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## Unlocking dynamic capabilities in the Scotch whisky industry, 1945–present

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### ABSTRACT

In this article we examine the development of the Scotch whisky industry since 1945 through the lens of dynamic capabilities. We explain how *sui generis* acts—novel initiatives outwith the established repertoire of practices of a firm or industry—by external actors joining the industry helped unlock dynamic capabilities at the firm level in the industry which in turn drove change across the sector after a series of takeovers. We detail the key structural changes in the Scotch whisky industry and demonstrate how important external actors can be in effecting sector level change by extending and connecting our analysis to existing debates in business history and strategy research.

### KEYWORDS

Dynamic capabilities; Scotch whisky; sector change; innovation; marketing

## Introduction

Business historians have long investigated how companies and industries develop, and respond to internal and external challenges and opportunities, over time. In the last twenty years the concept of dynamic capabilities, originally developed by Teece, Pisano and Shuen, has emerged as a significant strand within the strategy literature for explaining how firms build, identify and reorganise their resources and capabilities to respond to new challenges and opportunities and maintain competitive advantage.<sup>1</sup> Dynamic capabilities are defined as the, ‘capacity of an organization to create, extend or modify its resource base’.<sup>2</sup> These are typically understood as a reaction to, or stimulated by, changes in internal or external operating environments.<sup>3</sup> Eisenhardt and Martin argue that dynamic capabilities ‘are a set of specific and identifiable processes such as product development, strategic decision making, and alliancing’.<sup>4</sup> Building his analysis of Smith Corona on Eisenhardt and Martin’s conceptualisation of dynamic capabilities, Danneels assesses them as ‘changes in the firm’s set of resources can be achieved by various modes such as leveraging, accessing, and releasing’.<sup>5</sup> Teece, Peteraf and Leih noted that dynamic capabilities govern the speed and agility with which an organisation can respond effectively to emergent environmental threats or identify and seize opportunities before competitors,<sup>6</sup> whereas Helfat and Peteraf introduced an important temporal dimension to the debate and concept with their ‘capabilities lifecycle’

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approach to capture 'a general pattern and set of paths that characterize the evolution of an organizational capability'.<sup>7</sup> Ambrosini, Bowman, and Collier extend the concept by categorising dynamic capabilities into three levels: incremental (based on continuous improvement of the firm's resource base), renewing (those that refresh, adapt, and augment the resource base), and regenerative (which change the way the firm changes its resource base).<sup>8</sup> Finally, Ambrosini and Bowman identify a lack of empirical studies of dynamic capabilities as hindering better understanding of the concept.<sup>9</sup> Consistent within these definitions is the recognition that internal resources and capabilities underpinning dynamic capabilities in firms accrue over time through historical decisions, actions, and resource allocation paths followed, embedding dynamic capability in an organisation's heritage.<sup>10</sup>

Teece also identified the scant understanding of the 'sui generis strategic acts that neither stem from routines (or algorithms) nor need give rise to new routines' that influence dynamic capability.<sup>11</sup> This partly builds on Spender's argument about 'industry recipes' and unenterprising managers who 'often deal with the problems that uncertainty creates in ways that are characteristic of that industry—part of what experienced managers take uncritically as professional common sense'.<sup>12</sup> Spender asserts that such behaviour is consistent with the mental models present within managers that are normative in nature—they don't typically think or act outside of their industry experience and follow existing patterns or expectations of behaviour. The sui generis acts that Teece identifies as being critical to unlocking dynamic capabilities come from acts or behaviours that fall outside the norm of Spender's 'industry recipes'. On this basis it would be reasonable to assume that such acts could come from outsiders in the industries, but to date the dynamic capabilities literature has largely focussed on the internal assets of firms and their reconfiguration rather than the role outsiders can play.

Both Teece and Lazonick have called for an enhanced role of business history in unlocking insights into the development and deployment of dynamic capabilities and build on Vergne and Durand's identification of evolutionary perspectives as important in understanding how dynamic capabilities emerge.<sup>13</sup> We examine this through an industry-level analysis of Scotch whisky to explore and understand firm specific capabilities and resources, industry competition and cooperation, and crucially, external competences.<sup>14</sup> In doing so we also seek to demonstrate how historical methods and perspective can not only 'test' and 'modify' theory, but also help drive it.<sup>15</sup> We track concentration within Scotch whisky and the embedding of 'industry recipes' before exploring the sui generis acts that unlocked dynamic capabilities in the industry in a period marked by Guinness' takeovers of two dominant Scotch whisky producers, Arthur Bell and Sons (Bell's) and Distillers Co Ltd (DCL). Our work prefaces that of McKendrick and Hannan on the reallocation of resources in the Scotch whisky industry, in explaining the historical context and how it relates to organisational change and the sui generis acts that create dynamic capabilities.<sup>16</sup>

In what follows, we outline how dynamic capabilities have been explored in relation to business history, then consider the development of dynamic capabilities within the Scotch whisky industry between 1945 and the present, before discussing its relevance for extending how dynamic capabilities can contribute to business history and vice versa.

### ***Business history and dynamic capabilities***

Various scholars have sought to connect business history explicitly with dynamic capabilities in various ways. As per our argument above, Wadhvani and Jones argue that the 'dynamic

capabilities framework implicitly incorporates a number of historical models of change over time, and that making these models of change explicit offers scholars a way to better identify opportunities for research at the intersection of history and strategy'.<sup>17</sup> Jones, Ghobadian, O'Regan and Antcliff in their analysis of the Bibby Line company in Liverpool traced the multi-generational family business and how it transformed from a shipping business through a process of diversification over the generations into a conglomerate with interests in retail, distribution, and financial services.<sup>18</sup> While Choudhury and Khanna in their analysis of Indian multinational enterprises posit that: 'The dynamic capabilities framework builds on distinctive processes (ways of coordinating and combining), shaped by the firm's asset positions and the evolution path(s) it has adopted or inherited'.<sup>19</sup> Raff in his analysis of US bookstores Borders and Barnes & Noble identified the two different evolutionary routes that the booksellers took to developing their own capabilities over time, characterising one as the management of information, and the other as scale.<sup>20</sup> Each of these contributions utilised business historical analysis to identify some of the different characteristics present within the emergence of dynamic capabilities. Consistent with each is the centrality of historical analysis of individual, firm, and sectoral actions in understanding how dynamic capabilities emerge to explain changes in strategy, firm behaviour, and wider industry development.

