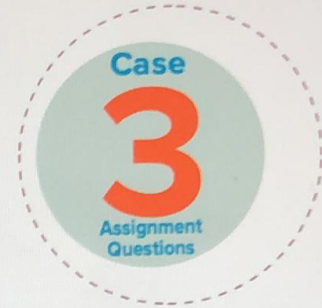


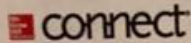
# Competition in the Craft Brewing Industry in 2017



## Assignment Questions

1. What are the strategically relevant components of the U.S. and global craft beer industry macro-environment?
2. What is competition like in the craft beer industry? Which of the five competitive forces is strongest? Which is weakest? What competitive forces seem to have the greatest effect on industry attractiveness and the potential profitability of new entrants?
3. What does your strategic group map of the craft beer industry look like? Which strategic groups do you think are in the best positions? The worst positions?
4. What key factors may determine the success of a start-up or smaller, craft brewery?
5. Identify the strategic issues facing craft brewers in 2017. What effects may these issues have on the industry?
6. What recommendations would you make to a smaller, craft brewery to improve its competitiveness in the market while mitigating any current and future risks?

# Competition in the Craft Brewing Industry in 2017



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Locally produced or regional craft beers caused a seismic shift in the U.S. beer industry during the early 2010s with the gains of the small, regional newcomers coming at the expense of such well-known brands as Budweiser, Miller, Coors, and Bud Light. Craft breweries, which by definition sold fewer than 6 million barrels (bbls) per year, expanded rapidly with the deregulation of intrastate alcohol distribution and retail laws and a change in consumer preferences toward unique and high-quality beers. The growing popularity of craft beers allowed the total beer industry in the United States to increase by 6.7 percent annually between 2011 and 2016 to reach \$39.5 billion. The production of U.S. craft breweries more than doubled from 11.5 million bbls per year to about 24.6 million bbls per year during that time. In addition, production by microbreweries and brewpubs accounted for 90 percent of craft brewer growth in 2016.<sup>1</sup>

The industry had begun to show signs of a slowdown going into 2017, with Boston Beer Company, the second largest craft brewery in the United States and known for its Samuel Adams brand, experiencing a 4 percent sales decline in 2016 that erased two years of growth. The annual revenues of Anheuser-Busch InBev SA, whose portfolio included global brands Budweiser, Corona, and Stella Artois and numerous international and local brands, remained relatively consistent from 2014 to 2016. However, the sales volume of Anheuser-Busch's flagship brands and its newly acquired and international brands such as Corona, Goose Island, Shock Top, Beck's, and St. Pauli Girl allowed it

to control 45.8 percent of the U.S. market for beer in 2016.<sup>2</sup>

Industry competition was increasing as grain price fluctuations affected cost structures and growing consolidation within the beer industry—led most notably by AB InBev's acquisition of several craft breweries, Grupo Modelo, and its pending \$104 billion acquisition of SABMiller—created a battle for market share. While the market for specialty beer was expected to gradually plateau by 2020, it appeared that the slowing growth had arrived by 2017. Nevertheless, craft breweries and microbreweries were expected to expand in number and in terms of market share as consumers sought out new pale ales, stouts, wheat beers, pilsners, and lagers with regional or local flairs.

## The Beer Market

The total economic impact of the beer market was estimated to be 2.0 percent of the total U.S. GDP in 2016 when variables such as jobs within beer production, sales, and distribution were included.<sup>3</sup> Exhibit 1 presents annual beer production statistics for the United States between 2006 and 2016.

Although U.S. production had declined since 2008, consumption was increasing elsewhere in the world, resulting in a forecasted global market of almost \$700 billion in sales by 2020.<sup>4</sup> Global growth seemed to be fueled by the introduction of

EXHIBIT 1

**Barrels of Beer Produced in the United States, 2006–2016 (in millions)**

Year	Barrels Produced (in millions)*
2006	198
2007	200
2008	200
2009	197
2010	195
2011	193
2012	195
2013	192
2014	193
2015	191
2016	189

\*Rounded to the nearest million.

