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Merger regulation, firms, and the co-evolutionary process: An empirical study of internationalisation in the UK alcoholic beverages industry 1985-2005

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Abstract

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Keywords:
Alcoholic beverages; Co-evolution; Competition policy; Merger regulation

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ABSTRACT

We present an historic industry study of the consolidation of the UK alcoholic beverages firms to inform debates in organisation studies relating to co-evolution and the dynamics of internationalisation. Given the constraints imposed on merger strategies by competition policy, once merger opportunities are exhausted at home firms are motivated to embark on international consolidation in order to continue a growth trajectory. This brings them into contact with unfamiliar and more complex institutional interactions. The ability to interact successfully with key agents in the institutional environment is likely to be an important source of firm competitive advantage. Our article conceptualises this process with reference to co-evolutionary theory. We distinguish behavioural and structural co-evolutionary factors in firms' strategic intent, mirroring the two types of remedies that competition authorities can impose on merging firms. We test this theoretical construct in an empirical investigation of the consolidating UK alcoholic beverages firms between 1985 and 2005. In this era Diageo was formed from the landmark merger of Grand Metropolitan and Guinness. Subsequently Diageo acquired the former international spirits empire of Seagram in partnership with a major competitor. Successful implementation of Diageo's merger strategy owed much to an ability to navigate the evolving multi-jurisdictional co-ordinated oversight of cross-border mergers and acquisitions. The formation of novel deal structures as well as co-operation with competitors to circumvent policy intervention were significant co-evolutionary mechanisms that have featured more generally in subsequent international mergers as others have copied these deal structures to achieve similar regulatory outcomes.

INTRODUCTION

We consider the role of sequential mergers and acquisitions in the internationalisation of the UK alcoholic beverages firms over the twenty year period 1985-2005. Although this is a relatively short time in the evolution of an industry whose brands have multi-decade histories characterised by internationalisation (da Silva Lopes, 2002), it was during the well documented 'merger wave' of the 1980s (Shleifer and Vishny, 1991) that the firms which controlled many of those brands came to international prominence. The landmark 1997 merger that created Diageo as the global leader in the spirits industry owed much to the strategic intent of and interplay between its two merger partners, UK conglomerate Grand Metropolitan (Grand Met) and Anglo-Irish brewer Guinness in the prior decade. It was during the 1980s that both firms made key decisions regarding their future orientation away from the UK and domestic brewing towards growth in the international spirits industry. Encouraged to internationalise by the backdrop of a UK brewing industry operating under the auspices of a second anti-trust investigation that would eventually end the political influence of the major firms (Bower and Cox, 2012), Grand Met and Guinness charted a series of moves and countermoves in a complex and dynamic international market. In interfacing with the multi-jurisdictional competition framework that was emerging, informed by economic and legal principles in lieu of the more traditional political influence over policy, an array of structures that included hostile bids, agreed mergers and international joint ventures were proposed on a 'trial-and-error' basis. The influence of Diageo over the evolution of international competition policy is significant, in particular with regard to exposing the difference in the economic treatment of 'portfolio effects' between the regulatory regimes of the US and Europe (Nalebuff, 2003). We have situated our case study as an extension to the developing co-evolutionary theory that features in the organisation studies literature but for which a definitive case for firm adaptation to as opposed to influence over institutional outcomes has not been established (Cantwell, Dunning and Lundan, 2010; Volberda and Lewin, 2003).

Although rarely discussed in the wider management literature, firm merger and acquisition activity is subject to and conditioned by the constraints of competition policy. This constraint precipitates strategic behaviour by firms as part of a deliberate attempt to circumvent policy intervention and smooth the acquisition process. Consequently firm and industry architecture is shaped by the formulation and implementation of policy. In identifying two discrete mechanisms whereby firm strategies might evolve to mitigate the remedial measures that competition policy can impose we seek to enhance existing co-evolutionary theory. We propose that 'behavioural co-evolution', with its political economy connotations underpinned by the regulatory capture literature of economics (Dal Bó, 2006), occurs more readily in a domestic setting. In this situation, relationships between firm and agency actors, often mediated via lobbying or trade-based institutions, are established and sustained through common affiliation such as political patronage and the funding of political parties. This was the situation in the UK domestic brewing industry for almost two centuries prior to a second anti-trust investigation in 1989 and subsequent legislation that imposed a major structural change on the industry in the early 1990s.

In moving onto the international institutional stage which is more complex and dynamic in its scope, opportunities for behavioural co-evolution are less likely to exist or indeed be sustained. Firms therefore have to find new ways to interact with their institutional environment. Through a process of 'trial-and-error' they establish new interaction mechanisms as part of their mergers and acquisitions experience. We refer to this as 'structural co-evolution' because it is manifest in novel structures such a temporary co-operative agreements between firms encountering unfamiliar environments with few pre-existing interpersonal or institutional linkages. The joining of forces between firms in the same industry to structure a deal that is likely to circumvent regulatory intervention bears similarities with risk-reduction strategies in international joint venture formation as a market entry strategy (Beamish and Lupton, 2009; Child and Rodrigues, 2011).

We develop the behavioural co-evolution and structural co-evolution conceptualisation as processes aligned closely to the manner in which competition policy has changed from a domestic process subject to political influence to one that has been forced to respond to the increasing international scope of many firms and industries. The internationalisation of the firms that owned or acquired portfolios of brands, some of which were international in their own right in the global Scotch whisky industry therefore presents an important empirical study. It showcases strategic intent in a transition period through firm-regulatory agent and inter-firm co-operation to accommodate and in some cases mark a seal of approval on the international competition policy framework. Behavioural co-evolution is evidenced empirically by reference to the pre-1989 'Beer Orders' politicised operating environment and the manner in which domestic mergers were regulated. Structural co-evolution is explained specifically in the transformation of the former Grand Met, from aggressive acquirer of its competitors to co-operative merger partner promoting and utilising a series of significant structural agreements to circumvent policy intervention.