In explaining how dynamic capabilities are developed the influence of historical activity on current options and potentiality is particularly relevant as actions taken today, or in the past, naturally constrain or enable potential in the future. As Raff also argues (in relation to his analysis of Borders and Barnes & Noble), 'the value of the (historically) later innovations depends on the implementation of earlier ones', illustrating that capabilities do not emerge from nowhere but can be dependent on past actions.<sup>21</sup> Zahra, Sapienza and Davidsson note that over time, entrepreneurial activities create 'strategic variety' which translates into renewal options for the organisation.<sup>22</sup> If we accept this, then the opposite must also be the case—that a lack of entrepreneurial activities will lead to a narrowing of strategic options. Vergne and Durand contend that resource base change often follows from 'chance encounters, coincidences, sudden insights, and creative thinking' that open up new paths and build momentum behind renewal.<sup>23</sup> Business history studies identify such activities almost as a matter of routine, but rarely in such terms. However, dynamic capabilities are often used as an organising concept to describe a category of processes associated with change, including merger and acquisition, product innovation, and marketing.<sup>24</sup> A critical point of enquiry in discourse on the subject is understanding how dynamic capabilities are continually fostered, renewed, and developed.<sup>25</sup> Business histories often naturally cover these areas in their analyses, but rarely articulate them explicitly as 'dynamic capabilities'.

Despite its valuable potential contribution, history remains comparatively neglected in strategy literature.<sup>26</sup> Where history features within strategy scholarship, this tends to be in reference to the work of Chandler, who has been described as the father of strategic management.<sup>27</sup> However, the strategy literature has often been selective in its use of Chandler. As Teece notes, Chandler overlooked capabilities in his analyses illustrating what would become an ongoing disconnect between historical analysis and the capabilities literature, not least given the ability of history to shed light on contingent outcomes, as well as understanding firm and industry responses against the complexities of a changing context.<sup>28</sup> Recent attention has focussed on the micro-foundations of dynamic capabilities, arguing that history is an important, but under-theorised component.<sup>29</sup> The value history brings to

developing understanding of strategy related phenomena such as dynamic capabilities is thus increasingly recognised by scholars.<sup>30</sup>

### **Research process**

In the interests of stimulating discussion not only within the business history community but also to reach out strategy and other business and management subjects, we start by offering a transparent explanation of the sources informing this article.<sup>31</sup> We use multiple archives pertaining to the Scotch whisky industry, including the National Records of Scotland (Edinburgh) and UK National Archives (London) (principally government correspondence), and the Scottish Business Archive at the University of Glasgow (records of the industry trade association, the Scotch Whisky Association, as well as those of leading firms, the Edrington Group, Wm Grant and Highland Distillers Company Ltd). More general whisky industry files include industry magazine articles, Guinness' Storehouse archive online, memoirs (Guinness family member Jonathan Guinness's autobiography and James Saunders' biography of his father Ernest), UK newspaper archives, secondary literature including whisky books, industry reports, government reports (Distillers Working Group papers), and related literature on the alcoholic drinks industry. These are supplemented with personal correspondence with a former director of United Distillers credited with launching the Classic Malts range of single malt whisky.<sup>32</sup> Aside from the correspondence, the archive materials are all publicly available and help provide insight into what has historically been a difficult industry to access.<sup>33</sup> We use these materials to analyse and develop historical narratives to understand how they inform strategic direction.<sup>34</sup> Major organisational moves that occurred within the Scotch whisky industry are articulated in terms of the takeovers, changes in strategic priorities, and operational characteristics over the period 1945–present to build a picture of how dynamic capabilities emerged in the industry.

### **The Scotch whisky industry—1945–present**

#### ***A period of sustained growth (1945–1975)***

In 1945, the Scotch whisky industry was characterised by a high degree of concentration of ownership and production into one dominant distiller and blender (DCL), several medium sized firms (Highland Distillers Co (HDCo), William Grant's and Robertson & Baxter's), and a cluster of smaller independents. This continued a pattern of consolidation following two trade agreements in the mid-nineteenth century and then in the mid-1920s, reflective of buoyant sales in the sector.<sup>35</sup> Major industry players as well as smaller independent distillers all embarked on major capital investment to increase productive capacity and warehousing between the late 1950s and mid-1960s.<sup>36</sup> The growth and investment in production and warehousing also saw a dramatic expansion in bonded whisky in warehouses rising from 148.5 m proof gallons in 1953 to 325.9 m by 1963.<sup>37</sup> Despite industry optimism about the future in single malts in the 1950s, the sectoral production focus remained predominantly on blended whiskies with malt whisky produced either for domestic blends or exported for blending abroad, and single malts almost nowhere to be seen other than in specialist stores.<sup>38</sup> In 1963, Wm Grant's launched The Glenfiddich Straight Malt, marketing it as a standalone single malt brand that contrasted with the dominant blended malts category. Independent

producers followed this with the release and relaunch of such brands as Glenmorangie, The Macallan, and Glentauchers in the mid-1970s. These prefaced the development of single malt as a heritage brand and heralded the beginning of what would later become a critical part of the industry, but which had previously played a very minor role compared with blended Scotch whisky.

This period has been described as the ‘golden age’ for the Scotch whisky industry with growing demand around the globe for whisky. The dominant firm in the industry was Distillers Company Ltd (DCL)—an industrial behemoth and former trade cartel comprising a federated collection of renowned Scotch whisky producers including Dewar’s, Walker’s (of Johnnie Walker fame), Buchanan’s, Haig, White Horse, and several others.<sup>39</sup> As the industry entered the 1970s, even with declining domestic sales it continued to be buoyed by an increase of 18 percent in exports to the US market in the first four months of 1970. Its industry recipe of focussing on production and exporting had worked well for it, despite various concerns expressed within the industry (and from outside) that it was not doing enough to modernise, and structural problems were becoming increasingly apparent.

