

Term paper

Trolls picking roses - The case of HBB's acquisition of Nøgne Ø -

Exam code and name:

Interorganizational strategies

Programme:

Master of Science in Business

Campus:

BI Nydalen

Table of contents

Executive summary	ii
Introduction	1
The beer industry and main actors in the case	1
Interorganisational relationships	3
<i>Definition</i>	3
<i>Types of interorganisational relationships</i>	3
HBB's motivation for entering the relationship	4
<i>Transaction cost economics</i>	4
<i>Resource based view</i>	5
<i>Framework for choosing between acquisitions and alliances</i>	7
<i>Profit pools and diversification</i>	9
Conclusion	10
Literature	11

Executive summary

This paper is a case study of the acquisition of the craft brewer Nøgne Ø by the brewing corporation Hansa Borg Bryggerier. The paper describes different types of IORs and motivations for choosing a specific type of IOR through relevant theoretical perspectives. The case is used as an illustration of theoretical insights into interorganisational relationships (IOR) in general. The research question addressed in this paper is: Can the acquisition of Nøgne Ø be seen as a good strategic move for HBB, and what are different choices involved in entering this interorganisational relationship? The research question is answered by applying transaction cost economics, resource based view, and the framework introduced by Dyer et al. (2003). The different theoretical perspectives offer different conclusions. The paper concludes that it is not entirely clear whether an acquisition was the best strategy in getting access to the resources and capabilities inherent in Nøgne Ø, but it might have been the only opportunity for HBB.

Introduction

This paper is about an acquisition in the beer brewing industry, an industry consisting of two very different segments. Although interesting in its own right, the case will be used to illustrate theoretical insights into interorganisational relationships (IOR) in general. The paper describes different types of IORs and motivations for choosing a specific type of IOR through relevant theoretical perspectives.

In 2013 Hansa Borg Bryggerier (HBB), the second largest corporation of breweries in Norway, made several offers to acquire Nøgne Ø, a successful Norwegian craft brewery. Nøgne Ø declined the offers, but eventually HBB bought stocks from several minority shareholders at many times the book value (Undlien and Sandvik 2014), acquiring 54,44% of the stocks. This can be considered a hostile takeover (Schneper and Guillén 2004) resulting from HBB becoming the majority shareholder. This acquisition strategy has been a trend in the international brewing industry (Witowski 2014), and in both the UK and the US large conventional brewers have acquired smaller craft brewers in order to differentiate, gain access to the craft beer market, and achieve growth (Farrell 2015). The two segments follow diametrically different strategies, and it is not clear that acquisitions of independent craft brewers are a sustainable strategy for mass producers in the long run. Thus, it is interesting to investigate what consequences the deal has for the two companies and for the relationship between them. 18 months into the deal, it is not yet clear if this acquisition has been successful. Thus, the research question of this paper is:

Can the acquisition of Nøgne Ø be seen as a good strategic move for HBB, and what are different choices involved in entering this interorganisational relationship?

There are many perspectives applicable to the field of IOR in general, and to acquisitions in particular. I will apply TCE, RBV and the framework introduced by Dyer, Kale and Singh (2003), using the case to illustrate issues when choosing between different forms of IOR.

The beer industry and main actors in the case

The beer brewing industry is a large industry with revenues of around 5 billion NOK per year (Proff forvalt), equivalent to 256 million litres per year (in 2010).

The growth in volume from 2001-2010 was 11,4%, with a national population growth of 7,3% in the same period (data from SSB). The industry is very concentrated and can be considered a duopoly, with two firms holding more than 80% of the market. Ringnes is the largest with 52,5%, and Hansa Borg Bryggerier (HBB) holds 29,5% (Lie 2013). The market can be divided into two segments: conventional beer and craft beer. The conventional beer segment includes large mass-producing actors. The second segment consists of smaller craft brewers. Until 1940, craft brewers were the norm in Norway, before the market was taken over by mass producers in a legal cartel (Lie 2013). Craft brewing in its current form originates from the US, and can be seen as a counter reaction to conventional segment. The American Brewers Association defines craft brewers as small, independent and traditional brewers (Brewers-Association 2015). Craft beer is made more manually than conventional beer, and offers a broad spectrum of distinct varieties, the prototypical craft beer being the Indian Pale Ale. The craft beer segment represents only 2,2% of the total market for beer in Norway (2013 by volume) (Undlien and Sandivik 2014), but there are large differences in the growth of the two segments. The market for conventional beer has been stagnant or falling the last 15 years, while the craft beer segment has been in strong growth (Undlien and Sandivik 2014). The total market has had a small growth because of this.