THEORETICAL PERSPECTIVE

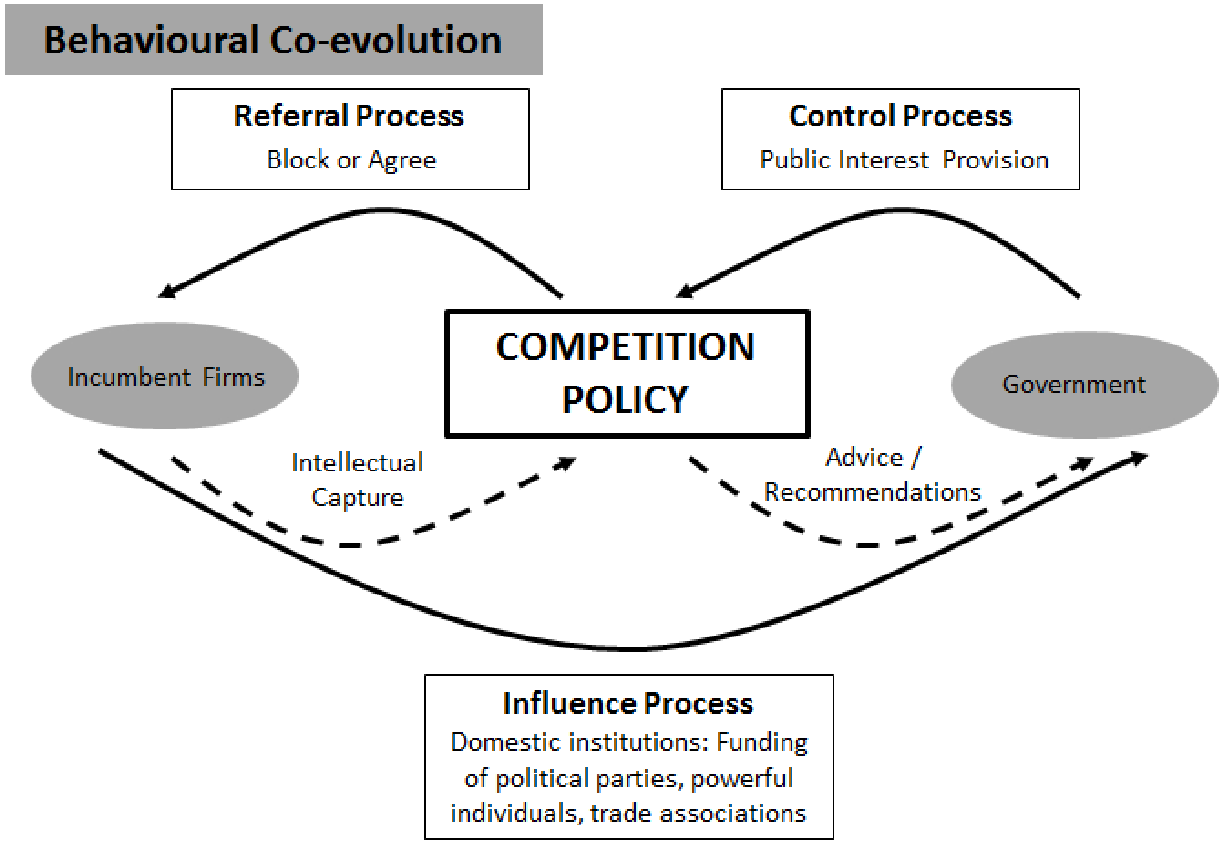
While there is a considerable and diverse academic literature on mergers and acquisitions, the role of institutions in sanctioning, constraining or indeed preventing a firm's mergers and acquisitions strategy has, in general, received limited attention. This is a surprising gap in the academic literature relative to practice. Firms and their advisors are acutely aware of the importance of managing the mergers and acquisitions process around two key features of the institutional environment; the relevant competition policy regime and the capital markets they require for finance. Given the financial and management costs of failed bids it is logical to anticipate that acquiring firms will want to be as sure as possible that a proposed merger will be cleared by the competition authorities. The importance of aligning firm strategy to the wider political context is not a new phenomenon (Baron, 1997; Ghemawat, 1986; Oliver and

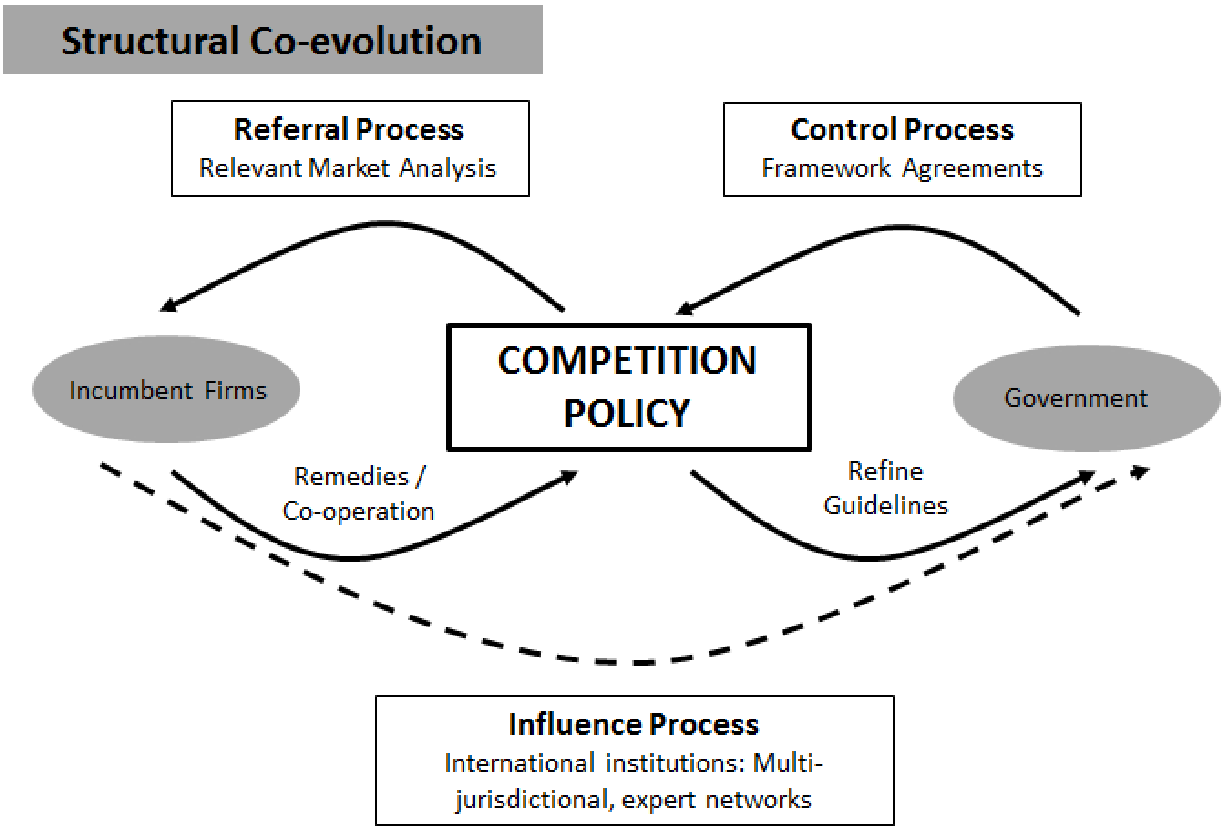
Holzinger, 2008) and the management literature recognises the key role of the institutional environment in influencing firm structure and behaviour (Kostova, Roth and Dacin, 2008; Peng, Sun, Pinkham and Chen, 2009). However extending theories of firm-institutional interaction internationally through informative empirical investigation of the merger process has been less forthcoming notwithstanding the crucial oversight of the competition framework of government (Shaffer, 1995) and how institutional variations might influence cross-border merger outcomes (Clougherty, 2005). Consequently the manner in which firms adapt to and seek to influence competition policy as part of the long-run sequential process of growth by mergers and acquisitions appears to be particularly important but remains relatively under-investigated.

Guided by the emerging co-evolutionary literature that seeks to incorporate multi-dimensionality into traditional static theories of how firms interact with their institutional environment (Cantwell, Dunning and Lundan, 2010; Rodrigues and Child, 2003; Volberda and Lewin, 2003), we propose a theoretic extension to the tools provided by co-evolution theory by reference to an empirical investigation of a key industry which during the 1980s and 1990s internationalised through a series of mergers and acquisitions. This is in keeping with earlier proposals for the integration of micro- and macro-level analysis in a unifying theoretical and empirical framework (Lewin and Koza, 2001). Although the co-evolutionary literature has progressed an understanding of firm-policy interaction at the axiom of power and politics feedback processes in a site-specific setting (Child, Rodrigues and Tse, 2012; Rodrigues and Child, 2003) the framework remains less well-defined with regard to the processes of internationalisation (Cantwell, Dunning and Lundan, 2010) notwithstanding its prior discussion in the strategic alliance literature (Hoffman, 2007; Koza, and Lewin, 1998). It is here that we seek to make an integrated theoretical and empirical contribution.

In characterising 'behavioural co-evolution' we draw guidance from the extensive regulatory capture literature of economics and political science which describes regulated firm behaviour through repeated interaction with regulatory agents (Dal Bó, 2006). Given that politically-motivated behaviour is not always possible within more complex multidivisional structures (Shaffer and Hillman, 2000) firms are motivated to identify other ways to circumvent regulatory intervention. Co-operation between firms is one such approach and it is important to note that the origins of the joint venture literature are in their use as structural mechanisms of anti-trust avoidance (Pfeffer and Nowak, 1976). Our case study situated in the 1980s and 1990s reveals considerable joint venture activity, often as a temporary organisation with a clear objective (Lundin and Söderholm, 1995), here, to manage the competition process. Recently researchers have identified the role of ‘experts’ in the causal mechanisms that precipitate co-evolutionary change in firms and industries (Murmann, 2013). Codified systems of regulation depend on expert opinion and interpretation under the auspices of ‘relevant market’ definitions in competition inquiries. With the additional macro overlay of cross-border institutional co-operation and negotiation, we propose that (formal) structure replaces (informal) behaviour in an effective merger strategy. We encapsulate this as co-evolutionary process models of merger strategy in Figure 1, and demonstrate its utility subsequently by means of our empirical case study.

