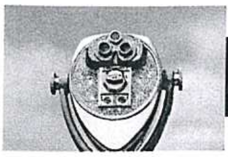

CLOSING CASE

Carlsberg faces political risk in Russia

In the early 1900s, Danish businessmen were rushing to invest in Russia, building cement plants, slaughterhouses and engine factories. Their advanced technologies gave them competitive advantages in the vast Russian market that gradually opened up to foreign investment. Then came the revolution of 1917, and all was lost as factories were expropriated. For the next seven decades, Russia was under Soviet rule and, with very few exceptions, closed to foreign investors.

When Soviet rule came to an end in 1990, Danish businesses – led by shipping company *Maersk*, pump maker *Grundfos* and building materials giant *Rockwool* – began setting up operations in Russia. *Carlsberg* was particularly successful, building a market share of 38% in the Russian beer market; their *Baltica* brands achieved market shares of 49% in the mainstream segment, and 37% in the premium segment. As part of its commitment to Russia, *Carlsberg* sponsored the national hockey league and the *Sochi Olympic Games*. Thus *Carlsberg* earned about 35% of its global revenues in Russia in 2013.

The success in Russia, however, exposed *Carlsberg* to the economic and political volatilities of Russia. In the 1990s, while Russia was experimenting with democracy, the economy had collapsed; by official estimates GDP fell approximately 40%. In the early 2000s, the economy was recovering at 7% annually, but remained highly volatile. Russia was highly dependent on exports of oil and gas, and thus on the world market prices of these commodities. Moreover, as Russia became richer and stronger (thanks to high oil prices), the government became more assertive *vis-à-vis* foreign businesses, for example putting pressure on foreign oil companies such as *BP* to reduce control over their operations in Russia.

While brewing is not a particularly sensitive activity, institutional changes still had a profound impact on *Carlsberg*. Russian leaders, from the czars to Boris Yeltsin, periodically tried to convince Russians to drink less alcohol, especially vodka. Vladimir Putin made a fresh attempt by increasing alcohol taxation, and in consequence the beer market shrank. Moreover, new laws banned TV, radio and outdoor advertising, and prohibited the sale of alcohol at non-stationary kiosks, which traditionally accounted for 26% of the off-trade (i.e. not in restaurants, clubs, or hotels) sales of beer in Russia.

These institutional changes had profound impact on brewers like *Carlsberg*. First, the demand surged ahead of the deadline of the new taxation as people stocked up their supplies, only to sharply drop in the next quarter as people destocked their supplies, creating challenges for logistics. Second, marketing resources had to be reallocated to, for example, in-store displays and channel marketing. Third, constraints on sales channels and advertising shifted the pattern of demand, leading to drop of sales especially in the economy segment. The economic crisis further reduced the demand for beer, especially in the premium and super-premium segment. By early 2014, capacity utilization in *Carlsberg*'s Russian breweries dropped to below 60%, creating speculation about possible brewery closures.

In 2014, Carlsberg was hit by the deteriorating Russian economy, worsening political relationships between Russia and the EU, and the collapse of the rouble. The trade sanctions introduced by the EU did not hit *Carlsberg* directly, because most of the beer it sold in Russia was brewed in Russia. Yet the economic crisis did: beer consumption dropped (especially of the more expensive brands) and the value of its Russian investments depreciated when the rouble dropped in value. Thus every time there was bad news from Russia, *Carlsberg*'s share price took a hit; in the second half of 2014, *Carlsberg* shares lost 20% of their value. Even so, *Carlsberg* remained committed to the Russian market, hoping for economic recovery, even though it reduced overcapacity by closing two breweries in early 2015. But not everyone did; some foreign investors, such as *Rockwool*, were concerned that Russia might introduce capital controls and divested some Russian assets. When the rouble collapsed, importing companies especially faced major losses if they had already contracted sales in the local currency. Some, like *Renault Nissan*, stopped taking orders as they could not price their cars appropriately.