### *A descent into unprecedented crisis, 1975–1983*

Continual sales growth in the industry begot a longstanding unwillingness in organisations of all sizes to consider changing strategy. The shared sectoral approach remained, as Jones noted, focussed predominantly on production.<sup>40</sup> Between 1953 and 1977, exports of whisky from the UK (mostly Scotch whisky with a fractional amount of Northern Irish whisky) rose from £37.8 m to £512.6 m, with over half of this to the United States. By 1964, Scotch whisky accounted for 28 percent of total UK exports by value. For much of this period the majority of market share (and of growth) was in blended whisky.<sup>41</sup> By 1976, DCL accounted for 60 percent of Scotch whisky exports to the value of £220 m.<sup>42</sup> However, by the late 1970s Scotch whisky’s share of the US market was falling, as the financial and the industry press had already consistently claimed. This was in part a response to the devaluation of the US dollar in 1971, the collapse of Bretton Woods, and the knock-on effects in currency exchange.<sup>43</sup> Scotch whisky was facing increased competition in spirits markets after joining the European Economic Community.

By October 1977, the EEC were pursuing action against DCL over their differential pricing policy. Government officials at the Ministry of Agriculture, Fisheries and Farming (MAFF) noted that the implications were profound:

DCL account for about half our whisky production and exports (the latter being 85% of production worth in total £400million last year). Any change in their marketing structure which adversely affects their production and exports would damage UK interests in terms of the consumer, employment and balance of payments. Furthermore, a finding against DCL could well lead to similar findings against the other companies. This is therefore a question of major importance to the UK.<sup>44</sup>

DCL’s response to the ruling it could no longer have differential pricing was unprecedented. In 1978 it withdrew Johnnie Walker Red Label from the UK market; prior to the withdrawal it was selling 1.25 m cases per year and was the market leader. This opened up opportunities for a number of smaller distillers to fill the gap in the market, as well as Bell’s and Famous Grouse blends. Nicholas Morgan writes ‘it spelled opportunity for the “new” single malt brands such as Glenfiddich, Glenmorangie and Macallan, which had already been

gaining a foothold in some continental European markets.<sup>45</sup> For their own part, Distillers also saw an opportunity to test the water with the relaunch of Cardhu in 1983 as a single malt (which was not enthusiastically endorsed by the DCL board),<sup>46</sup> presaging what would come later with the Classic Malts launch. The removal of Johnnie Walker Red Label also contributed to the problems facing the industry regarding overproduction—DCL had been storing single malt ‘fillings’ for Johnnie Walker with the intention of returning Black Label to a 12 year old age statement globally and developing a younger blend. DCL later argued that the withdrawal was necessary ‘to protect the export trade of a number of our brands (including the world’s largest selling brand, Johnnie Walker Red Label) by withdrawing them from, or pricing them out of, their home market.’<sup>47</sup> The crisis came on the back of exponential growth in the sector in the decades following the Second World War. Crucially, that industry success was largely export driven—exports grew as a proportion from 50 percent of total production in 1939 to 75 percent by 1954.

However, there was an increasing stakeholder recognition that the industry was unwilling to confront the changing circumstances it found itself in; a feature in October 1977 in *Drinks International* suggested that there were ‘no easy answers’ for the problems of Scotch whisky. This was exacerbated for DCL by its long-standing diversification into non-potable spirits sectors including chemicals, foodstuffs, and most crucially, pharmaceuticals. In 1958 DCL’s pharmaceuticals division introduced to the market the drug Thalidomide to treat morning sickness in pregnant women. However, it quickly became apparent that the drug was causing serious birth defects in newborn children and was withdrawn from sale in 1961. What followed was a series of legal and moral disputes over DCL’s liability for the effects of the drug amidst significant public outcry and a campaign by *The Times* newspaper in 1967 resulting in a public boycott of DCL products, and a stock market loss of £35 m for the company across nine days. In 1973, DCL settled for £28 m through its Distillers Biochemicals division to be shared amongst affected children, having previously offered £3000 per arm affected in 1968.<sup>48</sup> The case severely impacted DCL’s reputation and confidence in its board who had refused to take responsibility for the disastrous effects of the drug it was distributing and had a hugely deleterious effect on both media and consumer opinions on the company which proved difficult to shake off.

The whisky industry in the late 1970s was increasingly suffering from structural problems. The Distilling Sector Working Group reporting to the National Economic Development Office in 1978 identified several weaknesses in the industry and made recommendations that included strengthening the domestic market, as well as improving its overseas market share in various different territories. It urged the industry to become more efficient and competitive and to improve shareholder returns.<sup>49</sup> In the late 1970s and early 1980s Scotch whisky producers ‘seriously over-estimated demand’ ignoring suggestions from commentators and shareholders that the industry was too production focussed.<sup>50</sup> These were calls that had been made for nearly ten years but fell on deaf ears by organisational leaders in an industry that remained focussed on production and wedded to its ‘industry recipes’ thinking. The industry had faced crises before (demand for whisky and production was/is cyclical) but this situation was especially problematic as it revealed the industry’s new reliance on exports which could not be easily overcome. As late as 1976, Scotch whisky distillers held 34.5 percent of the market in global whisky sales, selling to 190 countries, with export sales valued at £513 m by 1977.<sup>51</sup> Of this, more than 50 percent at least derived from DCL.<sup>52</sup> However, global sales of Scotch started to decline in the late 1970s and early 1980s. Nevertheless, Scotch

producers refused to change their productionist strategies by refusing to react to criticisms from commentators and shareholders that the industry was too production-focused and not generating enough profit.<sup>53</sup> Continued production and stockpiling led to the creation of a glut and over-production, what became known in the industry as the 'Whisky Loch', as well as the 'whisky lake', and 'spirit lake'. The massive oversupply of Scotch meant the industry was faced with significant problems that it was ill-equipped to deal with.<sup>54</sup>