Figure 1: Two mechanisms of co-evolution with competition policy





In ascribing behavioural co-evolution to firms and competition policy in Figure 1 we are guided by the understanding of behaviour between firms and regulatory agencies through the process of repeated interaction. The academic foundations of this literature emanate largely from early investigation in economics (Stigler, 1971) and the law (Posner, 1974) to describe, in its simplest form, the idea that regulators could be swayed by special interests that served to protect the powerful positions of a set of incumbent firms in an industry. The 'agency-theoretic framework' (Laffont and Tirole, 1991) and subsequent mathematical game theory applications seek to explain the behaviour of interest groups in influencing public decision makers through corruption and manipulation at the extreme (Dal Bó, 2006), to the mere eagerness to please private interests (Martimort, 1999). In some senses this is a natural response to a social interaction, where regulators are swayed by the arguments and perspective of the firms they are supervising as a function of their ongoing relationship, that is, intellectual capture. To what degree regulatory capture might extend to the oversight of mergers, where interaction is less frequent and where firms are part of competitive non-regulated industries has received more limited investigation. Insofar as it has been investigated the cross-sectional research design militates against uncovering changing temporal patterns and relationships. Empirical studies have, however, identified political interference in the merger process in both the US (Coate, Higgins, and McChesney, 1990), and Europe (Aktas, de Bodt, and Roll, 2007; Bougette and Turolla, 2007), in an era when policy was largely driven by domestic considerations. In the US analysis politicians were seen intervening directly in the workings of the competition authorities.

As firms increasingly embark on international expansion they face the task of adjusting merger strategies in order to conform to the constraints of the more complex cross-border competition policy framework (Clougherty, 2005). In these circumstances domestically-derived power and influencing mechanisms are less relevant. Moreover, the acquisition strategies of new entrants and multinational firms are more likely subject to the scrutiny of regulators in the face of adverse national public opinion. This is particularly the case for hostile bids, a feature of the 1980s unbundling 'merger wave' that saw the dismantling of many industrial conglomerates, frequently by foreign investors, in both the US and the UK (Franks and Mayer, 1996; Shleifer and Vishny, 1991). In the 1960s, the formation of these conglomerates had been driven by the desire to maintain corporate growth in an institutional environment that featured more aggressive anti-trust control over horizontal mergers within the same industry. Under these circumstances, firms employed alternative approaches to circumvent competition policy such as collaborative joint ventures. In the US, despite suspicions that joint venture structures had similar adverse competitive effects to horizontal mergers, they were often less frequently and vigorously prosecuted owing to their complexity (Pfeffer and Nowak, 1976). While there are many reasons why firms co-operate, co-evolutionary researchers have considered that inter-firm alliances need to be understood in the context of how firm strategy, institutional, organisational and competitive environments co-evolve (Koza and Lewin, 1998) and how during a process of mediation, firms with little power over their environment enhance their influence through co-operation with similar organisations (Child and Rodrigues, 2011). In the contemporary context of the oversight of complex cross-border mergers depicted through our analysis as Figure 1 we have been guided by the role of expert networks in the co-evolutionary process (Murmann, 2013). In this instance the expert network, as discussed below, incorporates economics and legal scholars both as independent firm advisers and as part of the agencies who determine the relevant market definition that underpins policy. In many respects this opens up the opportunity for intellectual capture in that these individuals are central to the evolution of policy within a codified framework; their advice is therefore crucial to both firms on one side of a merger negotiation and regulators on the other and their influence supports and ultimately changes policy. Indeed, high-profile academic economists operate on both sides of this interaction in much the same way as investment banks advise either buyers or sellers in corporate transactions.

The importance of considering firm mergers and acquisitions activity as a co-evolutionary process is an acknowledgment that firm structures today reflect historical processes of evolution in which the process of path dependency plays an important role in strategic choice (Sydow, Schreyögg and Koch, 2009), whilst mechanisms of feedback and learning bring new patterns (Child, 1997). The sense that some actors have more (political) influence than others in complex two-way interactive systems (Child and Rodrigues, 2011) has been proposed as the rationale for an apparent contradiction between a Schumpeterian view of firms converging over time in their appearance and behaviour and the resource and capabilities view of firms as idiosyncratic entities (Huygens, Baden-Fuller, Van Den Bosch and Volberda, 2001; McKelvey, 1997).

The concept of strategic choice and the vision and abilities of key actors in firms has been the subject of several case studies. Burgelman's longitudinal field study of strategy-making at Intel during its period of extraordinary success (1987-1998), drew attention to a phenomena known a 'co-evolutionary lock-in', defined as a positive feedback process that increasingly ties the previous success of a firm's strategy that makes it difficult to change direction (Burgelman, 2002). Firms searching for capabilities not only evolve in their role as competitors, but also prompt new search behaviour by others in the industry. Pioneering firms that successfully introduce new capabilities to the industry force their rivals to try to imitate those capabilities, initiating a period of turmoil where the industry is establishing a new equilibrium. It is from this process of search that novel capabilities emerge including the emergence of new organizational forms and new business models (Huygens et al, 2001). Yet how this evolves in a more politicised and regulated environment, as opposed to a freely competitive one, is in need of further analysis (Child, Rodrigues and Tse, 2012). While our study pertains to a partially-regulated industry, in that it is the subject of regulation through wide-spread licensing restrictions, it offers insights into political behaviour at both the firm, and industry level. Other studies have sought to link organisational evolution with regulatory change, using regulation as a natural experiment to decompose the bivariate relationship between attributes of organisational morphology and the environment (Lewin and Koza, 2001). In considering situations of 'deinstitutionalisation' in the context of the external pressure applied to firms, changing government regulations are considered most likely to dissolve practices due to coercion in legal enforcement (Oliver, 1992). Firms obtain competitive advantage through actively utilising political strategies to influence government policy and this requires active management of an organisation's capital resources (Frynas, Mellahi and Pigman, 2006; Shaffer, 1995) as well as at the level of individual managers (Bower and Cox, 2012; Jones and Miskell, 2005).

The above theoretical discussion identifies key concepts that have informed our proposed extension to the co-evolutionary framework to incorporate both behavioural and structural aspects to the process of firm interaction with competition policy. To explain more fully how merger activity, collaboration between competitors and the internationalisation of competition policy interact as part of a feedback system we outline below a historically-informed longitudinal study of the major UK brewing firms as they navigated the policy regime during their transition from domestic brewing and pub retailing-driven operators to leaders in the global alcoholic beverages market.

METHODOLOGY AND DATA

Following the inductive approach of other co-evolutionary studies (Child, Rodrigues and Tse, 2012; Murmann, 2013; Rodrigues and Child, 2003) we seek to trace the relationship between institutional change and the process of internationalisation through a multi-level, multi-period empirical study of a key industry. This methodology has been used in similar investigations of political events and processes where the often covert – or sensitive - behaviour that is the subject of investigation requires more careful conceptualisation and theory building (Frynas, Mellahi and Pigman, 2006). Notwithstanding the usual pitfalls of case studies, namely subjectivity and lack of generalisability (Eisenhardt and Graebner, 2007) we have chosen this methodology to assist us in describing aspects of path dependency (Siggelkow, 2007; Sydow, Schreyögg and Koch, 2009) and the process dynamics of collaboration (Doz, 1996), which the cross-sectional, statistical analysis that is frequently utilised in the analysis of mergers and acquisitions is less well equipped to uncover. We are concerned with sequential mergers and acquisitions of a series of large UK alcoholic beverages firms which extended their scale and scope from a purely domestic to a wide-ranging international sphere of operation in the period 1985-2005. These firms interacted with each other as well as the evolving competition policy regime as it moved from domestic to multi-jurisdictional oversight. The study therefore informs the debate on mergers and acquisitions strategies at the level of the interplay of power and influence in competitive market setting by uncovering key aspects of the process dynamics of international growth.