HBB is the second largest corporation of breweries in Norway. It is comprised of several large and smaller breweries from all around Norway. According to Proff Forvalt, HBB has more than 500 employees, and annual sales of about 1 billion NOK (2013). Nøgne Ø was founded in the early 2000's in Grimstad, Norway, and has a staff of about 20. It was one of the first craft breweries of its kind in Norway, and has enjoyed great growth and profitability. Today, Nøgne Ø is the largest craft breweries in Norway. Innovation is central in the company, culminating in they becoming the first European sake producer in 2009 (Kleiberg 2009). The two companies practice different strategies. Described with Porter's generic strategies (Porter 1980), HBB follows a cost leadership strategy, with a low cost and a broad competitive scope. Nøgne Ø follows a focused differentiation strategy, with higher costs and a more narrow competitive scope. They have different philosophies, HBB seeks scale advantages and market power, whereas Nøgne Ø seeks innovation and excellence in its field (Lie 2013).

Interorganisational relationships

Definition

There is no consensus of how to define interorganisational relationships. Gulati (1998) refers to all IOR's as alliances, and defines them as "voluntary arrangements between firms involving exchange, sharing, or co-development of products, technologies, or services. They can occur as a result of a wide range of motives and goals, take a variety of forms, and occur across vertical and horizontal boundaries." (Gulati 1998, 293). This is a very broad definition, which includes all inter-firm relationships. Buckley (Buckley 1992, 91) introduces a time element, suggesting that alliances may have a limited duration: "inter-firm collaboration over a given economic space and time for the attainment of mutually defined goals". I will use the term IOR, treating alliance as a specific subcategory of IOR, described in more detail below.

Types of interorganisational relationships

There are many different types of IOR. By applying transaction cost economics (TCE) we can arrange the different types of IOR on a continuum from market to hierarchy, depending on the boundary of the firm, using Santos and Eisenhardt's (2005) concept of the boundaries of efficiency. The type of IOR referring to market, is defined as an alliance under Gulati's definition, but may not be considered an alliance by many. These are market transactions, and can be anything from a one-off deal to a tight-knit life-long customer-supplier relationship. Mergers and acquisitions represent the other extreme, and is when the two firms in the alliance are included within the same legal boundary. Between these two extremes, we find equity and non-equity alliances. Equity alliances are closer to hierarchy, and involve investing in another firm. There are different forms of equity alliances, such as joint ventures and equity swaps. Non-equity alliances are closer to market. The actors are not financially involved with each other. Different forms include licencing and R&D networks. There are many differences between these forms of IORs. One important aspect is the necessary investment costs and uncertainty involved, and these are at the highest level in the hierarchy side of the continuum.

Choices faced by HBB's in entering the relationship

The motivation for choosing one type of IOR over another can be viewed through the lens of many different theories (Dong and Glaister 2006). I will focus on transaction cost economics (TCE) and the resource based view (RBV). Dong and Glaister (2006) focus on international strategic alliances, but some of their points are general. Through the TCE lens, they argue that a strategic alliance enables diversification in products and services. Applying RBV, they argue that motivations for alliances are to share R&D costs and to enable faster payback on investments. In mainstream economics, they argue that the motivation may be to spread investment costs and risk, to achieve economies of scale, and to cooperate with existing or potential competitors to reduce competition.

Transaction cost economics

TCE assumes that actors are rational and will display opportunistic behaviour if given the possibility (Williamson 1991). TCE defines the choice as a “make or buy” decision, and analyses all transactions discretely (Williamson 1991). The make or buy decision results in a choice between market, hierarchy or one of the hybrid forms. In the IOR context these correspond to market transactions, merger and acquisition or (non-)equity alliance (Williamson 1991).