The growing crisis in the industry was evident also in DCL's abandoned attempt at a 1982 takeover of Bank of Scotland, which the Bank of England described as 'defensive diversification'.<sup>55</sup> It was an attempt to move away from whisky due to an estimated £700m of its net worth being tied up in maturing bonded whisky (partly also due to the disruption caused by the abrupt removal of Johnnie Walker Red Label from the UK market). Concurrent discussions within the Scottish Office and the UK Treasury both interpreted DCL's motives in the same manner and were sceptical about the seriousness of the bid.<sup>56</sup> Ultimately the bid never amounted to anything, but such discussions nevertheless point to DCL's concerns by this time of the 'whisky loch' they were sitting on. In the early 1980s Scotland's largest distiller, DCL controlled five of the country's 14 grain, and 45 of the 118 malt distilleries. Between 1983 and 1985, faced with a collapse in demand and a growing inventory held in bonded warehouses, it closed 21 distilleries, alongside many other companies closing their distilleries (or running shorter working times), but continued to produce significant amounts of whisky.<sup>57</sup>

Since the Second World War, growth has been so phenomenal that it has made people forget about the slumps during the 1850's, the 1890's, the 1920's, and now the 1980's. Due to estimations of stock so many years in advance, and the fact that Scotch is subject to the crises in capitalism, just like any other commodity, it has cyclically slumped.<sup>58</sup>

By 1986, the industry had lost around a quarter of its distilleries with others going to short time working hours and reducing production.<sup>59</sup> The closures signalled crisis in the industry—DCL and others had been forced to act by the changing global context of their markets. The change in the global context meant the comfort with which whisky producers had become accustomed to was jeopardised. Productionist strategies created a problem for the industry that it was unable or unwilling to address. A lack of entrepreneurial thinking and action in the industry had narrowed its strategic options (the opposite effect of Zahra et al.'s argument) to the point where it was having significant difficulty trying to extricate itself from its problems. However, outsiders looking on saw opportunities with the under-performing firms, oversupply of products, and shareholder concerns over performance dominating the discourse on the industry.

### *Takeovers and change, 1984–1989*

In 1984, Guinness, led by Ernest Saunders and his new consultants Bain and Co, was looking to move into the international spirits market, launching a hostile takeover bid for Perth-based Scotch whisky distiller and blender Arthur Bell & Sons. Under its strong-willed sales-oriented chief executive Raymond Miquel, Bell's had grown to hold the largest share of the UK Scotch whisky market, taking advantage of Johnnie Walker's exit. Miquel was regarded as an extremely able and demanding Chief Executive, but who did not have many friends in the industry (he played no role in the Scotch Whisky Association, for example) and was not especially well-connected in Scottish circles by his own admission.<sup>60</sup> Consequently, when



Guinness launched its surprise bid for Bell's, Miquel found himself isolated in fighting to retain his company's independence with little support in the industry, and less still from financial institutions.<sup>61</sup> The takeover was bitterly fought, before Guinness eventually emerged victorious after major Perth-based shareholders The Gannochy Trust (established by former Bell's owner A.K. Bell) and General Accident voted against Miquel and supported Guinness' offer. In 1985, Guinness eventually paid £370 m for Bell's, cementing Saunders' position in British business as one of the most lauded CEOs in the country.<sup>62</sup> The takeover of Bell's was Guinness' first foray into spirits, and a taster of what was to come next. Having successfully acquired Bell's, Guinness moved next for DCL in what was to become an infamous takeover battle.

In the mid-1980s DCL faced simmering discontent about its share performance and declining performance of its brands.<sup>63</sup> A series of announcements by DCL in the early to mid-1980s revealed ongoing problems in the company:

Our brands performed satisfactorily in the context of generally depressed trading conditions.<sup>64</sup>

... profitability was adversely affected by the relatively low utilization of production capacity.<sup>65</sup>

I am sure that the considerable wealth of talent within the Company will, backed by our financial strength, enable us to face the future with confidence.<sup>66</sup>

... a modest improvement in prospects has begun to develop in some countries.<sup>67</sup>

DCL's share performance had declined against both its export and domestic performance. Its once dominant domestic market share of 75 percent in the early 1960s had been whittled down to 15 percent by 1984, mirroring its declining share of the world Scotch whisky market where it had gone from 45 percent in 1977 to 35 percent in 1984. More problematically, the company had also failed to develop new whisky products except for Claymore; a heavily discounted blended whisky.<sup>68</sup> DCL's problems reflected the issues facing the industry more generally—declining consumption of Scotch was met with attempts at discounting and cheapening the product, with no commensurate improvement in sales. Moreover, the structural, distribution, and marketing problems were issues that it could not readily solve. However, for companies on the outside looking at the industry with fresh eyes, it presented enormous opportunity. Guinness' hostile takeover of Bell's was a sign of what was about to come for DCL.

In December 1985, DCL became the target of a takeover bid from Jemmy Gulliver's Argyll Group (who owned a number of UK supermarkets) in competition with Guinness in April 1986.<sup>69</sup> The discontent concerning DCL's failure to address its underperforming share price opened the door for Gulliver and the Argyll Group to launch a bid for the company. Gulliver had purchased a number of shares in DCL and used the declining share performance to criticise DCL's directors' management of the company. Gulliver highlighted the decline in DCL's performance in a series of newspaper adverts arguing that Argyll would be better able to run the company. DCL acknowledged some criticisms when it reorganised its management structure, home division for whisky sales, and established a new products division. However, this was considered to be 'too little and too late' meaning it was now a prime takeover target.<sup>70</sup>

Gulliver's due diligence on the company discovered that DCL was 'a manufacturing and production-oriented business without sales or marketing skills. Traditionally they didn't have to sell in the home market, they just supplied it. The overseas markets were mostly run on an agency basis, and that bred arrogance and complacency.'<sup>71</sup> Another observer of the company later opined, 'When Distillers were in charge they just didn't think about marketing.... A consignment of Scotch would be loaded on to a ship at Southampton and Distillers just waved it goodbye.'<sup>72</sup> Using due diligence to evidence their position and exploit dissatisfaction with DCL's slow response to its declining performance, Argyll gained institutional backing for a takeover bid, but it was a mammoth task. DCL was the biggest whisky company in the world and seen as unconquerable. Argyll's director David Webster later said: 'It was a Scottish company, with a wonderful Scottish heritage, but it was being directed from St James's Square (in London). It was seen as impregnable, in part on account of its size, and also because of the Scottish factor. It was that which deterred the big North American operators from making a play for it.'<sup>73</sup> Argyll identified DCL's federated structure as the source of its many problems. Others have argued that the management was inbred and had given too much control of marketing to its long-established network of distributors, meaning it had failed to exploit its 'unique portfolio of brands bequeathed them by an earlier generation of management', with wastefulness embodied in the 'seven prestigious offices in the West End' of London.<sup>74</sup> DCL naturally did not view themselves as poorly managed, wasteful, or complacent but as continuing as they always had in focussing on production which had driven the industry previously to growth.