There were two high-profile and controversial anti-trust investigations in the UK brewing industry which occurred in 1969 and 1989, along with considerable mergers and acquisitions activity. These included a number of politically sensitive hostile bids, and internationalisation strategies that impinged on, and indeed influenced, aspects of US and European Union competition policy. Consequently there are multiple data sources in addition to academic studies in the economics, finance and business history literature against which we situate an empirical co-evolutionary study. Drawing on this extensive body of data and information, including a dataset constructed for an earlier related multivariate statistical study by one of the authors, we have subsequently conducted ex-post reflective analysis of key events with the guidance of newly available information and a more complete set of official regulatory secondary source material. The original dataset incorporated industry and firm data from publicly available sources such as annual reports and accounts and industry trade association statistical data. In combination with the retrospective analysis of official and other documents by both authors we seek to develop an argument in more detail regarding the nature of specific interactions between firms and their institutional environment. Other researchers adopting a similar research design have identified this as being of benefit to extending the co-evolutionary framework to better encapsulate political firms processes and strategic intent (Child, Rodrigues and Tse, 2012).

The timeline of the study corresponds to a period of significant regulatory upheaval for many UK industries as a function of the political objectives of Mrs Thatcher's Government to de-regulate and modernise key aspects of industrial organisation. In this year the UK brewing industry witnessed the dismantling of the vertical brewing tie that had endured an earlier anti-trust inquiry and several decades of embedded political influence. However, while several of the original firms in the analysis have been consigned to history, Diageo survives as the decisive leader of the international spirits industry, following several influential and at the time significant - from a regulatory perspective - mergers. During 2002 and 2007 one of the authors formalised the investigation of the mergers and acquisitions activity of the alcoholic beverages firms as a multivariate statistical analysis of quantitative and qualitative information of 40 merger transactions over the period 1969 to 2005. The information from trade associations and official publicly available documentation that has been revisited through a textual analysis for this article is listed in Table 1 below. In aggregate some 40 official documents from the Competition Commission (UK), European Commission (EC), Federal Trade Commission (FTC) and the US Department of Justice (DoJ) have been incorporated into our study. This is supplemented with specific information from firm annual reports, data and information from trade associations such as the British Beer & Pub Association Statistical Handbook and the Scotch Whisky Association annual statistical report. Archive information on firms located in London Business School, the British Library and the University of Strathclyde extended the dataset to more than 200 annual report and accounts, comprising 37 years of historical information for each of the six major UK firms.

Combining these two longitudinal datasets and periods of study the authors seek to identify and explain factors that influenced the mergers and acquisitions strategies of the major alcoholic beverages firms as a function of the changing domestic and international competition policy regime. Considering new literature, contemporaneous documentation and archive information aligned to the emerging co-evolutionary framework our a priori view is that discrete mechanisms of interaction were occurring in each case. It is from this detailed investigation that we distinguish what we call 'behavioural co-evolution', exemplified in the politically-driven behaviour and organisation of the UK brewing industry before the imposition of the 'Beer Orders' anti-trust inquiry from 'structural co-evolution', which describes the process whereby the less politically-embedded Grand Met came to establish a global spirits enterprise. In the period of transition from domestic to international, behavioural co-evolution gave way to a period of structural co-evolution as the firms embarked on interactions both with one another and the international institutional framework of competition policy.

Table 1: Competition analysis data and information

Year	Type	Document Title
UK		
1985	MMC Inquiry	Scottish & Newcastle Breweries PLC and Matthew Brown PLC: A Report on the Proposed Merger (Cmnd 9645)
1985	Offer Document	Time Please! Scottish & Newcastle PLC Final Offer for Matthew Brown
1986	MMC Inquiry	Elders IXL Ltd and Allied-Lyons PLC: A Report on the Proposed Merger (Cmnd 9892)
1988	Defence Document	Scottish & Newcastle Breweries – Reject the Inadequate Elders Offers
1989	MMC Inquiry	The Supply of Beer: A Report on the Supply of Beer for Retail Sale in the United Kingdom (Cm 651)
1989	MMC Inquiry	Elders IXL and Scottish & Newcastle Breweries PLC: A Report on the Merger Situations (Cm 654)
1989	Press Notice	Decision on Beer Orders, DTI (89/745)
1990	MMC Inquiry	Elders IXL Ltd and Grand Metropolitan PLC: A Report on the Merger Situations (Cm 1227)
1992	MMC Inquiry	Allied-Lyons PLC and Carlsberg A/S: A Report on the Proposed Joint Venture (Cm 2029)
1995	Listing Particulars	Scottish & Newcastle PLC Proposed Acquisition of the Courage Business and Rights Issue
1997	MMC Inquiry	Bass PLC, Carlsberg A/S and Carlsberg-Tetley PLC: A Report on the Merger Situation (Cm 3662)
1997	Press Notice	Margaret Beckett Blocks Bass/Carlsberg-Tetley Merger, DTI (97/424)
1997	Listing Particulars	Proposed Merger of Guinness PLC and Grand Metropolitan PLC
1999	Press Notice	Stephen Byers Refers Whitbread PLC's Proposed Acquisition of Allied Domecq Retailing to the Competition Commission, DTI
2000	OFT Report	The Supply of Beer: A Report on the Review of the Beer Orders by the Former DGFT (317)
2000	Press Release	Whitbread Strategic Review
2000	Press Release	Diageo PLC and Pernod Ricard SA to Acquire Seagram Spirits and Wine Business
2001	MMC Inquiry	Interbrew SA and Bass PLC: A Report on the Acquisition by Interbrew SA of the Brewing Interests of Bass PLC (Cm 5014)
2001	OFT Report	Advice on the Report by the Competition Commission into the Acquisition by Interbrew SA of the Brewing Interests of Bass PLC
2005	Offer Document	Recommended Offer by Pernod Ricard SA for Allied Domecq PLC
2008	CC Report	Merger Remedies: Competition Commission Guidelines (CC8)
US/EU		
1988	Seanad Eireann	Proposed Takeover of Irish Distillers (Volume 120)
1989	EEC	Merger Regulation (4064/89)
1992	DoJ and FTC	Horizontal Merger Guidelines
1992	EEC Report	Grand Metropolitan/Cinzano (Case IV/M.184)
1994	DoJ and FTC	International Anti-trust Enforcement Assistance Act
1997	EC Official Journal	Notice on the Definition of Relevant Market for the Purposes of Community Competition Law (97/C 372/03)
1997	EC Report	Guinness/Grand Metropolitan (Case IV/M.938)
1998	FTC Report	Guinness PLC, Grand Metropolitan PLC and Diageo PLC – Complaint (Case C-3801)
1998	FTC Press Release	FTC Approves Sale of Dewar's Scotch and Bombay Gin to Bacardi for $1.9bn
2001	EC Report	Pernod Ricard/Diageo/Seagram Spirits (Case COMP/M.2268)
2001	FTC Report	Diageo PLC and Vivendi SA – Analysis on the Provisionally Accepted Consent Order
2001	FTC Report	With Conditions, FTC Approves Joint Acquisition of Seagram Spirits and Wine by Diageo PLC and Pernod Ricard SA (No 011 005)
2001	DoJ Speech	International Antitrust in the 21st Century: Cooperation and Convergence (Charles A James, Assistant Attorney General, Antitrust Division)
2002	EC Speech	Review of the EC Merger Regulation – Roadmap for the Reform Project (Mario Monti, EC Commissioner)
2004	EC Report	Merger Regulation (139/04)
2005	EC Report	Commission Approves Acquisition of Allied Domecq by Pernod Ricard, Subject to Conditions (IP/05/792)
2005	EC Report	Fortune Brands/Allied Domecq (Case COMP/M.3813)
2006	FTC/DoJ Report	Commentary on the Horizontal Merger Guidelines