Source: Alcohol and Tobacco Tax and Trade Bureau website.

differing styles of beer to regions where consumers had not previously had access and the expansion of demographics not normally known for consuming beer. Thus, exported beer to both developed and developing regions helped drive future growth. As an example, China recently saw a number of domestic craft breweries producing beer as well as experimenting with locally and regionally known flavors, enticing the domestic palette with flavors such as green tea.

The Brewers Association, a trade association for brewers, suppliers, and others within the industry, designated a brewery as a craft brewer when output was less than 6 million barrels annually and the ownership was more than 75 percent independent of another non-craft beer producer or entity. The rapid increase in popularity for local beers allowed the number of U.S. brewers to reach almost 5,500 in 2016—nearly double the number in 2012. Of these breweries, 99 percent were identified as craft breweries with distribution ranging from local to national. While large global breweries occupied the top four positions among the largest U.S. breweries, five craft breweries were ranked among the top 10 largest U.S. brewers in 2015—see Exhibit 2.

EXHIBIT 2

**Top 10 U.S. Breweries in 2015**

Rank	Brewery
1	Anheuser-Busch, Inc.
2	MillerCoors
3	Pabst Brewing Co.
4	D.G. Yuengling and Son, Inc.
5	Boston Beer Co.
6	North American Breweries
7	Sierra Nevada Brewing Co.
8	New Belgium Brewing Co.
9	Craft Brewing Alliance
10	Lagunitas Brewing Co.

Source: Brewers Association.

EXHIBIT 3

**Top 10 Global Beer Producers by Volume, 2014–2015**

Rank	Producer	Volume (millions of barrels)* 2014	Volume (millions of barrels)* 2015
1	AB InBev	351	353
2	SABMiller	249	250
3	Heineken	180	186
4	Carlsberg	110	107
5	Tsingtao (Group)	78	72
6	Molson Coors Brewing Company	54	54
7	Beijing Yanjing	45	41
8	Kirin	36	35
9	Castel BGI	26	26
10	Asahi	26	24

\*Not in original report. Computed using 1 hL = .852 barrel for comparison; to nearest million bbl.

Source: AB InBev 20-F SEC Document, 2015 and 2016

Exhibit 3 shows the production volume of the 10 largest beer producers worldwide for 2014 and 2015. The number of craft breweries in each U.S. state are presented in Exhibit 4.

EXHIBIT 4

Number of Craft Brewers by State, 2015

State	Brewers	State	Brewers
Alabama	24	Montana	49
Alaska	27	Nebraska	33
Arizona	78	Nevada	34
Arkansas	26	New Hampshire	44
California	518	New Jersey	51
Colorado	284	New Mexico	45
Connecticut	35	New York	208
Delaware	15	North Carolina	161
Florida	151	North Dakota	9
Georgia	45	Ohio	143
Hawaii	13	Oklahoma	14
Idaho	50	Oregon	228
Illinois	157	Pennsylvania	178
Indiana	115	Rhode Island	14
Iowa	58	South Carolina	36
Kansas	26	South Dakota	14
Kentucky	24	Tennessee	52
Louisiana	20	Texas	189
Maine	59	Utah	22
Maryland	60	Vermont	44
Massachusetts	84	Virginia	124
Michigan	205	Washington	305
Minnesota	105	West Virginia	12
Mississippi	8	Wisconsin	121
Missouri	71	Wyoming	23

Source: Brewers Association.

### The Beer Production Process

The beer production process involves the fermentation of grains. The cereal grain barley is the most common grain used in the production of beer. Before fermentation, however, barley must be malted and milled. Malting allows the barley to germinate and produce the sugars that would be fermented by the yeast, yielding the sweetness of beer. By soaking the barley in water, the barley germinates, or grows, as it would when planted in the ground. This process is halted through the introduction of hot air and drying after germination began.