Argyll continued with its approach, identifying every weakness it had found in DCL in a series of adverts placed across the national press. At this point DCL began to respond, hiring the American marketing expert Bill Spengler who crafted one particularly cutting response that [Argyll's chairman] 'Jimmy (Gulliver) deals in potatoes and canned beans. We are not selling brown water in cheap bottles. We are selling Scotch and that requires international marketing expertise.'<sup>75</sup> DCL's arrogance did little for its position. The City and others began to support Argyll, who eventually launched a highly leveraged £1.9bn offer for DCL (Argyll's value at the time was £600m). In the early part of 1986, Guinness and Ernest Saunders, again supported by Bain and Co as consultants whose Olivier Roux (in what was a very unusual move) had been seconded as Financial Director of Guinness' board, entered the fray to contest the bid. Invited in by DCL as a white knight friendly bidder against Argyll's hostile bid, the takeover battle between Argyll and Guinness was characterised as 'a campaign of unprecedented viciousness',<sup>76</sup> through the very public fighting between the two via adverts in the national press. As the battle between Argyll and Guinness continued, DCL took to heavy discounting to boost sales and looking into selling off brands in order to boost its own share price, earning itself the sobriquet 'Damn Cheap Liquor Co.' in industry circles.<sup>77</sup>

Saunders, a former marketing executive with Nestlé who was involved in the related baby formula scandal in Africa in the 1970s and 1980s,<sup>78</sup> worked closely with his City advisors Morgan Grenfell and Bain and Co. Together they spotted the potential of DCL's brands and heritage during the takeover of Bell's with a view to establishing Guinness as an international drinks company able to compete on a global scale.<sup>79</sup> Bain and Co were known for their meticulous planning, understanding of client competitors, and absolute secrecy.<sup>80</sup> Argyll originally thought that Bell's would be sufficient for Guinness and they wouldn't consider bidding so soon after due to the size of DCL. Saunders and Bain had other ideas and subsequently entered into a series of secret agreements with financial intermediaries that would

later be found to be fraudulent in boosting its share price (which was part of the final offer for DCL). Saunders and his colleagues, unbeknownst to the Guinness board, offered significant financial incentives and indemnities to external parties to purchase Guinness shares to artificially inflate its share value—the side agreements amounted to tens of millions of pounds of illegal inducements and indemnities to guarantee returns to investors to inflate its bid value for DCL. Guinness' bids were based on a cash and shares offer, so the artificial inflation of Guinness' share-price made its bid more valuable to DCL than it should have been. By offering guaranteed returns to investors via the inducements and indemnities against share price fluctuation, Saunders et al were increasing their bid value and it was later found, breaking stock market rules.<sup>81</sup>

Guinness eventually won the battle with a £2.7bn for DCL in what was one of the most audacious, and in equal parts controversial, takeovers in twentieth century business history.<sup>82</sup> Guinness won out over Argyll with Gulliver admitting that 'Saunders could have walked on water. He was regarded ... as near genius.'<sup>83</sup> For their part, DCL executives were relieved that their preferred bidder had won, but misunderstood Guinness and Saunders' intentions. Saunders recalls 'They kept making indiscreet remarks along the lines of "Thank goodness we've escaped from Gulliver, now we can carry on as before." I was not impressed'. Saunders then set about ignoring many of the promises he made during the takeover to retain much of DCL's management structures and locations, quickly implementing an 'action-oriented command structure' in the company directly under his control.<sup>84</sup> In order to address the Monopolies and Mergers Commission's concerns, Guinness sold a number of DCL brands to Whyte and Mackay including John Barr, The Buchanan Blend, The Real Mackenzie, the aforementioned Claymore (which had become its leading brand in the UK, with 5.9 percent market share) and Haig Gold Label, none of which would adversely affect DCL's export sales.<sup>85</sup>

However, the share price scheme was soon discovered leading to Saunders losing his job, under investigation by the UK Department of Trade and Industry, then conviction for false accounting and theft. Three others involved in Guinness' successful bid were also indicted with one being granted immunity from prosecution in return for testifying. Saunders was eventually sentenced to five years in prison, but gained early release after only 10 months after being diagnosed with the incurable neurological condition Alzheimer's. He subsequently made a full recovery. Guinness taking over DCL was a gamble—family member Jonathan Guinness described it as 'appallingly risky' but writing in his memoir states: 'What was important was the exciting future that Saunders seemed to promise for our company; a future, which, let us not forget, did in fact materialise. Saunders' successor, Anthony Tennant, was to reap, admittedly with great skill and panache, where he had sown.'<sup>86</sup> The Scotch whisky industry in the space of just a few years saw Bell's, with the largest domestic market share, and DCL, its largest export seller, both purchased by the same company, in controversial circumstances. Within a few short years the industry changed markedly with the entry of Guinness as the now dominant player and with it a significant shift in perception of its capabilities.

### *Sui generis acts and unlocking dynamic capabilities, 1987–present*

Prior to the takeover DCL and other producers had tried to cut prices to stimulate demand, but instead created cheap secondary whisky products which 'degraded the image of Scotch' with no commensurate increase in consumption, which in turn failed to drain the 'whisky

loch.<sup>87</sup> Guinness' new Chief Executive Anthony Tennant, an aristocratic Scot and drinks industry veteran who had led the growth of regional beer brands then international spirits for Grand Metropolitan, was appointed in 1987 and held the opinion that Scotch was 'about high value-added brands and margins. It has nothing to do with volume.'<sup>88</sup> Once the formalities of the takeover were complete and the dust settled with the legal fallout, Tennant set about changing the business to focus on premiumisation through a series of sui generis acts, outlined below. Guinness started this by merging its various spirits holdings to create United Distillers with a new focus on branding, marketing, and distribution of Scotch whisky, in some respects mimicking trends more generally across the alcoholic beverages industry.<sup>89</sup>