2008	FTC Report	A Brief Overview of the Federal Trade Commission's Investigative and Law Enforcement Authority

COMPETITION POLICY: EVOLUTION, CO-EVOLUTION AND CO-OPERATION

Firms are frequently motivated to grow by merger and would thus be expected to employ all legitimate means to ensure their proposed merger and takeover activity is successful. On the other hand, the central objective of competition policy is to ensure that consumers do not suffer as a result of an array of anti-competitive practices by dominant firms. This tension will naturally tend to set firms in conflict with the objectives of competition policy, creating the pretext for lobbying and acquiring political influence in order to gain the upper hand in negotiations. However, given that interactions stemming directly from the implementation of competition policy are infrequent firms have to develop other mechanisms to influence the threat of regulation. With policy retaining the ultimate sanction of the forced separation of assets in anti-trust and merger cases (Joskow, 2002), merging firms will necessarily consider pre-emptive changes to minimise or eliminate the risk of post-event intervention. How policy has evolved to gradually eliminate opportunities for behavioural co-evolution in favour of structural co-evolution is a function largely of the co-operation and co-ordination of competition policy regimes that has seen US merger practice gradually infuse other jurisdictions in an effort to police the rapid internationalisation of industries in the last two decades. In short the significance of political interference has been reduced as part of the process of the harmonisation of policy across jurisdiction with the attendant emphasis on rules and regulations implemented and policed by independent agencies.

Legal background to competition policy in the US, UK and Europe

That the principles of US competition policy have come to essentially determine the trajectory of cross-border mergers can be attributed to the long history of anti-trust and merger policy dating from the Sherman Act of 1890. Early high profile rulings under this Act were passed in 1911, with the famous dissolutions of Standard Oil and the American Tobacco Company (Winerman, 2003). Running in parallel with legal precedent has been continual guidance offered to firms by way of 'Merger Guidelines', issued by the Department of Justice (DoJ) and the Federal Trade Commission (FTC) to inform business of the economic analysis that will be applied to mergers under Federal anti-trust law (for example, as discussed in FTC/DoJ report 'Commentary on Horizontal Merger Guidelines', 2006). This is informed by the latest academic economics thinking and econometric methodologies that seek to answer the fundamental question of whether a merger is *likely* to create or enhance market power or to facilitate its exercise. In so doing, the FTC is charged with the task of making an assessment of whether a merger would significantly increase concentration in a properly defined and measured 'relevant market', delineated by what is referred to as the 'SSNIP' or 'Hypothetical Monopolist Test' ('*a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximising firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a "small but significant and nontransitory" increase in price, assuming the terms of sale of all other products are held constant*') as laid out in US Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, 19 August, 2010. Further, by reference to the Herfindahl-Hirschman Index of market concentration the DoJ and FTC assess the potential for '*significant lessening of competition*' (the 'SLC test') through either tacit or express collusion within the industry.

Competition policy in the UK and Europe did not develop in legislative form until after the Second World War and was more heavily politicised as a function of this historical context. Significant milestones in the evolution of UK competition policy were the Monopolies and Restrictive Practices Act of 1948, followed by the Monopolies and Mergers Act of 1965 (Roberts, 1992). The Fair Trading Act of 1973 that created the Office of Fair Trading (OFT) granted the Secretary of State (for Trade and Industry) the powers to both refer a merger to the MMC and to overrule its findings, thereby creating a direct route for political interference in the process at the level of the 'public interest provision' (Wilks, 1999). As a feature of the overhaul of competition policy that was part of wider cross-jurisdictional change towards the US regulatory system, the Labour government of Tony Blair paved the way for the Enterprise Act of 2002, creating an independent Competition Commission (CC) charged with the task of investigating mergers on purely competition grounds. Not until the remedy stage of the process has been reached can the former 'public interest provision' be brought into play; the CC may then, if it sees fit, temper its competition-based decisions to promote reasonable and practicable solutions (discussed in report CC8, 'Merger Remedies: Competition Commission Guidelines', 2008).

UK policy has gradually become irrelevant to UK-based multinational firms, as merger activity has increasingly fallen within the investigative remit of the European Commission (EC). After World War II, France and Germany embarked on a period of 'institutionalised co-operation' that gradually brought Italy, the Netherlands, Belgium and Luxembourg into the supranational mechanism of the ECSC Treaty of 1951 (Cini and McGowan, 1998). The subsequent Treaty of Rome of 1957 was designed to create a common market for trade across Europe, with the UK and Ireland ratifying the Treaty in 1973. The Treaty contained provisional anti-trust legislation; Article 81 (formerly known as Article 85), was concerned with restrictive practices (specifically, provision 81 (3) granted certain vertical agreements, including the then UK brewers' traditional vertical tie what was known as a 'block exemption' from EC law until 1997. Article 82 contained the EC's 'abuse of dominance' policy and it was with reference to this that mergers were evaluated. However, as the Treaty did not provide for advance vetting of mergers, it was not until Merger Regulation 4064/89 was adopted in 1989 that a 'concentration' was defined in the context of creating or strengthening a dominant position. This has been enhanced subsequently with a series of notices to explain to firms the circumstances in which a merger would trigger competition concerns, the most significant of which was Commission Notice 97/C 372/03 in 1997 that set out the EC's guidance for the definition of the relevant product and geographic market for anti-trust purposes. In reviewing Merger Regulation the EC introduced Regulation 139/04 in 2004 which removed the dominance test in Article 82 with a '*significantly impede effective competition*' test. The latter terminology was aimed at aligning EC policy with the US and UK's 'significant lessening of competition' (SLC) test. The backdrop to this legislative development was the high profile challenges to Commissioner Mario Monti's analysis of three significant merger cases: Airtours, Tetra Laval and GE/Honeywell (Vickers, 2004).

Co-operation and co-ordination in competition policy regimes

At the macro level competition policy co-evolves with firm strategies largely as a function of two phenomena. The reliance on econometric analysis in establishing the relevant market in high profile anti-trust and merger inquiries brings expert academic and consultancy witnesses representing merging firms into direct and regular contact with the in-house economic expertise of the regulatory authorities. This creates the pretext for changes in policies and procedures, often as a result of legal challenges, evidenced in particular by the EC's decision to move policy closer to that of the US following the GE/Honeywell controversy. Secondly, the internationalisation of firms and industries that has been a feature since the 1980s has required a level of co-operation, co-ordination and harmonisation of competition policy to adapt to the multi-jurisdictional nature of contemporary mergers and acquisitions strategies.

How the former phenomenon has influenced policy formulation is illustrated by the key cases that have been instrumental in underpinning the role of economics (and economists) in competition policy. This was precipitated by the historic US monopolisation case referred to as the 'Cellophane Trap', the discrediting of cross-price elasticity analysis in the 1957 Du Pont case that concluded that all packaging materials were substitutes for cellophane at the then prevailing market price (Massey, 2000). Notwithstanding the subsequent refinements discussed earlier questions remain about the efficacy of much of the analysis and quality of data used (Muris, 2000), in particular in highly differentiated consumer product mergers (Hausman, Leonard and Zona, 1994; Pinkse and Slade, 2004; Scheffman and Coleman, 2003; Werden, 2004). The reliance on complex econometric analysis owes much to a perceived 'safety' in numerical (quasi scientific) evidence in a highly litigious environment and a desire to signal independence in a process associated historically with political interference. It is important to note at this juncture that many of the authors referred to above were either economics experts employed by the regulatory authorities or acted as expert advisers to firms and/or the competition agencies in the course of specific merger and anti-trust inquiries in this period.