After malting, the barley is milled to break open the husk while also cracking the inner seed that has begun to germinate. Once milled, the barley is mashed, or added to hot water. The addition of

the hot water produces sugar from the grain. This mixture is then filtered, resulting in the wort. The wort is then boiled, which sterilizes the beer. It is at this stage that hops are added. The taste and aroma of beer depend on the variety of hops and when the hops were added.

After boiling, the wort is cooled and then poured into the fermentor where yeast is added. The sugar created in the previous stages is broken down by the yeast through fermentation. The different styles of beer depend on the type of yeast used, typically either an ale or lager yeast. The time for this process could take a couple of weeks to a couple of months. After fermentation, the yeast is removed. The process is completed after carbon dioxide is added and the product is packaged.

Beer is a varied and differentiated product, with over 70 styles in 15 categories. Each style is dependent on a number of variables. These variables are controlled by the brewer through the process, and could include the origin of raw materials, approach to fermentation, and yeast used. For example, Guinness referenced on its website how barley purchased by the brewer was not only grown locally, but was also toasted specifically after malting, lending to its characteristic taste and color. As another example of differentiation through raw materials, wheat beers, such as German-style *hefeweizen*, are brewed with a minimum of 50 percent wheat instead of barley grain.

### Development of Microbreweries and Economies of Scale

Although learning the art of brewing takes time, beer production lends itself to scalability and variety. For example, an amateur—or home brewer—could brew beer for home consumption. There had been a significant increase in the interest in home brewing, with over 1 million people pursuing the hobby in 2016.<sup>5</sup> It was also not uncommon for a home brewer to venture into entrepreneurship and begin brewing for commercial sales. However, beer production was highly labor intensive with much of the work done by hand. A certain level of production volume was necessary to achieve breakeven and make the microbrewery a successful commercial operation.

A small nanobrewery may brew a variety of flavor experiences and compete in niche markets, while the macrobrewery may focus on economies of scale and mass produce one style of beer. Both may attract consumers across segments, and were attributed to the easily scalable yet highly variable process of brewing beer. In contrast, a global producer such as AB InBev could produce beer for millions of consumers worldwide with factory-automated processes.

### Legal Environment of Breweries

As beer was an alcoholic beverage, the industry was subject to much regulation. Further, these regulations could vary by state and municipality. One such regulation was regarding sales and distribution.

Distribution could be distinguished through direct sales (or self-distribution), and two-tier and three-tier systems. Regulations permitting direct sales allow the brewery to sell directly to the consumer. Growlers, bottle sales, as well as taprooms were all forms of direct, or retail, sales. There were usually requirements concerning direct sales, including limitations on volume sold to the consumer.

Even where self-distribution was legal, the legal volumes could be very small and limited. Very few brewers were exempt from distributing through wholesalers, referred to as a three-tier distribution system. And often to be operationally viable, brewers need access to this distribution system to generate revenue. In a three-tier system, the brewery must first sell to a wholesaler—the liquor or beer distributor. This distributor then sells to the retailer, who then ultimately sells to the consumer.

This distribution structure, however, had ramifications for the consumer, as much of what was available at retail outlets and restaurants was impacted by the distributor. This was further impacted by whether a brewery bottles or cans its beer, or distributes through kegs. While restaurants and bars could carry kegs, retail shelves at a local liquor store needed to have cans and bottles, as a relatively small number of consumers could accommodate kegs for home use. Thus, there may only be a few liquor stores or restaurants where a consumer may find a locally brewed beer. In states that do not allow self-distribution or on-premise sales, distribution and exposure to consumers could represent a barrier for breweries, especially those that were small or new.