There are three main characteristics to consider when making this decision (Williamson 1991). The first and most important characteristic is asset specificity. This compares the value of a specific investment in the current relation, to the value in its second best use. The asset specificity is high if this difference is high. High asset specificity in the relationship favours hierarchy organisation, or M&A's. The second characteristic is uncertainty, divided into environmental uncertainty and behavioural uncertainty (Rindfleisch and Heide 1997). Environmental uncertainty results in an adaption problem, referring to difficulties in modifying contracts to changing environments. Behavioural uncertainty is a performance evaluation problem, giving difficulties in verifying if the delivered product is in compliance with the agreement. Transactions with a high degree of uncertainty favours hierarchy organisation. The third characteristic is frequency, how often transactions between two actors occur. A relationship with a high frequency of transactions favours hierarchy organisation.

To tie this more concretely to the field of IOR in general and to the case in particular, we can frame the choice as HBB wanting to diversify into craft beer using Nøgne Ø and others as suppliers. In that case they have two alternatives. They could use the market and buy craft beer from different suppliers regulated by contracts, or use a hierarchy solution and acquire a craft brewer to brew for them. When considering the asset specificity, it is high if HBB wants the craft brewer to develop a line of craft beers for HBB, and low if they only buy off-the-shelf products. In considering the uncertainty in the acquisition, the environmental uncertainty can be argued to be high because of low barriers to entry for foreign new entrants. Behavioural uncertainty can also be argued to be high, as it is difficult to evaluate the quality of craft beer, because of differing quality measures in the two industries. The frequency would be high in this relationship. Overall, the TCE framework is not a perfect fit for analysing this case, but would nevertheless conclude with recommending an acquisition. I will proceed with an analysis based on more fitting perspectives, more specifically RBV and the framework proposed by Dyer, Kale and Singh (2003).

Resource based view

According to RBV, the firm is considered a bundle of resources and capabilities (Barney 1991). Peteraf (1993) argues that four conditions underlie sustainable competitive advantage, all of which must be met. Firstly, a firm needs to have superior resources, and RBV assumes that resources are heterogeneous across firms. Secondly, there must be ex-post limits to competition. This means that heterogeneity in resources is preserved, so that the supply of scarce resources is not increased. Thirdly, imperfect resource mobility is required. This implies that the resources are tradable, but have more value within the firm that currently employs them than the value in another firm. Lastly, there must be ex-ante limits to competition. This means that there is limited competition for a given resource, due to one firm having the foresight to anticipate that this resource will be valuable in the future. Without this last requirement, all future rents will be competed away.

There are four possible strategies in acquiring new resources and capabilities: Internal development, external procurement, full acquisitions and IOR's (Riviera-Santos and Inkpen 2009 cited in Parmigiani and Riviera-Santos 2011).

(Here we see that differing definitions of IOR's may lead to confusion. In this case, the researchers are not including acquisitions and market transactions in their IOR definition.) Internal development is considered the least resource intensive, but slowest, strategy to attain new resources and capabilities. IOR's are considered a quicker strategy than developing the resources and capabilities internally, but carries the risk of dissemination of valuable knowledge. Acquisition mitigates this threat, but requires significantly more resources (Parmigiani and Rivera-Santos 2011).

A good place to start when applying RBV to the case, is defining what resources and capabilities HBB wants to attain from Nøgne Ø. Nøgne Ø has a leading market position in its segment, making high quality craft beer and enjoying a superior brand. The resources in this case could be defined as the brand "Nøgne Ø", the domain-specific knowledge, and access to the segment. But will these resources give sustainable competitive advantage for HBB? Firstly, one can argue that the human resources in Nøgne Ø are heterogeneous by nature, and by this it is possible to achieve superior resources. Secondly, even though there are several successful craft brewers, and the number of them is increasing, the price for the firms are not decreasing, thus the second requirement is met. Thirdly, it is not definitive that the resources are imperfectly immobile. Each resource separately are more worth in Nøgne Ø than in HBB, but when all the resources are bundled together like the firm Nøgne Ø, we can not say definitively whether this is more worth by its own or acquired. Lastly, the requirement for ex-ante limits to competition is also not definitive, but a hint towards the requirement being met, is that HBB paid 5,8 times book value for the stocks, thus they might have recognized Nøgne Ø as an underexploited resource. On the other hand, they could just have overpaid for the stocks. Overall, we see that Nøgne Ø might be a valuable resource for HBB, and attaining it could give them sustainable competitive advantage.