In response to the rapid internationalisation of firm merger strategies, and the sense that policy was failing to keep up with practice, the EC's adoption of Merger Regulation 4064/89 in 1989 created the basis for a discussion of policy harmonisation, with a more formal agreement to co-operate in anti-trust and merger cases reached in 1991. In 1994, the US passed the International Anti-trust Enforcement Assistance Act, authorising the FTC and DoJ to enter more widely into mutual assistance agreements with foreign competition authorities. After the first case of concurrent merger enforcement – the 1995 merger of Shell and Montedison SpA – several cases in the later part of the 1990s "*revealed an evolution in the ways that the EC and the US agencies were able to coordinate their enforcement*" (Katona and Parisi, 2011, p30). Of particular note was the 1997 merger of Grand Metropolitan and Guinness which forms a key element of our case study. Legal experts such as Katona and Parisi (2011) point to the significance of merging parties coordinating their approaches to the authorities from the outset rather than leaving it to the post-investigation remedy phase. In some cases this has guaranteed early clearance notwithstanding potential competitive effects that would ordinarily require detailed evidence gathering and evaluation. In other words through such co-ordination and co-operation with the authorities a long and costly inquiry is averted. A key part of this process incentivises merging firms to seek 'upfront buyers' for divestment assets that will a priori alleviate a potential competition issue. While this is a practical solution emanating from the co-evolution of firms and policy, it might be seen as legitimising collusion between a wider set of competitors within the industry.

Although the US and EC competition policy regimes have gradually moved closer together, fundamental differences in approach were evident in many of the late 1990s/early 2000s cross-border mergers, the period which corresponds closely to that of our study. The EC decision to block General Electric's proposed acquisition of Honeywell, when the US authorities had previously cleared the deal, relates to a different interpretation of 'portfolio effects'. Mr Monti's EC accepted their relevance to merger analysis whereas in the US "*so-called 'portfolio effects' or 'range effects' as it has recently been employed is neither soundly grounded in economic theory nor supported by empirical evidence*" (James, 2001). This has been attributed to the US's 'Chicago School' view of economic fundamentals that has underpinned much of the analysis of mergers and which disputes the concept of the leveraging of monopoly power (Nalebuff, 2003). The EC was forced to relinquish much of its analytical premise regarding portfolio effects following a successful appeal by GE to the European Court of First Instance. In 2011, 'Best Practice' guidelines outlined a new system of co-ordination requiring consultation between the reviewing agencies' economic counterparts with the sharing of information and analyses of market definition, competitive effects, theories of harm and remedies to avoid the surprise decision of one authority clearing and another blocking the same merger (Katona and Parisi, 2011).

THE UK ALCOHOLIC BEVERAGES FIRMS: FROM BEHAVIOURAL TO STRUCTURAL CO-EVOLUTION

We have defined the terms behavioural and structural co-evolution as analytically useful distinctions based on our review of the regulatory capture and joint ventures literature. It has been conceptualised to explain how competition policy has co-evolved with firm merger strategies that are mediated by either specific behaviour or structures that align with the remedial action in competition policy. In '*Merger Remedies: Competition Commission Guidelines*' (CC8, 2008), the UK's competition authority characterises remedies that re-establish the structure of the market expected in the absence of the merger as structural remedies (for example, by divestitures) or those that seek to regulate the on-going behaviour of firms (for example by price caps, supply commitments or restrictions on use of long term contracts). The latter is at the heart of the regulatory capture literature and, as described earlier, it relates to the power and influencing process whereby firms seek to 'game the regulator' (Laffont and Tirole, 1991).

The preference for structural remedies in the merger process that is now apparent in the multi-jurisdictional co-operative oversight of multinational firm acquisitions relates to the concept of codification of policy and a move to independence of the regulatory process that sought to eliminate political discretion. This was the basis of the UK Government's decision to establish an independent Competition Commission through the legislation of the Enterprise Act, 2002. We elaborate on these two processes of co-evolution by outlining the manner in which competition policy interacted with the UK alcoholic beverages sector prior to the step-change that occurred in the 1980s through the 'Beer Orders' intervention. Prior to that, the industry as a whole, and Scottish & Newcastle in particular, had evolved strategically in a framework of political influence over policy supported in many cases by political donations to the Conservative Party (Allied-Lyons, Scottish & Newcastle and Whitbread). In contrast, Grand Met and Guinness, with different political affiliation and strategic ambitions, internationalised through a process of sequential corporate activity. They responded directly in the mergers and acquisitions market to the actions of each other as well as the evolving cross-border competition policy environment.

Behavioural co-evolution in the UK alcoholic beverages industry

In characterising behavioural co-evolution to describe the relationship between the UK alcoholic beverages firms and their pre-'Beer Orders' operating environment the affectionately coined name of 'The Beerage', emanating from their reputed political influence in the licensing system (Gourvish and Wilson, 1994), encapsulates an essentially institutionalised power-influence dynamic. This influence was sustained by a combination of specific political donations - the industry collectively provided 10% of Conservative party funds in the 1992 General Election (House of Commons debate, 15 February, 1995) – as well as the lobbying efforts of their industry trade association, The Brewers' Society. Consequently the large 'Big 6' brewers were able to retain a vertically integrated industry structure that was deemed to act against the public interest; a 1969 extensive anti-trust inquiry (Monopolies Commission '*A Report on the Supply of Beer*', HoC, 216) concluded this was the case, but elected to allow the industry association, the Brewers' Society, to police market behaviour rather than impose structural conditions on the vertical tie. The Brewers' Society was described by the MMC in its 1989 inquiry as "*formidably effective in championing its members' interests*" (MMC, Cm 651: Paragraph 1.17). Other evidence as to how this reciprocal relationship evolved in close harmony is evident from the merger activity of the 1980s, and in particular the nature of evidence, of a political and lobbying nature, that was instrumental in thwarting entry into the industry from overseas interests. The intense lobbying of the Brewers Society, though not sufficient to prevent the imposition of the 'Beer Orders' was nonetheless sufficient to force a partial climb-down in policy (DTI Press Notice, 89/745).The uncertainty of a changing environment, however, with the additional macro-political considerations of a UK gradually being subsumed into European Commission legislation, as discussed below, prompted major reappraisals of consolidation strategies.

One of the major beneficiaries of this era of UK competition policy was Scottish & Newcastle, under the guidance of Sir Alick Rankin as group chief executive officer, then subsequently group chairman. Rankin had significant links to the upper echelons of not just the Scottish business establishment and the Conservative government of Margaret Thatcher, but indeed the Crown (Bower and Cox, 2012). Although the political influence of Scottish & Newcastle continued into the 1990s (with clearance for the acquisition of a major domestic competitor, unusually without even a provisional competition inquiry) that the industry's influence had waned was in little doubt by 1997 (*'Margaret Beckett Blocks Bass/Carlsberg-Tetley Merger'*, DTI Press Notice). That it had terminated was apparent in 1999 (*'Stephen Byers Refers Whitbread PLC's Proposed Acquisition of Allied Domecq Retailing to the Competition Commission'*, DTI Press Notice).