The Alcohol and Tobacco Tax and Trade Bureau (TTB) was the main federal agency for regulating the industry. As another example of regulations, breweries were required to have labels for beers approved by the federal government, ensuring they meet advertising guidelines. In some instances, the TTB may need to approve the formula used for brewing the specific beer prior to the label receiving approval. Given the approval process, and the growth of craft breweries, the length of time this takes could reach several months. For a small microbrewery first starting, the delay in sales could potentially impact cash flow.

Employment law was another area impacting breweries. The Affordable Care Act (ACA) and changes to the Fair Labor Standards Act (FLSA) greatly affected labor cost in the industry. Where the ACA mandated health care coverage by employers, the FLSA changed overtime rules for employees previously classified as exempt or salaried. Finally, many states and municipalities passed or were considering passing increases to minimum wage. These changes in regulations could lead to significant increases in business costs, potentially impacting a brewery's ability to remain viable or competitive.

Lawsuits might also impact breweries' operations. Trademark infringement lawsuits regarding brewery and beer names were common. Further, food-related lawsuits could occur. In 2017, there were potential lawsuits against breweries distributing in California that did not meet the May 2016 requirement of providing an additional sign warning against pregnancy and BPA (Bisphenyl-A) consumption. BPA was commonly found in both cans and bottle caps, and thus breweries were potentially legally exposed, exemplifying the potential legal exposure to any brewery.

### Suppliers to Breweries

The main suppliers to the industry were those who supply grain and hops. Growers might sell direct to breweries or distribute through wholesalers. Brewers who wish to produce a grain-specific beer would be required to procure the specific grain. Further, recipes might call for a variety of grains, including rye, wheat, and corn. As previously mentioned, the definition of craft was changed not only to include a higher threshold for annual production, but it also was changed

to not exclude producers who used other grains, such as corn, in their production. Finally, origin-specific beers, such as German- or Belgian-styles, might also require specific grains.

The more specialized the grain or hop, the more difficult it was to obtain. Those breweries, then, competing based on specialized brewing were required to identify such suppliers. Conversely, larger, global producers of single-style beers were able to utilize economies of scale and demand lower prices from suppliers. Organically grown grains and hops suppliers would also fall into this category of providing specialized ingredients, and specialty brewers tend to use such ingredients.

Exhibit 5 illustrates the amount of grain products used between 2010 and 2014 in the United States by breweries.

It was estimated that hops acreage within the United States grew more than 70 percent from 2011 to 2016,<sup>6</sup> which seems to follow the growing demand due to the increased number of breweries. Hops were primarily grown in the Pacific Northwest states of Idaho, Washington, and Oregon. Washington's Yakima Valley was probably one of the more recognizable geographic-growing regions. There were numerous varieties of hops, however, and each contributes a different aroma and flavor profile. Hop growers have also trademarked names and varieties of hops. Further, as with grains, some beer styles require specific hops. Farmlands that were formerly known for hops have started to see a rejuvenation of this crop, such as in New England. In other areas, farmers were introducing hops as a new cash crop. Some hops farms

were also dual purpose, combining the growing operations with brewing, thus serving as both a supplier of hops to breweries while also producing their own beer for retail. Recent news reports, however, were citing current and future shortages of hops due to the increased number of breweries. Rising temperatures in Europe led to a diminished yield in 2015, further impacting hops supplies. For breweries using recipes that require these specific hops, shortages could be detrimental to production. In some instances, larger beer producers had vertically integrated into hops farming to protect their supply.

Suppliers to the industry also include manufacturers and distributors of brewing equipment, such as fermentation tanks and refrigeration equipment. Purification equipment and testing tools were also necessary, given the brewing process and the need to ensure purity and safety of the product.

Depending on distribution and the distribution channel, breweries might need bottling or canning equipment. Thus breweries might invest heavily in automated bottling capabilities to expand capacity. Recently, however, there had been shortages in 16-ounce aluminum cans.

