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Analysis based on the industry of Grupo Modelo the giant beer company

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Abstract

The objective of this research is to determine from the point of view of strategic management the causes that Grupo Modelo is losing part of its market share in Mexico. In this sense, the question that triggered the writing of this article was: What are the causes of Grupo Modelo is losing part of its market share in Mexico? The hypothesis is that the strategies implemented by Grupo Modelo are not adequate for the industry in which it operates.

*Keywords:*Industry, competitive advantage, strategy, market.

JEL classification: L11, L13, L20.

1 Introduction

In 1925, the history of Grupo Modelo began, a brewery of industrial production that managed to position itself as one of the two most important in the production, distribution and sale of beer throughout Mexico (Grupo Modelo, s.f.). The success of the Group was such that in 2013 it attracted the attention of a corporate of international stature: Anheuser-Busch InBev, a company that managed to acquire it in June of that year (Expansión, 2013). During the 94 seasons of operation, Grupo Modelo successfully developed 17 national brands (Corona Extra is the most sold), so the taste and quality of all of them has allowed the company to penetrate the market of more than 180 countries through export of eight brands (Grupo Modelo, sf).

It should be mentioned that along with its lucrative nature, Grupo Modelo (2018) points out that it has given a leading role to the diversity and inclusion of all the members of its team, in this way, encouraging love for their place of work and for the world. The latter through its sustainability strategy to reduce the environmental impact of its operations, that is, the negative externalities. However, its historical performance of excellence and environmental strategies have not been sufficient to preserve the gap that existed over its greater competition: Heineken. According to data from El Financiero (2017), Grupo Modelo's market share has been decreasing since 2004; of ascending to 63.1% in said year, for 2016 it was reduced to 57.4%, while for Heineken it went from 34.9 to 40.1% and for the craft breweries the percentages were of 2 and 2.5 for each of the mentioned years.

In this sense, it is clear that Grupo Modelo continues to have supremacy, although its market share has decreased. Given this problem, the objective of this research is to determine from the point of view of strategic management the causes

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that Grupo Modelo is losing part of its market share in Mexico. Although the research will be limited to one segment of the industry, it should be remembered that in Mexico the production of beer is shared between two beer monsters, Grupo Modelo and Heineken, and the 630 craft breweries that the Association of Craft Brewers of Mexico (2018) says that they existed in 2017. However, the market to which industrial and craft beer is directed is different, because the second is produced following a recipe whose ingredients may vary, contrary to the industrial that is always made following the same recipe, this big difference sets the tone for craft beers to be much more expensive than industrial beers.

Due to the above, the beer production market has been further segmented and, therefore, for the purposes of this research the behavior of the Model Group within the limits of the industrial beer market will be studied.

But why study this case? One of the reasons is the importance it holds within the beverage industry. According to the National Institute of Statistics and Geography (2017) beer brewing is the second most important economic activity within the beverage industry and the 14th most relevant in the manufacturing industry. In addition, the beer industry becomes relevant because it shows a tendency to increase its trade surplus each year, for example, in 2016 it reached 2,614 million dollars. Similarly, it should be considered that the beer industry is expected to continue to grow over the next few years. In fact, MarketLine Industry Profile: Beer & Cider in Mexico (2019) points out that an increase in the market value of the beer is expected.

Consequently, the state of the industry and the nature of the problem that has arisen before generates a question from which all this research arises: What are the causes of Grupo Modelo losing part of its market share in Mexico?

To answer the above general question, a series of specific questions have been posed:

- In what type of market structure does Grupo Modelo compete?
- What is the strategy of Grupo Modelo?

The hypothesis is that the strategies implemented by Grupo Modelo are not adequate for the industry in which it operates, however, that premise cannot be accepted or rejected until the following discussion is presented.

2 Analysis of Grupo Modelo's strategic decisions

In what type of market structure does Grupo Modelo compete?

One of the most relevant elements that condition the suitability of strategic decisions is the concentration of the industrial production beer market and, consequently, the market structure in which Grupo Modelo operates. In this sense, a measurement of the concentration has been made by means of two instruments: the concentration rate and the Hirschman Herfindahl Index (HHI). According to George, Joll and Lynk (1992) the market structure determines the behavior and performance that companies have. In consideration of the above, these authors argue that, in certain markets, the smaller the number of companies that exist, the more disproportionate will be the competition between them.

Given the importance of this topic, multiple indices have been developed that measure the concentration of the market. Two of the most popular are the concentration rate and the IHH. Tirole (1988) mentions that the first of them takes the m companies (where $m < n$) with the largest market shares in the industry, that is, classifies them from the highest to the lowest, and performs a summation of all them by the following formula:

$$R_m = \sum_{i=1}^{m} \propto_i$$

Where $\propto_i$ is the market share of each company expressed as a percentage, either of sales or production.

On the other hand, Tirole (1988) says that the IHH is calculated by performing the following operation:

$$R_H = \sum_{i=1}^{m} \propto_i^2$$

The main difference between the concentration rate and the HHI is that the second performs a weighting of the market shares, giving greater weight to those companies that have a higher proportion. By virtue of this, the calculation of the concentration of industrial production breweries in Mexico will be carried out using both instruments. Ex ante, it is assumed that the industry where Grupo Modelo operates is an oligopoly, especially a duopoly, because there are only two companies, but the calculation of the indices is justified because the distribution of the market between the companies results in a different concentration.