A number of appointments were made to kickstart the new premiumisation strategy. James Espey, formerly Marketing Director under Tennant at International Distillers and Vintners (Grand Met's spirits division) was appointed as chairman of United Distillers<sup>90</sup> and worked closely with Tony Greener as Managing Director on the new strategy. Greener had run the luxury goods firm Dunhill and was a non-executive director of Guinness. Both understood both the target market and parent organisation. DCL's federated structure was replaced with a clear territory-based marketing approach, reducing competition between brands and focussing on portfolios, meaning many of the old companies in DCL began to lose their individual identities, but the new divisional structure could utilise the complete brand range of the new company in their dealings and thus leverage marketing and distribution support accordingly.<sup>91</sup> Espey for his part sought to focus on the key variables to have control over in the business including the top ten brands, expenses, staff numbers, debtors' days, creditors, and cash flow believing that keeping control of these would allow the business to focus on the strategy.<sup>92</sup> The lack of any strategy was apparent to the new Group Marketing Director Mike Collings who identified the malts portfolio as a key untapped resource. Collings had previously worked in the wine trade, as well as on the Jack Daniels and Southern Comfort brands, all of which he used his experience of to underpin a new malts strategy.<sup>93</sup>

Allied to his belief in the premium potential for Scotch, Tennant also set about disposing of holdings that were not core to the business (owned by both DCL and Guinness it should be said) including a health food restaurant, food processing, newsagents, yeast producers, a chemicals operation, a photographic business, a chain of chemists, and the seven palatial head offices in the West End of London. These moves freed up managerial attention, replenished financial capital and fostered organisational capacity for new activities that was subsequently deployed. The explicit mission of the new organisation was to 'restore Scotch to its rightful position as the leading and most respected spirit product in the world'.<sup>94</sup> Tennant took the critical decision to shift away from the old 'produce more' approach, investing heavily in marketing to create cachet for its brands and price them at premium levels.<sup>95</sup> Greener was key to the new strategy with his experience of luxury products at Dunhill: 'United Distillers is now clearly focussed on marketing high quality branded spirits in portfolios tailored to the needs of each market. Central to this goal is a determination to restore and enhance the prestige of Scotch whisky through careful marketing and packaging.'<sup>96</sup>

In 1987 Guinness controlled the distribution of around a quarter of its spirits output; under Tennant's direction this grew to over three quarters by 1989 through a series of the distributors themselves funded by the divestment of non-core businesses and assets.<sup>97</sup> A key component of its reorganisation and change in strategy was a joint venture partnership with Louis Vuitton Moet Hennessy (LVMH) which Tennant considered 'the most important' of the various joint ventures as it allowed United Distillers to work with another

world-renowned luxury goods business and complement each other's portfolios.<sup>98</sup> This allowed United Distillers to start repositioning its brands towards premium products and link into LVMH's own distribution networks. Rather than dumping the stocks cheaply and 'degrading' the product, Greener directed his teams to hold the stock and explore ways of using it with premiumisation key to the approach. There was a clean slate for Greener and Tennant to do this as Saunders' arrest and the confiscation of company documents meant there was very little existing materials to follow or build on. Tennant recalled: 'all the files had been taken away and there was no briefing from my predecessor either. I had nothing to go on except my own views about how the organisation should be conducted.'<sup>99</sup>

Consistent within the new United Distillers approach was the recognition of the potential of history, regionality, and the discrete tastes of the existing Scotch whisky brands as potential luxury products.<sup>100</sup> In the past single malts were 'fillings' (ingredients) for blended whisky, but now they were recognised as having potential for premium branding on their own. They had provenance, a long history of production, tradition, and were unique but had hitherto been treated as simple ingredients in the more popular blends rather than as products in their own right. United Distillers had significant stocks of them as a result of the over-production of the 1970s and 1980s—the 'whisky loch'. Noted whisky writer Charles MacLean writes:

The decision was borne of the discovery of just how vast was the stock of mature whisky its predecessor had amassed, largely owing to faulty market forecasts. In the past, the DCL had used its dominant stock-holding to keep the price of whisky down; United Distillers approached it in the opposite way, driving the price up, making better use of its old fillings [single malts] to introduce deluxe and super-deluxe blends (such as Johnnie Walker Blue Label) and, for the first time, to place emphasis on malt whiskies.<sup>101</sup>

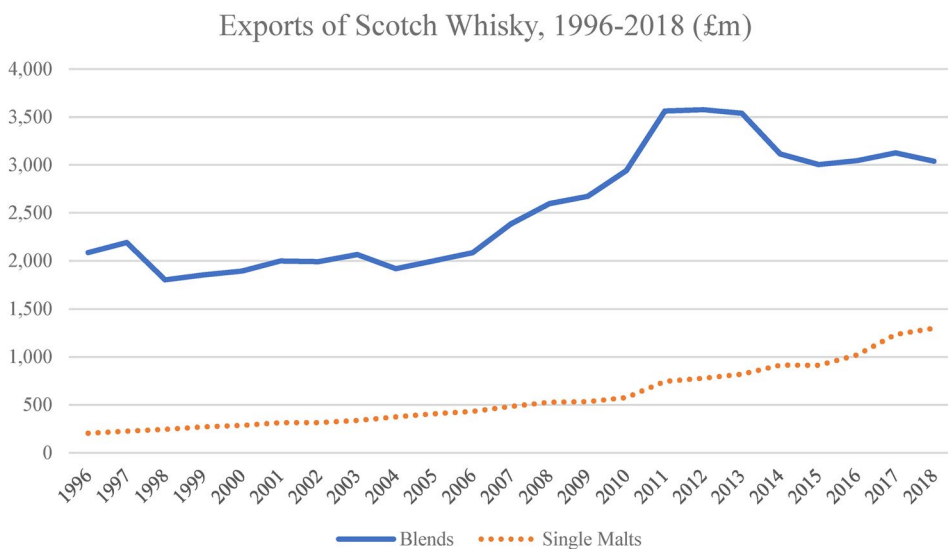
In 1989 under Guinness' control and ownership in 'perhaps the biggest impetus to the industry', the Classic Malts single malt Scotch whisky range (Lagavulin, Cragganmore, Talisker, Oban, Glenkinchie, and Dalwhinnie) was launched explicitly stating the history of each brand's distillery, location, provenance, and taste.<sup>102</sup> The brainchild of Mike Collings and Roy MacMillan (who worked for DCL),<sup>103</sup> the Classic Malts were premium priced and designed to establish single malts as a category of value in the whisky market in of themselves, rather than as simple ingredients for blends. The brands were chosen on specific criteria of history, how photogenic the distillery was (for marketing and visiting purposes), regional location, and flavour profile.<sup>104</sup> This was an important step in the development of single malts as a distinct, high value category; prior to their launch there was no malts strategy in the company, and no focus on distillery level branding—United Distillers set about creating an archive of their brands' histories with the explicit intention of leveraging this for marketing purposes.<sup>105</sup> This has since become commonplace in the industry, with most of the major distillers and brands having their own archives for marketing purposes.