Taking a step back, HBB had several alternatives when attaining these resources. They could have developed the resources themselves. Although possible in theory, this would likely take many years, and would probably not compete successfully with Nøgne Ø. External procurement would not have been applicable here because of the "soft" nature of the resources. An alliance could have been an

alternative, for instance a joint venture where the two organisations pool their resources together to make the resources available to both organisations.

However, this strategy requires Nøgne Ø to also gain something from the joint venture, this could be scale advantages, but a disadvantage with this is that HBB does not gain control over the resources, only access. Also, Nøgne Ø would maybe not enter this cooperation due to risk of dissemination of knowledge and “watering out the brand”.

By choosing an acquisition, they gained control over the resources quickly, but at a higher investment cost than the other alternatives. Moreover HBB might not have gained control over the resources, merely access. When acquiring knowledge that is not codified, the firm acquires the employees carrying the knowledge within them. If the employees decide to leave the firm, they take all the knowledge with them. It is possible to include time limited do-not-compete clauses in the contracts (Rubin and Shedd 1981), but this does not keep them from taking away the knowledge, it only keeps them from using the knowledge against the acquiring firm. These contracts can also be considered anti-competitive, and are not always enforced by courts. However, they are sometimes deemed necessary to create incentives to invest in human resources (Rubin and Shedd 1981). Thus, it is not definitive whether the resources in question in fact will give HBB sustainable competitive advantage. But the fact that they actually followed through with the acquisition, might suggest that Peteraf’s framework is insufficient to fully understand this case, or that HBB knows something we do not.

Framework for choosing between acquisitions and alliances

In this case, a partial acquisition was chosen. Being the majority shareholder HBB has a considerable influence on Nøgne Ø, so for this paper I will treat it as a full acquisition, even though some may treat this as an equity alliance. A 2002 survey shows that a majority of top US managers do not differentiate between alliances and acquisitions (Dyer, Kale and Singh 2003). Dyer et al. (2003) propose a framework for choosing between acquisitions and alliances – to use our established definition; alliances refer to equity and non-equity alliances. It has five dimensions, and an acquisition should be chosen when (1) the synergies are reciprocal (as opposed to modular), (2) the relative value of soft to hard resources

is low to medium, (3) the extent of redundant resources is high, (4) the degree of market uncertainty is low to medium, and (5) the level of competition for resources is high. I will go into some of the points in more detail. (1) Modular synergies are achieved when the resources are managed individually, and only the results are pooled together for greater results. On the other hand, reciprocal synergies are achieved when the firms are working closely together. This requires customisation of the resources, and combining them through an iterative knowledge-sharing process. (2) Human resources are considered soft resources, and Dyer et al. (2003) strongly advice against choosing acquisitions when dealing with a large proportion of soft resources to hard. The employees may become unproductive because they feel disinclined to work for the firm that used to be their competitor (Dyer, Kale and Singh 2003).

In this case, the synergies are mostly modular, as they aim to keep the brands separated, and somewhat sequential, as Nøgne Ø make the recipes for the most popular beers, and hand the production and distribution over to HBB. The resources in Nøgne Ø can be considered mostly soft, as craft brewing requires specific know-how. The hard resources are relatively easy to acquire in the market, but are a very small proportion of the total value of the resources. The extent of redundant resources is more difficult to evaluate. The production equipment, like kettles, bottling machines and storage, are redundant, but the knowledge in the firm is not. The brand is also an important resource, and is unique. The redundant resources are the hard resources, so in value, the share of redundant resources is low to medium. Compared to faster-paced industries like the IT industry, the beer market has relatively low uncertainty, but it is still difficult to assess the future value of the acquired firm. As we have seen in the US and UK beer industries, the competition for targets for acquisition is high. And although there are few competitors to HBB in Norway, there are many international competitors, and the market for conventional beer is decreasing. We see that there are many reasons for HBB to choose alliance over acquisition – only the level of competition and market uncertainty count towards choosing an acquisition. The framework does not offer advice on what to choose when the dimensions diverge. Reaching a definitive answer would need careful further analysis.