According to information from El Universal (2018) in 2017 Heineken had a market share of 40.4%, Grupo Modelo 57.3% and the remaining 2.3% was distributed among the craft breweries. Considering that according to Cerveceros de México (2019) the production of beer in 2017 was 109.94 million hectoliters, the quotas for industrialized beer companies in 2017 would be 58.65% for Grupo Modelo and 41.35% for Heineken. Consequently, the concentration rate for this market would be:

$$R_m = 58.65 + 41.35 = 100\%$$

As noted, the concentration rate is 100%, however, if you do not have more information you might think that you are talking about a monopoly, but it is known that there are two companies, so this result reflects an oligopolistic market highly concentrated.

In contrast, the IHH is:

$$R_H = 58.65^2 + 41.35^2 = 0.51$$

The HHI of 0.51 suggests that the market is highly concentrated, but in this index the result alone indicates that there an oligopoly. At the moment there has been about an oligopoly market structure, which Keat and Young (2004) define as a market where a relatively small number of companies operate that have market power and offer a differentiated or standardized product, although they generally seek differentiation to have power over price and production.

In the current investigation, it is known that we are working with a duopoly (specific case of the oligopoly) because only two companies compete: Grupo Modelo and Heineken.

What is the strategy of Grupo Modelo?

With respect to the competitive strategy, one of the ways in which Grupo Modelo has tried to stop the entrance to new competitors is through competition not based on price, specifically through reputation, in the terms that Barney (1986) proposes that such element is an un-appropriable resource that can become part of a company's strategy to maintain its competitive advantage.

A clear example of the above is the attempt of the company to create an image of a sustainable company that reduces the negative externalities it generates through its production processes. On March 29, 2017, Cerveceros de México released the news that Grupo Modelo would start using renewable energy to make beer. But five days later a new note was published where it read in the heading: "Heineken will start making beer with solar energy" (Brewers of Mexico, 2017).

What does Grupo Modelo intends with it? Obviously compete, attract loyal consumers through the projection of a friendly image with the environment.

Although undoubtedly, the most marked competition between both companies has been in advertising, which Keat and Young (2004) classify as a determinant of demand not based on price. According to information from El Universal (2016) one of Heineken's biggest victories in advertising was one that went around social networks whose slogan was: "Do you need to see more box?". Even so, Grupo Modelo continues to maintain supremacy in mass media, injecting more and more capital into advertising on social networks, however, the budget allocated to this item has been decreasing over the years, while Heineken has increased it (El Universal, 2016).

Regarding the number and type of products that both companies offer, Grupo Modelo outperforms Heineken. While the former has 18, the latter has 31. Despite the above, the beers they make are not too different between them, both produce types such as pilsner, lager or Vienna. In fact, the price is also quite similar, according to information from Super Walmart (2019), 12 cans of 355 ml of Tecate Light (Heineken) are priced at $ 162.01 and the same package, but Corona Light (Grupo Modelo) is at $ 160.00. Consequently, it is obvious that both companies do not have competition based on prices because the products are similar. If one company decreases the price of the product the other would also have to do so not to lose part of its market share. The result would be a price war in which both would lose many of its benefits.

Instead of it, they compete on the base of production levels. In fact, according to Forbes' (2015) information, since 2015 both companies tried to capture a larger market share by opening more locals, Grupo Modelo with its Modeloramas and Heineken with its Six stores, but the objective was not only to retain the existing market, but also to position itself among the million new users (approximately) that are incorporated each year.

To this respect, and referring distribution, Grupo Modelo has direct distribution centers to attract a greater market share. In addition, this company (similar to Heineken) has licenses for the sale of alcohol, which cede to various establishments such as bars or restaurants in exchange for an exclusive contract in which the new premises are equipped with refrigerators and furniture stores in exchange for only offering their products (Forbes, 2015). These practices are the result of the market power that Grupo Modelo has and government regulations that do not allow the granting of new licenses, which alters the balance and subtracts part of the benefit to the premises that must be adapted to the demands of the brewers. Something similar is what happened for a long time with Heineken and Oxxo, because according to Galván (2019) approximately 25% of that company's sales are made through the Oxxo stores because they only sold the Heineken brands. However, as of April Grupo Modelo managed to occupy part of the refrigerators of that self-service store, so the brands of the former Cervecería Cuauhtémoc Moctezuma will now have to compete with Modelo.

Concerning the vertical integration strategy, Grupo Modelo has 10 plants where goods other than beer are produced, among the items manufactured in these facilities are stained glass, malts, boats and plasticaps. This strategy was implemented since the costs that Grupo Modelo incurred in continuing to buy from different suppliers were greater than the construction of factories that were owned by it.

Finally, according to Forbes (2015), Grupo Modelo intended to make its operations more profitable through economies of scale, as the company sought to reduce expenses and make cuts of personnel, but continuing to increase production to serve a larger segment of the market. This strategy of reducing production costs would have to contribute to the maximization of its benefits (Keat & Young, 2004).

3 Conclusions

At the beginning of the case study it was established that the problem faced by Grupo Modelo is that during the last few years it has lost a certain percentage of its market share, which has gained its main competence: Heineken. The analysis carried out in the previous pages suggests: (1) the market structure is a duopoly, with a high concentration, where Grupo Modelo is the undisputed sales leader; (2) Grupo Modelo has tried to win the loyalty of customers through different means that raise barriers to enter of new competitors; (3) economies of scale are relevant; and (4) vertical integration was a successful strategy on the part of Grupo Modelo to end the problem of high suppliers' bargaining power.

So, if these critical issues are not a big problem for the company, why is Grupo Modelo losing market share? The most feasible answer is its inability to maintain competitive advantage. Thus, what would be the recommendation for Grupo Modelo? Fairly obvious but complicated to achieve: Create/Maintain a competitive advantage that exceeds that of Heineken. The current strategy where Grupo Modelo tries to excel while being more sustainable is very easy to imitate and does not attract enough consumers to maintain its current market share. Innovate or, as your performance goes, settle for second place, those are the options that the Mexican beer monster has.

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