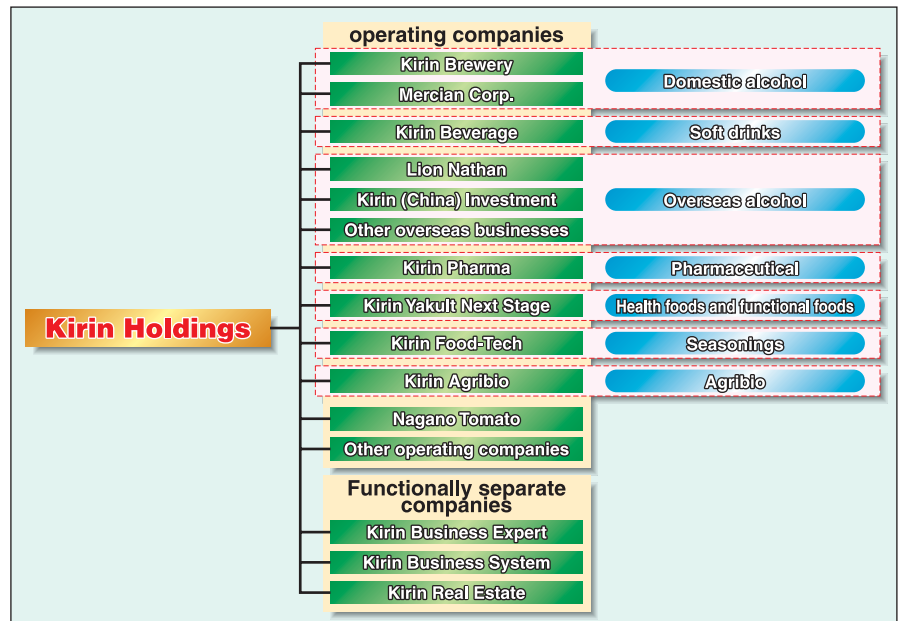
and take a fresh look from the perspective of becoming a comprehensive alcoholic drink maker. Kirin is extending its business fields from traditional beer to *happoshu*, other new types of beer-like beverages, whiskey, *shochu* (distilled spirits), and wine. Kirin took over Japan's No. 2 wine maker Mercian Corp. this year to strengthen the group's wine business. Sales of canned *chubai* drinks (*shochu* highball beverages) are expected to grow steadily. Kirin needs to offer various products to customers at a steady pace from the viewpoint of an all-round producer of alcoholic drinks.

Putting Resources Flexibly into Growing Fields

Kirin launched a new group management system led by the holding company in July this year on the occasion of the 100th anniversary of its founding. Kirin is not going to remain just a maker of alcoholic drinks and aims to branch out into various other business fields.

Kato: Kirin's previous strategy was to use its group resources to strengthen Kirin Brewery Co., which was a business-operating holding company. Under the new management system, the new holding company has boldly transferred authority to business firms under its wing to help them make speedy decisions in response to market needs. I believe the new system will help operating companies achieve stronger growth than before. Moreover, the holding company will look over the whole Kirin group and put its human resources and funds into promising fields in a bolder manner. This is

Organogram of Kirin Holdings



particularly effective to M&A deals. A single operating company cannot make a flexible response, partly because of financial constraints.

Kirin views M&A as an important strategy to achieve growth.

Kato: We have worked out a business plan to invest ¥300 billion in M&A in the coming three years. But we will not stick to that figure and are ready to be more active if there are chances. We are prepared to make active M&A investment beyond that amount if necessary.

On which business field do you place the biggest importance in your M&A strategy?

Kato: Under our strategy, we are not planning to promote M&A in order to boost the sales volume or increase profits. We are planning to strengthen the group’s development capability and expand its business areas through M&A by combining our own technologies and advantages with those of targeted companies. All mainstay business fields are subject to our M&A targets. In the field of alcoholic drinks, Kirin has acquired Mercian. This means that Kirin could advance, through M&A, into the wine business. We have now acquired licenses for production of all types of alcoholic drinks. We are required to search for targets under our M&A strategy in all business fields, such as beverages and medicine.

Aggressive Management Needed at Time of Market Shrinkage

You said all business fields are subject to your M&A targets. How are you going to share out the M&A funds of more than ¥300 billion?

Kato: I believe half the funds will go to alcoholic drinks and the other half to other sectors. If fund destinations are

categorized into Japan and abroad, the proportion will also be half and half. But I don’t know what will be the results. Such a proportion will be a rough guide to our M&A strategy. The results can be different, but we have taken such an assumption. An overseas beverage operation is also a promising field.