In reorienting the dominant business in the industry, Tennant and Greener worked to refocus the whisky industry on high quality, premium branding, and marketing with control over all aspects of production and sales. The control over distribution was key to the shift of the industry to focus on premium branding and pricing—the 'whisky loch' that had occurred could only be drained effectively and without compromising the growth prospects of the industry if it didn't embark on deep discounting or dumping of stocks (which is the likely path DCL would have taken). Espey recalls in his memoirs being asked to sell more Johnnie Walker stock in the USA in the 1990s, but declined on the basis that he thought it

would risk damaging the brand and upset the credit control measures he had in place.<sup>106</sup> Taking control of the distribution of the product allowed Guinness to maintain/increase the price point, which they otherwise would have had difficulty doing by relying on third party distributors who could discount if they wished. They complemented this by recruiting large numbers of marketing and management people under the directors with proven track records to ensure the modernisation of their activities was developed in line with improvements in human capital and the reduction of silo behaviour across the organisation.<sup>107</sup>

It wasn't long before their efforts started to bear fruit. For Guinness, group profits increased from £408 m in 1987 to £956 m in 1991, with 75 percent coming from its United Distillers arm.<sup>108</sup> By the following year United Distillers was contributing 80 percent of Guinness' profits.<sup>109</sup> In 1992, United Distillers closed a further four malt distilleries, developed two further grain distilleries, and centralised packaging to a single location in Shieldhall in Glasgow next to the airport.<sup>110</sup> It further retained bottling plants in Kilmarnock (the home of Johnnie Walker), Leven (home of Haig), and Perth (home of Dewar's), as well as smaller operations in Dunfermline, Broxburn, and Leith. The Perth site closed in 1994, and Kilmarnock in 2012, retaining the plants at Leven and Shiedhall. Other Scotch whisky producers followed United Distillers' cue in the 1990s with Allied Distillers repackaging several of its single malts at premium prices, followed in 1994 by Chivas and Glenlivet doing the same. Single malts had become a premium priced product which grew substantially and is still growing (Figure 1):

From a starting point of sales of around £200 m in 1996, single malt exports now comprise over £1bn in export value, demonstrating steady and continual growth in market share. Jones argued that 'The adoption of a brand-driven strategy thus appears to have played a significant part in raising prices and profitability.'<sup>111</sup> Although single malts are not at the same volume as blended malts when it comes to exporting, the growth in value of the single malt category has been significantly and steadily higher over a 20-year period, despite production and export of single malts by volume remaining relatively steady.<sup>112</sup> Blends remain



**Figure 1.** Source: HMRC Trade Statistics, 2018 (current prices).

dominant in sales: Bell's whisky is now the second bestselling Scotch in the UK behind Famous Grouse, with Johnnie Walker Black Label in third place, and Red Label in fifth place.<sup>113</sup> Johnnie Walker is the world's best-selling Scotch and has seen a number of new iterations based around quality such as Johnnie Walker Blue introduced in 1992 using aged malts (which helped with the whisky loch) as a premium blend, and Johnnie Walker Platinum using 18 year old whiskies as its base.

The unlocking of the industry's potential went beyond focussing on marketing, distribution, and relaunching single malts, however; significant effort also went into the infrastructure supporting the industry. In 1996, almost exactly ten years after the takeover, United Distillers committed £25 m to computerising its stock systems for more accurately matching supply with demand; a long-standing issue for the industry. The investment in information technology infrastructure to support distribution and marketing activities was influenced by the experience of other industries, most notably Benetton in the clothing industry, Rover in the car industry, and Coca-Cola in the beverages industry that the operations manager of United Distillers sought to emulate, illustrating the new forward looking approach present in an industry which, until the takeover by Guinness, had been overly comfortable in its position.<sup>114</sup> Scotch whisky is now characterised by a near constant level of innovation around the core principles of distilling the product from barley, yeast, and water in oak casks in Scotland.

The sophistication of the marketing and distribution strategies developed alongside the profile of the products—brands now no longer rely just on age statements, but a combination of age, 'finishing' by maturing the individual whiskies in different oak barrels including (but not limited to) the traditional sherry, red wine, port, white wine, and rum casks all under individual brand identities. Partnerships with celebrities, distillery tours, associations with the Royal Family through Royal Warrants, support from politicians, and sponsorships of key areas all contribute to the industry's bottom line, as well as its ability to develop new offerings focussed on its single malt identities. Stock projections (often a decade or so into the future), warehousing, inventory control, and continuous customer engagement are all results of the experience of the whisky loch. Draining it to a level where the industry could manage its holdings was key and took until the early 2000s where demand grew again resulting in shortages of mature whisky.<sup>115</sup> Anchoring all of this is the history and heritage of the brands, based in no small part on the industry's recognition of its value to leveraging the prestige of the product.

## Discussion

By using a dynamic capabilities lens to explore the Scotch whisky industry's transformation from a productionist mindset to a marketing and distribution-led shift, we identified several *sui generis* acts and contextual shifts to allow us a better understanding of the mechanics of industry change. Consistent within this is the recognition that the confluence of micro-level actions and macro-level changes are key to understanding longer term change in the industry, which gives rise to a key insight derived from our analysis regarding external actors and dynamic capabilities. As our analysis reveals, by continuing to apply a production focus (the 'industry recipe') when it no longer fitted with circumstances, DCL (and the industry more generally) was storing up a crisis in the sector by resisting change while the harvest

was ample. The conflation of these sectoral and structural challenges with the Guinness takeover of the industry incumbent DCL manifested the opportunity for change.