Profit pools and diversification

Zook (2007) argues that when the profit pools, places in the value chain where attractive profits are earned, are shifting or shrinking, it can be time to evaluate the core business. One way to do this is by evaluating the industry's profit pools. Key figures include size, growth and stability, shifts and projections, and costs and prices. For the beer industry, we can see that the profit pool for conventional brewers is large, but the profits and growth are low (Undlien and Sandvik 2014). The trend is negative, and prices are low (Lie 2012). Adjacent to HBB's current profit pool, the craft beer segment enjoys a high growth, and the largest producers also enjoy high profits (Undlien and Sandvik 2014). Zook further argues that when firms seek to shift or expand its core business, they are often tempted by large acquisitions far from their original core, but a shift that is closer to its original core is usually more successful.

For HBB the dominant strategic motivation for the acquisition can be argued to be diversification. Looking at the growth in the two segments, we see that HBB needs to diversify in order to gain access to the craft beer segment. From a financial viewpoint, HBB needs to enter this industry to mitigate the stagnant market growth recent years. At first glance, the segment appears to have low entry barriers, however, Undlien and Sandvik (2014) argue that it is only the first movers who today enjoy profits in the craft beer market, suggesting the existence of extensive learning effects. Thus new entrants will have difficulties in achieving profitability. Considering Nøgne Ø's favourable position in the market segment, acquiring this firm seems like a viable option for HBB from both a strategic and a financial point of view.

Although forced into the relationship, there may be some benefits for Nøgne Ø in this relationship as well. For instance, they have had capacity problems, and are able to transfer the production of larger volume beers to one of HBB's breweries. By doing this, they are able to secure future profits, allowing them to concentrate their core business on innovation and excellence. However, as a majority shareholder HBB exerts considerable influence on Nøgne Ø's activities, and may not be as eager to invest the surplus into bold innovations. Furthermore, it is not certain that increasing scale is the right strategy for Nøgne Ø, as they follow a focused differentiation strategy, and when changing from a focused differentiation

strategy to a differentiation strategy, there is a risk of getting caught in the middle (Porter 1980).

Conclusion

Many acquisitions fail (For instance Selden and Colvin 2003). This may partly be attributed to managers' choice of IOR strategy (Dyer, Kale and Singh 2003). Different perspectives offer different conclusions in choosing an IOR form, and it is important to choose the most fitting strategy, not just the one initially preferred. In this case, RBV had a better fit than TCE. The framework of Peteraf (1993) showed that Nøgne Ø is a valuable resource for HBB, and may give them sustainable competitive advantage. The analysis also showed that HBB might have recognised Nøgne Ø as an underexploited resource that might prove highly valuable applied in the right way. The framework of Dyer et al. (2003) did not offer a definitive conclusion in the choice between acquisition and alliance, but warns against choosing acquisitions when there are soft resources and modular synergies involved as in this case.

We do not yet know if this acquisition has been successful for HBB. To assess this, we need to know the true motivation for making the acquisition. It could be that the motivation was based on a pre-emptive argument, if HBB did not make the acquisition, someone else might have; or by institutional arguments, like "everybody else is doing it". Having made the acquisition, the important part of managing the acquisition is still to be done. However, it has recently been announced that one of the two founders of the company, head brewer Kjetil Jikiun, is leaving the company, only 18 months after the deal was made. This is said to be because of "internal struggles" (Berg 2015). In the context of this acquisition, this might be interpreted as sign of failure. In an interview one year before the acquisition, Jikiun said that he did not like the way HBB conducted business, and hinted towards HBB being anti-competitive (Lie 2012).