The “Gogo-no-kocha” (afternoon tea) series of bottled black tea that Kirin Beverage Co. has begun marketing in Shanghai, China, is selling explosively well now. It has become popular in China, especially among young women. China will be a considerably large market because of such a large population. Green tea also sells well abroad, notably in Thailand and China. World-famous beverage makers have their own traditional styles of product development. The Kirin group has taken the leadership in the world in terms of capability to develop beverage products. Kirin’s development capability that has been built up through tough competition among Japanese makers will be helpful in our overseas operation.

Kirin is breaking out of the shell of a beer brewer into an all-round manufacturing group of alcoholic drinks and also is aiming at

branching out into various fields, such as medicine, as you said earlier. Then, are you turning around Kirin’s management policy?

Kato: Kirin has marked the 100th anniversary of its founding. I think we must lay the groundwork for another 100 years. Now is the time to expand the company’s business base and strengthen its advantages further. We should never seek a mere extension of the company’s conventional business. I believe our duty is to develop Kirin into a notch-above firm. In that sense, M&A is one of Kirin’s mainstay activities. There was little or no thinking of the kind in the past 100 years. Kirin must make another leap in the next 100 years even under tough business conditions such as a market shrinkage stemming from a population decline. I have maintained such awareness. A large amount of funds is on hand to achieve those targets.

Sales Style Changed to Customer-oriented One



Hangzhou Qiandaohu Brewery Co., Kirin's Chinese base, is located in the capital of Zhejiang.

Let me return to the topic of beer. Japanese beer brewers continue to fight a bitter battle for a larger share in the shrinking beer market. Some industry people say Kirin will regain the position as Japan's top beer brewer this year for the first time in six years.

Kato: We are not conscious of market share and the position of an industry leader in drawing up business plans. Our basic idea is to consider what Kirin ought to be and to steadily achieve the targets. If we could seize the largest market share as a consequence of such efforts, that is of course better. We have rolled out a new product, "KIRIN THE GOLD," for younger-generation customers who have stayed away from beer. It is Kirin's first big-ticket product in 20 years. "KIRIN THE GOLD" offers a wonderfully satisfying combination of rich-tasting malt and mildly bitter hops. I believe younger customers must be feeling "KIRIN THE GOLD" as a next-generation beer product offered by Kirin as a culmination of its 100 years of technological expertise.

Kirin had long retained the biggest domestic market share before losing the top position to Asahi Breweries Ltd. in 2001. What lessons did Kirin learn from the fall from the No.1 position?

Kato: Kirin's goal at that time was to maintain the top spot in terms of domestic market share. Our sales and marketing targets were to boost figures

Photos: Kirin Holdings Co.



Construction of a state-of-the-art brewery, commenced in February 2006 in Zhuhai, Guangdong Province, will be completed this year.

and raise our market share. To achieve such targets, we focused on product pricing in sales activities. We did not place much importance on such aspects as offering fresh value-added to customers, developing new, attractive products, showing a fresh recipe, telling how to provide tasty products, or proposing a fresh style of product display at stores. Kirin tended to pay attention to competition with rival brewers and was not customer-oriented. After losing the top spot in terms of market share, we have noticed that our conventional business style of setting numerical targets was wrong. In the fall of 2001, Kirin decided to abandon such a business style. We confirmed that we must restore the quality-oriented, customer-oriented spirit that was established at the time of the founding. We departed from the price-oriented business style that called for boosting sales volume even at a discount.

But it was not so easy to make a shift swiftly to the customer-oriented style calling for proposing fresh values to customers. Sales figures continued to decline even after the departure from the price-oriented business style. There emerged a chorus of worrying in-house voices. Some said Kirin is pursuing ideals too much, while others were concerned about the future of the company amid an unabated decline in Kirin's market share. But we hung on to the new business style, believing that it would come to naught if we turned back. We never moved to turn back. If Kirin resumed the previous price-oriented sales practice at that time, it might have led to a temporarily

extended lease of life. But it would have never led to the present-day Kirin. We must offer such products as customers will select if our products and those of our rivals are of the same price.

3 Strongholds in Growing China

Beer consumption is quickly expanding in China in line with its economic growth. China accounted for nearly 20% of the world's total beer consumption in 2005. On the backdrop of the shrinking domestic market in Japan, Kirin's beer business in China is expected to become a major pillar, isn't it?