### How Breweries Compete: Innovation and Quality versus Price

The consumer might seek out a specific beer or brewery's name, or purchase the lower-priced globally known brand. For some, beer drinking might also be

EXHIBIT 5

Total Grain Usage in the Production of Beer, 2010–2014 (in millions of pounds)

Grain*	2010	2011	2012	2013	2014
Corn	701	629	681	593	574
Rice	714	749	717	724	604
Barley	88	128	136	158	169
Wheat	22	24	26	30	33
Malt	4,147	4,028	4,117	3,916	3,689

\*Includes products derived from the type of grain for brewing process.  
Source: Alcohol and Tobacco Tax and Trade Bureau website.

seasonal, as tastes change with the seasons. Lighter beers were consumed in hotter months, while heavier beers were consumed in the colder months. Consumers might associate beer styles with the time of year or season. Oktoberfest and German-style beers were associated with fall, following the German-traditional celebration of Oktoberfest. Finally, any one consumer might enjoy several styles, or choose to be brewery or brand loyal.

The brewing process and the multiple varieties and styles of beer allow for breweries to compete across the strategy spectrum—low price and high volume, or higher price and low volume. Industry competitors, then, might target both price point and differentiation. The home brewer, who decided to invest several thousand dollars in a small space to produce very small quantities of beer and start a nanobrewery, might utilize a niche competitive strategy. The consumer might patronize the brewery on location, or seek it out on tap at a restaurant given the quality and the style of beer brewed. If allowed by law, the brewery might offer tastings or sell onsite to visitors. Further, the nanobrewer was free to explore and experiment with unusual flavors. To drive awareness, the brewer might enter competitions, attend beer festivals, or host tastings and “tap takeovers” at local restaurants. If successful, the brewer might invest in larger facilities and equipment to increase capacity with growing demand.

The larger, more established craft brewers, especially those considered regional breweries, might compete through marketing and distribution, while offering a higher value compared to the mass production of macrobreweries. However, the consumer might at times be sensitive to and desire the craft beer experience through smaller breweries—so much so that even craft breweries who by definition were craft might draw the ire of the consumer due to its size and scope. Boston Beer Company was one such company. Even though James Koch started it as a microbrewery, pioneering the craft beer movement in the 1980s, some craft beer consumers do not view it as authentically craft.

Larger macrobreweries mass produced and competed using economies of scale and established distribution systems. Thus, low cost preserves margins as lower price points drive volume sales. Many of these brands were sold en masse at sporting and

entertainment venues, as well as larger restaurant chains, driving volume sales.

Companies like SABMiller and AB InBev possessed brands within their portfolio that were sold under the perception of craft beer, in what Boston Beer Company deems the better beer category—beer with a higher price point, but also of higher quality. For example, Blue Moon—a Belgian-style wheat ale—was produced by MillerCoors. Blue Moon’s market share had increased significantly since 2006 following the rise in craft beer popularity, competing against Boston Beer Company’s Sam Adams in this better beer segment. AB InBev had also recently acquired the larger better-known craft breweries, including Goose Island, in 2011. With a product portfolio that included both low-price and premium craft beer brands, macrobreweries were competing across the spectrum and putting pressure on breweries within the better and craft beer segments—segments demanding a higher price point due to production.

However, a lawsuit had claimed the marketing of Blue Moon was misleading and its marketing obscured the ownership structure. Although the case was dismissed, it further illustrated consumer sentiment regarding what was perceived as craft beer. It also illustrated the power of marketing and how a macrobrewery might position a brand within these segments.

## Consolidations and Acquisitions

In 2015 AB InBev offered to purchase SABMiller for \$108 billion, which was approved by the European Union and finalized in 2016. To allow for the acquisition, many of SABMiller’s brands were required to be divested. Asahi Group Holdings Ltd. purchased the European brands Peroni and Grolsch from SABMiller. Molson Coors purchased SABMiller’s 58 percent ownership in MillerCoors LLC—originally a joint venture between Molson Coors and SABMiller. This transaction provided Molson Coors with 100 percent ownership of MillerCoors. It should be noted that AB InBev and MillerCoors represented over 80 percent of the beer produced in the United States for domestic consumption.