One question that still is unanswered is whether an acquisition like this is possible at all. Can a large conventional firm like HBB acquire a small, enthusiast firm like Nøgne Ø without destroying what they originally were after? Using an analogy, one can say that this acquisition may be like a troll picking roses. He can bend down and take them, but not without destroying them in the process.

Literature

- Barney, Jay. 1991. "Firm resources and sustained competitive advantage." *Journal of management* 17 (1): 99-120.
- Berg, Pål Yngve. 2015. "Suksessgründer går etter 13 år" Accessed May 25th 2015. <http://www.agderposten.no/nyheter/suksessgrunder-gar-etter-13-ar-1.1387459>
- Brewers-Association. 2015. Accessed May 25th 2015. <https://www.brewersassociation.org/statistics/craft-brewer-defined/>.
- Buckley, Peter J. 1992. "Alliance, technology and markets: a cautionary tale." *Studies in International Business, London: Macmillan*.
- Dong, Li and Keith W Glaister. 2006. "Motives and partner selection criteria in international strategic alliances: Perspectives of Chinese firms." *International Business Review* 15 (6): 577-600.
- Dyer, Jeffrey H, Prashant Kale and Harbir Singh. 2003. "When to ally & when to acquire." *Harvard business review* 82 (7-8): 108-15, 188.
- Farrell, Sean. 2015. "SAB Miller buys Meantime to enter UK craft beer market". The Guardian Accessed May 25th 2015. <http://www.theguardian.com/business/2015/may/15/sab-miller-buys-meantime-to-enter-uk-craft-beer-market>.
- Gulati, Ranjay. 1998. "Alliances and networks." *Strategic Management Journal* 19 (4): 293-317. doi: 10.1002/(SICI)1097-0266(199804)19:4<293::AID-SMJ982>3.0.CO;2-M.
- Kleiberg, Gunnar. 2009. "Japansk sake fra Rygende". NRK Accessed May 25th 2015. <http://www.nrk.no/sorlandet/japansk-sake-fra-rygene-1.6544558>.
- Lie, Øystein. 2013. De som brygger landet. *Magasinet Plot*, December 2012, 24-53.
- Parmigiani, Anne and Miguel Rivera-Santos. 2011. "Clearing a path through the forest: a meta-review of interorganizational relationships." *Journal of Management* 37 (4): 1108.
- Peteraf, Margaret A. 1993. "The cornerstones of competitive advantage: a resource-based view." *Strategic management journal* 14 (3): 179-191.
- Porter, Michael E. 1980. *Competitive strategy : techniques for analyzing industries and competitors*. New York: Free Press.
- Rindfleisch, Aric and Jan Heide. 1997. "Transaction cost analysis: Past, present, and future applications." *Journal of Marketing* 61 (4): 30-54.
- Rubin, Paul H. and Peter Shedd. 1981. "Human capital and covenants not to compete." *J. Legal Stud.* 10: 93.
- Santos, Filipe M and Kathleen M Eisenhardt. 2005. "Organizational boundaries and theories of organization." *Organization science* 16 (5): 491-508.
- Schneper, William D. and Mauro F. Guillén. 2004. "Stakeholder Rights and Corporate Governance: A Cross-National Study of Hostile Takeovers." *Administrative Science Quarterly* 49 (2): 263-295.
- Selden, Larry and Geoffrey Colvin. 2003. "M&A needn't be a loser's game." *Harvard Business Review* 81 (6): 70-9, 137.
- Undlien, Mari and Siri Sandivik. 2014. "Norske mikribryggeriers lønnsomhet." *Magma :tidsskrift for økonomi og ledelse* 17 (4): 52-55.
- Williamson, Oliver E. 1991. "Comparative economic organization: The analysis of discrete structural alternatives." *Administrative science quarterly*: 269-296.

-
- Witowski, Wallace. 2014. "Small craft-beer buyouts face big problems" Accessed May 25th 2015. <http://www.marketwatch.com/story/small-craft-beer-buyouts-face-big-problems-2014-11-07>
- Zook, Chris. 2007. "Finding your next core business." *Harvard Business Review* 85 (4): 66.