The process of change in the co-evolution between the UK brewers and domestic competition policy emanates from the surprise announcement by the Office of Fair Trading (OFT) to recommend a second anti-trust inquiry into firm and market behaviour in 1986. It is now clear from recently available OFT archive material that Anglo-Irish brewer Guinness was lobbying actively behind the scenes for the ending of the vertical brewing tie (Spicer, Thurman, Walters and Ward, 2012: Page 43). It is also likely that Guinness was the then un-named major brewer that provided evidence to the MMC in the 1985 Scottish & Newcastle controversial hostile bid for Matthew Brown, supporting calls for actions to curtail the power of the larger 'Big 6' brewers (*'Scottish & Newcastle Breweries PLC and Matthew Brown PLC: A Report on the Proposed Merger'*, MMC, Cmnd 9645, 1985). The OFT's surprise decision to press for a second anti-trust inquiry came after both the Scottish & Newcastle/Matthew Brown bid, as well as Guinness' market entry into the spirits industry through the acquisition of leading UK Scotch brand-owner, Arthur Bell, in 1985. Unlike its peers, Allied-Lyons, Grand Met and Whitbread, Guinness did not own or control an estate of public houses (pubs). That pubs were also required to sell spirits produced and supplied by their brewer owners meant that Guinness was now doubly disadvantaged from the existing industry architecture. It is also likely that Guinness garnered high-level political legitimacy albeit temporary from the January 1986 appointment of Paul Channon, a member of the Guinness family, to the role of Secretary of State for Trade and Industry. Certainly the OFT referral decision came as a surprise to the other major brewers as well as the Brewers' Society who had maintained an on-going dialogue with the competition policy framework through the self-regulatory policing system that followed after the 1969 inquiry.

Structural co-evolution in the international spirits industry

Table 2 below shows not only the major deals that occurred sequentially for Guinness and Grand Met but how the structures of the deals evolved from the politicised operation of domestic competition policy towards a mechanism that sanctioned and indeed encouraged international collaborative agreements between competitors. The timeline also shows that hostile bids, always controversial and almost invariably the subject of intervention, tended to decline over the period, from their peak during the 1980s merger wave (Shleifer and Vishny, 1991).

Table 2: Key corporate events of Grand Met, Guinness and Diageo

Year	Acquirer	Target	Rationale	Structure	Referral	Processes
1985	Guinness	A Bell	Entry into spirits industry (Scotch)	Hostile bid	No	Yes (Scottish MP debates in UK Parliament)
1986	Guinness	Distillers	Entered contested bid; access to whisky stocks	Agreed bid	Yes	Set aside during Takeover Panel investigation of bid
1987	Grand Met	Heublein	Acquisition of Smirnoff; extended US position	Agreed bid	No	None
1987	Guinness	LVMH	Asia and US distribution for Scotch and Cognac brands	IJV formed	No	None
1987	Grand Met	Martell	Entry into Cognac; contested bid	Hostile bid	No	Intense media campaign derailed bid
1988	Grand Met	Irish Distillers	Control of distribution in Ireland and whiskey brands	Hostile bid (jointly with Guinness and Allied-Lyons)	Yes	Yes (Irish lobbying to EC)
1988	Guinness	LVMH	Defensive move to protect underlying distribution ijvs	Cross-shareholding structure	No	None
1990	Grand Met	Elders IXL	Post 'Beer Orders' rationalisation and part-exit	Breweries-for-pubs joint venture with upfront remedies	Yes	First transaction after 'Beer Orders'; remedies ensured early clearance
1992	Grand Met	Cinzano	Control of distribution in Italy and brands	Agreed acquisition of joint venture partner	No	None; discussion of 'relevant market' and concentration in brand category
1997	Grand Met	Guinness	Portfolio rationalisation and cost reduction	Agreed merger	Yes	Landmark case study for 'portfolio effects' discrepancy between US and EC policy
2000	Diageo	J Seagram	Additional brands and 'control' of US market	Agreed merger (joint venture with Pernod Ricard)	Yes	Negotiated deal structure to apportion brands based on Diageo 'relevant market' analysis

In terms of intra-industry behaviour and the transition from behavioural to structural approaches to co-evolution the role of Guinness, and in particular its consecutive senior managers in this era, is critical. In contrast to Grand Met, which became the initially reluctant owner of International Distillers & Vintners (IDV) as a result of the 1972 acquisition of brewer Watney Mann (Williamson and Rix, 1988), Guinness' decision to enter the spirits industry was part of a deliberate diversification strategy of the new management team brought in to stem the decline of the eponymous stout brand at the family firm. Although the firm's 1985 hostile bid for Arthur Bell was non-contentious and unopposed from a policy stance, the subsequent contested and controversial bid for the Distillers Company, the world's leading Scotch whisky producer, in early 1986 became one of the UK's largest corporate scandals of the 1980s. The aftermath of the 'Guinness affair' that led to the demise of Ernest Saunders and three other leading UK businessmen (Takeover Panel, 1989) had wider implications for the UK alcoholic beverages firms. Specifically, the relationship between Guinness and Grand Met and their joint control of the global spirits market today through the combined enterprise Diageo owes much to the Guinness affair and the strategic actions of two then-Grand Met contemporaries, Anthony Tennant and Allen Sheppard, in the hostile mergers and acquisitions environment of the 1980s.

Sheppard was chosen to lead Grand Met in preference to Tennant largely because his more aggressive approach was in keeping with the deal-making culture of the firm's founding partner Maxwell Joseph (Williamson and Rix, 1988: Page 12). Although Sheppard had been responsible for running the brewing subsidiaries his first strategic move at Grand Met was the acquisition of Heublein, the largest spirits firm in the US and owner of Smirnoff vodka. By this stage Tennant had been recruited by rival Guinness to add stability and stature at a crucial period of its corporate development. That the two men knew each other and were likely to respond to each other's strategic moves was apparent from Guinness's response to an increasingly aggressive spirits acquirer in Grand Met. The (unsuccessful) hostile approach for Martell Cognac was accompanied by rumours of plans for hostile bids for Guinness, LVMH and Highland Distilleries. This was credited with prompting a series of 'defensive' international joint venture and equity-protected strategic alliances in the late 1980s spirits industry. Foremost among these was the Guinness partnership with the spirits subsidiary of the French luxury goods firm, Louis Vuitton Moët Hennessy (LVMH) that evolved into a complex cross-shareholding relationship designed to both strengthen their relationship as well as protect the underlying international distribution joint ventures from outside approach (Diageo, 1997, *Listing Particulars*).

Although the focus in the latter part of the 1980s was on the domestic brewing industry as a result of the anti-trust investigation, the basis for what we consider to be structural co-evolution can be seen in the strategic actions of Grand Met and Guinness, both in their approach to each other and their competitors, and in the emergence of new mechanisms through which to interact with competition policy. Of particular note is the alliance formed by Grand Met, Guinness and Allied-Lyons as part of a joint 1988 hostile bid for Irish Distillers. A structure was formed that had a clear objective of circumventing intervention by the European competition regime (Burnside and Meyntjens, 1990). The EC blocked the joint bid, and mandated the parties bid separately. This bid preceded the 1989 Merger Regulation and the emergence of codification in 1997 (Commission Notice 97/C 372/03). Up to that stage researchers have pointed to country-specific political interference and lobbying in European mergers (Aktas, de Bodt and Roll, 2007).

By May 1997, the merger between Grand Met and Guinness that created the world's largest spirits group (Diageo, 1997, *Listing Particulars*), was one of the first major international deals to fall under the new US-EC collaborative competition policy agreement, and was investigated under the provisions of the EC's newly established guide to relevant market analysis. At the time, many industry observers had questioned whether a major deal would be likely to gain regulatory clearance. In the event, the ease with which Grand Met and Guinness were able to negotiate a deal subject to only minor anti-trust remedies - against the opposition of substantial lobbying from competitors - caused considerable surprise. The views of Seagram (rumoured to have employed a team of US lawyers to lobby the EC to block the merger) chimed with market commentary that a merger of the scale of Grand Met/Guinness raised serious anti-trust issues in the US, Europe and elsewhere that required a level of scrutiny that would likely result in the need for a major divestment of brands and other assets before the deal could proceed. Yet the merger was cleared by the EC in October 1997 with minor remedies, largely related to distribution in certain member states (EC Case IV/M.938). In the US, retrospective remedies imposed in April 1988 were more demanding albeit not sufficient to cause an unwinding of the merger. The negotiated remedy required Diageo to divest Guinness' Dewar's Scotch and Grand Met's Bombay gin (Complaint Case C-3801). The FTC released a statement in which it praised the significant international co-operation between the US, EC, Canadian, Mexican and Australian authorities. The sale of two brands considered non-core to the combined international brand portfolio to Bacardi for $1.9bn was at the time, however, a record sum for a government-mandated divestment (FTC, 1998).