With this came the opportunity to reorganise, reconfigure, and reconsider how business was done. Single malt whisky now trades at significantly higher prices per bottle than its blended counterpart and illustrates the industry's transformation over the period, which without the refusal to dump the stocks of aged single malts, the shift to premium, high value product lines wouldn't have been possible. McKendrick and Hannan articulate this thus:

The dominant producers were late to appreciate the potential of the emerging category. Once they did, they designated one or a few of their distilleries as single-malt brands—underscoring the history and unique character of their distilleries—and deployed specialized marketing divisions to this new market. Their strategy succeeded to such an extent that nearly all of the celebrated single malts are produced by distilleries owned by the dominant branded-beverage companies.<sup>116</sup>

In being able to resist dumping stocks, United Distillers were creating the potential for the subsequent transformation of their (and by extension Guinness') resource base, and a reshaping of the industry. Tennant was very clear in his articulation of what he perceived to be the value of Scotch based on high end, premium marketing and pricing, but not volume and worked to ensure that was the focus of the newly configured business. Faced with large overstock it would have been in many respects sensible to dump it cheaply through heavy discounting or down the drain to retain prices and existing lines; this is standard practice amongst businesses today. The resistance to both courses of actions instead created a premium product line of a nature and scale that was outwith industry norms and transformed its resource base and economic performance thereafter.

Dynamic capabilities to date have been largely characterised as internal capabilities of firms that are a reaction to changes in internal or external operating environments, but how these changes occur, and the non-repeatability of them, are less well understood. What we demonstrate from the Scotch whisky industry's history is that dynamic capabilities were unlocked by external actors coming into the industry via mergers and acquisitions where they were not encumbered by existing industry mental model and human capital elements of Adner and Helfat's definition of dynamic capabilities. As Danneels' analysis of Smith Corona also reveals,<sup>117</sup> the accessing of external resources was important to the unlocking of dynamic capabilities in the industry. In the Scotch whisky industry, Ernest Saunders, Anthony Tennant, Tony Greener, and James Espey were key actors in the shift towards premiumisation and leveraging of brands, history, and heritage based upon their experience in other industries. What's distinctive in their actions is the number of non-repeatable *sui generis* acts includes identification of the potential of existing brands, takeover, divestment of non-core activities and raising of finance to pay for the new strategies, resisting pressure to dump stocks or heavily discount, and recognition of the potential of prestige branding and products. DCL did not have the managerial capabilities to reconfigure its resource base in of itself. It required the actions of outsiders brought in to identify such changes.

The acts we identify fit Teece's definition—they did not stem from existing routines nor give form the basis of new routines, but rather helped create the conditions for the new strategies and routines to be implemented. In this sense Tennant, Greener and Espey did end up transforming industry routines, ultimately embodied in the success of Classic Malts story through these actions. What this tells us is that external actors can help establish the



conditions necessary for new routines through *sui generis* acts which in turn can unlock dynamic capabilities present not just within firms, but also within industries. The historical analysis reveals the distinctive insight that none of the three key actors we identify as responsible for unlocking those capabilities were originally employed by DCL or in the industry, and two of the three were external to the industry altogether.<sup>118</sup> Guinness' move into the Scotch whisky industry via its takeovers of Bell's and DCL meant it brought a different approach to the sector, with a clear focus on marketing, branding, and distribution, rather than production. The identification of single malts as potential premium products was key to this. Tennant, Greener, and Espey's reorganisation fits with different processes associated with change we identify at the beginning of the article, including merger and acquisition, product innovation, and marketing. The *sui generis* acts we discuss can be characterised across these different categories, and beyond in that they not only transformed the business, but the industry more generally.<sup>119</sup> Our empirical analysis contributes to the ongoing debates on dynamic capabilities by addressing Ambrosini and Bowman's point about the lack of such analyses hindering our understanding.<sup>120</sup>

## Conclusion

Understanding the structural and firm level changes in the Scotch whisky industry since 1945 through a dynamic capabilities lens allows us to identify the *sui generis* acts and actors central to the transformation both in the incumbent firm and industry. The single malt whisky category developed rapidly from the Guinness takeover in the late 1980s to become a significant part of the industry. DCL (and other Scotch whisky leaders) had largely ignored single malts or 'fillings' as they were known as ingredients for blends, in favour of the established market for their blended Scotch whisky brands. In so doing, it built up a whisky loch of warehoused single malt whiskies which grew in age but caused DCL, and the industry as a whole, significant problems with overstock; the 'Whisky Loch'. These well-worn 'industry recipes' were manifest in the productionist culture of the Scotch Whisky industry. Guinness' takeover led to the reorganisation and reorientation of DCL into a marketing and distribution led organisation that took advantage of this overstock and rather than dumping the whisky, instead turned it into a competitive advantage. Our analysis extends understanding of dynamic capabilities by highlighting the importance of external actors in firm and industry change. Business historians have long identified *sui generis* acts in their analyses of firms and industries, but by connecting the concept of dynamic capabilities to business historical analysis we extend understanding of the former by demonstrating that change can also come from outside the firm and sector.

Our examination of the Scotch whisky industry details the transformation of its resource base from a production-oriented exporter towards a sophisticated marketing and distribution-led sector. By using a dynamic capabilities lens to explore this, we make two main contributions. The first is the identification of the potential of external actors in understanding firm and industry level changes; and the second is the addressing of both Teece and Lazonick's calls for more business history work to analyse the emergence of dynamic capabilities and the *sui generis* acts that lead to such changes. These contributions also address calls for further exploration of the intersection of strategy and business historical analysis, and the testing and driving of our understanding of concepts underpinning those. We

propose that our analysis of the Scotch whisky industry especially allows for the identification, and modification, of sui generis acts and outside actors that work to unlock existing capabilities and assets, re-defining them and thus creating dynamic capabilities in firms and the sectors in which they operate, which in turn can help us understand longer term changes in other industries.

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## Disclosure statement

No potential conflict of interest was reported by the authors.

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