Purchases of craft breweries by larger companies had also increased during the 2010s. AB InBev had purchased 10 craft breweries since 2011, including Goose Island, Blue Point, and Devil's Backbone Brewing. MillerCoors—whose brands already included Killian's Irish Red, Leinenkugel's, and Foster's—acquired Saint Archer Brewing Company. Ballast Point Brewing & Spirits was acquired by Constellations Brands. Finally, Heineken NV purchased a stake in Lagunitas Brewing Company. It would seem that craft beer and breweries had obtained the attention of not only the consumer, but also the larger multinational breweries and corporations.

## Profiles of Beer Producers

### Anheuser-Busch InBev

As the world's largest producer by volume, AB InBev employed over 150,000 people in 26 different countries. The product portfolio included the production, marketing, and distribution of over 200 beers, malt beverages, as well as soft drinks in 130 countries. These brands included Budweiser, Stella Artois, Leffe, and Hoegaarden.

AB InBev managed its product portfolio through three tiers. Global brands, such as Budweiser, Stella Artois, and Corona, were distributed throughout the world. International brands (Beck's, Hoegaarden, Leffe) were found in multiple countries. Local champions (i.e., local brands) represented regional or domestic brands acquired by AB InBev, such as Goose Island in the United States and Cass in South Korea. While some of the local brands were found in different countries, it was due to geographic proximity and the potential to grow the brand larger.

AB InBev estimated its market share in China as 19 percent, United States 46 percent, Brazil 68 percent, and Mexico 58 percent.<sup>7</sup> Its strength in brand recognition and focused marketing on what it deemed as core categories resulted in AB InBev as the top brewery in the United States, Brazil, and Mexico markets, and number three in China by volume. AB InBev reported that its 2016 volumes declined in Asia Pacific, parts of Latin America,

and Europe, Middle East, and Africa. However, AB InBev's total revenue increased by 3 percent in 2016, led by 6 percent and 14 percent growth attributed to Stella Artois and Corona, respectively.

AB InBev invested heavily in marketing. Budweiser planned to sponsor the 2018 and 2022 FIFA World Cups™, as it had sponsored the 2014 competition. This marketing helped bolster the Budweiser brand, which experienced revenue growth of 3 percent in 2016. Bud Light—which was the best-selling beer in the United States in 2016, is official sponsor of the National Football League through 2022.

AB InBev had also actively acquired other brands and breweries since the 1990s, including Labatt in 1995, Beck's in 2002, Anheuser-Busch in 2008, and Grupo Modelo in 2013. All of these acquisitions preceded the SABMiller purchase. These acquisitions provided AB InBev greater market share and penetration through combining marketing and operations to all brands. The reacquisition of the Oriental Brewery in 2014 was a good example of the potential synergies garnered. Cass was the leading beer in Korea and was produced by Oriental Brewery; however, while Cass represented the local brand for AB InBev in Korea, Hoegaarden was distributed in Korea, along with the global brands of Budweiser, Corona, and Stella Artois.

A summary of AB InBev's financial performance from 2014 to 2016 is presented in Exhibit 6.

### Boston Beer Company

Boston Beer Company was the second largest craft brewer by volume in the United States with sales of 4 million barrels in 2016. The company's 2016 sales volume declined by 100,000 barrels in 2016, but it remained the fifth largest overall brewer in the United States—see Exhibit 2. The company history states the recipe for Sam Adams was actually company founder Jim Koch's great-great-grandfather's recipe. The story of Boston Beer Company and Jim Koch's success was referenced at times as the beginning of the craft beer movement, often citing how Koch originally sold his beer to bars with the beer and pitching on the spot.