In December 2000, Diageo and family-controlled French spirits producer, Pernod Ricard, joined forces to acquire the international spirits portfolio of Seagram. In structuring a temporary joint venture known as the 'Framework and Implementation Agreement', informed by the 'relevant market' conditions applied in the 1997 merger of Grand Met and Guinness, the two firms were able to extract the brands each wanted from Seagram's portfolio with minimal intervention in Europe (EC, COMP/M.2268). In the US Diageo was required to divest the Malibu brand to accommodate US relevant market concerns (FTC, No 011 005). The significance of this deal was two-fold; it forced the exit of UK rival Allied Domecq in 2005 to a joint venture vehicle of Pernod Ricard and Fortune Brands of the US, and it cemented a structural approach to circumventing policy rolled out in subsequent merger, Pernod Ricard/Fortune Brands (Jim Beam) and the Carlsberg/Heineken joined bid for Scottish & Newcastle in 2008, the latter of which was cleared by the EC with minor remedies in Ireland.

CONCLUSIONS

The objective of this article has been to extend co-evolutionary theory to one of the key constraining institutional forces on corporate strategy, that is, competition policy. Our contribution to the co-evolutionary framework lies in its use of longitudinal data and an historical approach to distinguish between two separate mechanisms by which firms have sought to overcome the institutional constraints of competition policy, by recourse to either behaviour or by the use of novel structural mechanisms.

These theoretical insights have been derived from an empirical study of the UK alcoholic beverages firms in the period 1985-2005, which has exposed the strategic and political behaviour of firms and key managers with regard to the formulation and implementation of government-directed policy. We approach the longitudinal study through the lens of contemporaneous analysis and a detailed retrospective consideration of the events of a period of industrial change aided by multi-source secondary documentation to explain the process of internationalisation of the UK alcoholic beverages firms.

At its core competition policy seeks to prevent the abuse of market power by dominant firms, and as part of the merger process, firms require clearance and approval from the relevant overseeing authority. While it is rare for competition authorities to block mergers outright, many proposed acquisitions are abandoned by firms at the mere suggestion of a merger inquiry. In the event of an inquiry, firms are motivated to minimise the constraining effect of subsequent regulatory action. Policy tools available to regulators include both behavioural and structural remedies; the former requires the on-going policing of firm and market activity whereas the latter calls for divestment of parts of the merged entity to address a priori competition issues. As part of the process of codification and cross-border harmonization of policy structural responses to competition policy have encouraged firms to work together and with other competitors in their industry to present workable solutions to competition concerns to speed up, simplify and avert inquiries. In defining and establishing relevant markets regulators are guided by the information and analysis provided by firms and their expert academic economic and legal advisers as well as their own – one informs the other through the auspices of an 'expert network' .

In developing the theoretical extension to the co-evolutionary framework we have conceptualised two discrete co-evolutionary feedback processes that relate directly to the nature of policy implementation, and which provide the axis from which co-evolving firms develop preferences for certain responses or variations. The 'trial and error' learning over history of organisation (Volberda and Lewin, 2003) is supported by both the regulatory capture literature of industrial economics (Dal Bó, 2006; Laffont and Tirole, 1991) as well as the strategic choice literature of organisation (Child, 1997; Shaffer and Hillman, 2000) where firms are cast as active agents in a power-political process (Child, Rodrigues and Tse, 2012). However, in common with other industry analysis that identifies multiple causal mechanisms of co-evolution in complex, dynamic environments with emergent system-level properties (Murmann, 2013), we have introduced a structural component of co-evolution, guided by the findings of early legal analysis of the benefits to firms from collaboration in competition policy (Pfeffer and Nowak 1976) that finds circumstantial support from the notion that firms with little power over their environments enhance their influence through co-operation with similar organisations (Child and Rodrigues, 2011). Indeed, the cross-border harmonisation philosophy of competition policy that has been evolving since the mid-1990s has reinforced the collaborative, intra-industry structural solutions to averting regulatory intervention.

While the theory of co-evolution has been considered in the context of multinational firms adjusting their strategies and structures to counter the complexity and dynamics of regional and supra-national standard-setting and regulation (Cantwell, Dunning and Lundan, 2010), an understanding and integration of political dynamics has been an acknowledged weakness of the approach (Child, Rodriges and Tse, 2012). Although it has been argued that the action choices of less-politically powerful or resource-challenged multi-divisional firms needs to adapt in different directions (Shaffer and Hillman, 2000), and indeed that there are multiple causal mechanisms of co-evolution (Murmann, 2013), we are not aware that any specific research has followed the interactions of a population of firms through the lens of differential regulatory mechanisms as the undergo the process of internationalisation. Yet the co-evolutionary framework in its early development envisaged a multi-faceted approach involving direct interactions and feedback from the system (Volberda and Lewin, 2003), with new organisational forms emerging during periods of radical change albeit from different actors in the population of firms (Lewin and Volberda, 1999). Firms exercising choice, judgement and creativity, may initiate a transformation of the system of which they are a part of, as well as transforming their own structure (Cantwell, Dunning and Lundan, 2010). The conduit for change relates to the role of senior managers who are able to influence the institutional environment and therefore the competitive regime by engaging in political actions that redefine regulatory and other boundaries (Rodrigues and Child, 2003).

Our case study explains how individual firms responded to institutional frameworks from a strategy perspective (Peng, Sun, Pinkham and Chen, 2009), through either behavioural mechanisms (e.g. Scottish & Newcastle) or structural mechanisms (e.g. Grand Met). Subject to the usual proviso of theory building from case studies (Eisenhardt and Graebner, 2007) we have forwarded a discussion based on an historic industry setting where all actors were subject to the same regulatory oversight during a critical period of consolidation. We utilised contemporaneous data and information to uncover the political allegiances and power bases of key individuals and firms relative to others. Firms with less embedded power and influence found alternative means to benefit from evolving competition policy in the more complex international environment. Grand Met emerged as the leader of the post-1989 era as its merger strategy adapted to the change in the policy framework. The 1997 merger with Guinness was in many senses the test case for the harmonisation of multi-jurisdictional oversight of mergers, legitimising its approach to interacting with the policy infrastructure. The greater reliance on inter-firm collaboration and the structural approach to circumventing the relevant market provisions of US and EC competition policy is evident in subsequent international alcoholic beverages mergers; the 2000 Diageo/Pernod Ricard joint bid for Seagram, the 2005 Pernod Ricard/Fortune Brands joint bid for Allied Domecq and the 2007 Carlsberg/Heineken joint bid for Scottish & Newcastle.

The co-evolutionary processes evident in the transformation of the UK alcoholic beverages firms is undoubtedly unique, given its origins that stemmed from the external shock of the 1989 Beer Orders anti-trust investigation. Nevertheless, it is anticipated that there will be other longitudinal industry studies, which are concerned with the process of firm/government interplay resulting from state regulation of merger activity, which will be able to benefit from applying the key propositions stemming from this paper. Understanding how some firms are better able to gain competitive advantage from changes in the regulatory environment, and the nature of the mechanisms and processes that they develop to achieve this, including the role of manager/entrepreneurs in the process is of more general significance. Our historically-grounded case study, shedding light on the nature of interactions in the key area of competition policy, is a step in this direction.

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