Kato: In China, we have picked three priority regions – three northeastern provinces, the Changjiang (Yangtze River) delta, and the Zhujiang (Pearl River) delta. We completed production and sales strongholds in all the three key locations by the end of 2006. Notably in the Zhujiang delta region, we have established a wholly owned subsidiary. China's beer market is growing at an explosive pace. China has widened its lead over other countries since becoming the world's No.1 beer consumer in 2003. Sales continue to grow in volume terms, but beer prices in China are low. We cannot put Kirin's upscale-brand products easily on the Chinese market. Our current main business policy in China is to introduce Kirin's technology to local brands and survive competition in the Chinese beer market. There were as many as 1,000 beer brewers in China at one point. The figure has decreased to several hundred now. But I believe competition will gradually force many of these brewers out of the market. Kirin has acquired equity stakes in Chinese brewers whose products are of good quality. Kirin's stakes currently are around 25% each. As a next step, we are planning to raise the stakes in those which are growing sharply or contributing much to our own business. We naturally have a separate strategy of searching for stable business partners to increase our investment destinations.

Eying Vietnamese, Thai Markets

Your long-term business plan, “Kirin Group Vision 2015,” sets the group’s overseas sales ratio in 2015 at 30%. It also sets a target to make Kirin the Asia-Oceania region’s leading company. Would you brief me on Kirin’s overseas strategies other than for China?

Kato: In areas other than China, Kirin has concluded capital and business alliance agreements with major Australian beer and wine producer Lion Nathan Ltd. and major Philippine food and drink maker San Miguel Corp. It is important to strengthen the partnerships with them. In other areas, we are studying possible entries into Vietnam and Thailand whose beer markets are growing. I believe these areas could be Kirin’s next investment destinations if there are chances. In reality, however, it is difficult for Kirin to launch its beer business by itself in these markets. The first step would be for Kirin to purchase stakes in local firms, provide technology to them, and help them grow into respectable companies.

Japanese beer brewers face fierce competition with US and European rivals in the growing Asian market. What advantages do you have in facing those competitors on the world stage?

Kato: Eventually, it would be a battle with US and European brewers in the Chinese market, too. All major players of the world are targeting the Chinese market. But Japanese brewers have the most sophisticated technologies in the field of draft beer. Kirin is doing business in that field in China. US and European brewers have no such technologies. Japan excels particularly in technologies for microorganism management and quality control. In the aspect of product packaging, Japanese beer brewers have accumulated expertise after undergoing tough selections by Japanese customers. In terms of marketing know-how and product development capability, Japanese brewers

are superior in appealing their products to customers in a finely tuned manner that has been established through extremely severe competition in the domestic market. This would definitely help us overwhelm foreign rivals that sell only the same products over tens of years. I believe the Japanese brewers are fully competitive on the world stage.

Beer Industry Realignment Not So Easy

US investment fund Steel Partners has moved to take over Japan’s No. 3 beer brewer Sapporo Holdings Ltd. Industry analysts believe that behind the move is speculation the size of Japan’s beer and beer-like beverage market is tapering off and that the Japanese beer industry will be unable to maintain the current framework of four major brewers in the long run. How do you see the future of the Japanese domestic beer industry and any possibility of an industry realignment?

Kato: We are closely watching Steel Partners’ moves. But I don’t think the number of unique brewers like Sapporo will decrease so easily. I don’t think Japan’s beer industry is so weak. I don’t think the number of brewers will decline so easily because they have firmly established brands and customers. However, waves of realignment have currently hit many of Japan’s industries, including financial services and distribution. Realignment would help brewers supplement each other in enhancing functions to gain strength and would also contribute to market stability. It is easier to talk about realignment than actually doing something that accompanies tough measures such as restructuring. In the event of realignment, we should avoid such a style that a superior one puts the other under its control. I think it is better and desirable for two brewers to produce effects greater than those of the two simply combined through their business integration.

Is it possible for Kirin and Sapporo to move to integrate their operations?

Kato: I cannot say we will never do that. But alcoholic businesses need to clear various hurdles, such as licenses and legal matters involving the Antimonopoly Law. There are difficult challenges to realize business integration between brewers.

Improved Corporate Value First Against TOB

Large foreign firms in terms of market value are expected to activate their takeover bids (TOB) for Japanese companies now that a ban on the so-called triangular merger was lifted in May. There are a number of food firms in the world whose market values exceed Kirin’s by several times. Some Japanese corporate managers are concerned about possible takeover bids by foreign companies. How do you see moves by foreign firms to buy Japan companies?

Kato: We must be fully careful not to be swept away by such a torrent. We need to work out business plans of higher growth, achieve targets under them, and make efforts to convince others that they cannot achieve such a high level of success if they are at the helm of management. It is most important to raise corporate value. It is important to achieve aggressive targets, not passive, and to do things that others cannot. We are currently looking into desirable defensive measures against TOB. Those measures must be effective and are also required to protect existing shareholder interests. I won’t say that such measures are not necessary, but I believe a rough-and-ready decision should be avoided. I don’t think the lifting of a ban on triangular mergers would immediately lead to a threat to us. But we are required to make sufficient studies to defend ourselves now that the number of takeover means has increased. **JS**

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