This beginning seemed to underpin much of Boston Beer Company's strategy as it competed in

## EXHIBIT 6

## Financial Summary for AB InBev, 2014–2016 (in millions of \$)

	2016	2015	2014
Revenue	\$45,517	\$43,604	\$47,063
Cost of sales	(17,803)	(17,137)	(18,756)
Gross profit	27,715	26,467	28,307
Selling, general and administrative expenses	(15,171)	(13,732)	(10,285)
Other operating income/expenses	732	1,032	1,386
Non-recurring items	(394)	136	(197)
Profit from operations (EBIT)	12,882	13,904	15,111
Depreciation, amortization and impairment	3,477	3,153	3,354
EBITDA	\$16,360	\$17,057	\$18,465

Sources: AB InBev Annual Reports, 2015, 2016.

the higher value and higher price-point category it referred to as the *better beer segment*. Focusing on quality and taste, Boston Beer Company marketed Samuel Adams Boston Lager as the original beer Koch first discovered. The company also produced several Sam Adams seasonal beers, such as Sam Adams Summer Ale and Sam Adams Octoberfest. Other seasonal Sam Adams beers had limited release in seasonal variety packs, including Samuel Adams Harvest Pumpkin and Samuel Adams Holiday Porter. In addition, there was also a Samuel Adams Brewmaster's Collection, a much smaller, limited release set of beers at much higher points, including the Small Batch Collection and Barrel Room Collection. Utopia—its highest-priced beer—was branded as highly experimental and under very limited release.

In the spirit of craft beer and innovation, several years ago Boston Beer Company launched a craft brew incubator as a subsidiary, which had led to the successful development and sales of beers under the Traveler Beer Company brand. The incubator, Alchemy and Science, also built Concrete Beach Brewery and Coney Island Brewery. Alchemy and Science contributed to 7 percent of the total net sales in 2015 and 4 percent of net sales in 2016.

Boston Beer Company offered three non-beer brands. The Twisted Tea brand was launched in 2001 and the Angry Orchard brand was originated in 2011. Truly Spiked & Sparkling was a 5 percent alcohol

sparkling water launched in 2016. These other brands and products competed in the flavored malt beverage and the hard cider categories, respectively.

A summary of Boston Brewing Company's financial performance from 2014 to 2016 is presented in Exhibit 7.

### Craft Brew Alliance

Craft Brew Alliance was the sixth largest craft brewing company in the United States, and was ranked ninth for overall brewing by volume in 2016. Founded in 2008, it represents the mergers between Redhook Brewery, Widmer Brothers Brewing, and Kona Brewing Company. Each with substantial history, the decision to merge was to help assist with growth and meeting demand. The Craft Brew Alliance also included Omission Brewery, Resignation Brewery, and Square Mile Cider Company. In addition to these brands, Craft Brew Alliance operated five brewpubs. In total, there were 820 people employed at Craft Brew Alliance, producing just over 1 million barrels in 2016.

Craft Brew Alliance utilized automated brewing equipment and distributed nationally through the Anheuser-Busch wholesaler network alliance, leveraging many of the logistics and thus cost advantages associated. Yet, it remained independent, leveraging both its craft brewery brands and the cost advantage associated with larger distribution

EXHIBIT 7

Financial Summary for Boston Brewing Company, 2014–2015 (in thousands of \$)

	2016	2015	2014
Revenue	\$968,994	\$1,024,040	\$966,478
Excise taxes	(62,548)	(64,106)	(63,471)
Cost of goods sold	(446,776)	(458,317)	(437,996)
Gross profit	459,670	501,617	465,011
Advertising, promotional and selling expenses	244,213	273,629	250,696
General and administrative expenses	78,033	71,556	65,971
Impairment of assets	(235)	258	1,777
Operating income	137,659	156,174	146,567
Interest income	56	56	21
Other expense, net	(594)	(1,220)	(994)
Provision for income taxes	49,772	56,596	54,851
Net Income	\$ 87,349	\$ 98,414	\$ 90,743

Source: Boston Beer Company Annual Reports, 2015, 2016.

networks. It was the only independent craft brewer to achieve this relationship and sought to leverage the partnership to distribute its products in international markets.

Craft Brew Alliance engaged in contract brewing—a practice where space capacity in production was utilized to produce beer under contract for sale under a different label or brand. In addition, it had partnerships with retailers like Costco and Buffalo Wild Wings, garnering further consumer exposure as well as sales.

A summary of Craft Brew Alliance's financial performance from 2014 to 2016 is presented in Exhibit 8.

**Strategic Issues Confronting Craft Breweries in 2017**

The vast majority of the craft breweries might produce only enough beer for the local population in their area. Many of these breweries started the same way as the larger breweries: Home brewers or hobbyists

EXHIBIT 8

Financial Summary for Craft Brew Alliance, 2014–2016 (in thousands of \$)

	2016	2015	2014
Revenue	\$202,507	\$204,168	\$200,022
Cost of sales	(142,908)	(141,972)	(141,312)
Gross profit	59,599	62,196	58,710
Selling, general and administrative expenses	59,224	57,932	53,000
Operating income	375	4,264	5,710
Income before provision for income taxes	(306)	3,718	5,099
Provision for income taxes	14	1,500	2,022
Net Income	\$ 320	\$ 2,218	\$ 3,077

Sources: Craft Brew Alliance Annual Reports, 2015 and 2016.

decided to start to brew and sell their own beer. Many obtained startup capital through their own savings or solicited investments from friends and family.

Given their entrepreneurial beginnings, these microbreweries and even smaller nanobreweries were usually located in industrial spaces. They were solely operated by the brewer-turned-entrepreneur, or a small staff of two or three. This staff would help with brewing and production, as well as potentially brewery tours and visits—probably the most common marketing and consumer relations tactic utilized by smaller breweries. While almost all breweries offered tours and tastings, these became ever more critical to the smaller brewery with limited capital for marketing and advertising. If onsite sales were available, the brewer could sell growlers to visitors.

Social media websites also offered significant exposure for free and had become a foundational element of brewery marketing. These websites helped the brewery reach the craft beer consumer, who tended to seek out and follow new and upcoming breweries. There were also mobile phone applications specific to the craft beer industry that could help a startup gain exposure. Participating in craft beer festivals, where local and regional breweries were able to offer samples to attendees, was another opportunity to gain exposure.

Some small microbreweries did not have enough employees for bottling and labeling, and had been known to solicit volunteers through social media.

To gain exposure and boost sales, the brewery might host events at local restaurants, such as tap-takeovers, where several of its beers are featured on draft. If enough consumers were engaged, local restaurants were enticed to purchase more beer from the distributor of the brewery. However, any number of variables—raw material shortages, tight retail competition, price-sensitive consumers—could dramatically impact future viability.

The number of beers available to the consumer throughout all segments and price points had continued to steadily climb since the mid-2000s. While the overall beer industry had seemed to plateau, the significant growth appeared to be in the craft beer, or better beer segments. Further, larger macrobreweries and regional craft breweries were seizing the opportunity to acquire other breweries as a method of obtaining distribution and branding synergies, while also mitigating the amount of direct competition. Complicating the competitive landscape were increasing availability and price fluctuations of raw materials. These sporadic shortages might impact the industry's growth and affect the production stability of breweries, especially those smaller operations that did not have capacity to purchase in bulk or outbid larger competitors. Overall, the growth in the consumers' desire for craft beer was likely to continue to attract more entrants, while encouraging larger breweries to seek additional acquisitions of successful craft beer brands.

## ENDNOTES

<sup>1</sup> "Steady Growth for Small and Independent Brewers," *Brewers Association*, March 28, 2017, <https://www.brewersassociation.org/press-releases/2016-growth-small-independent-brewers/> (accessed December 17, 2017).

<sup>2</sup> Beer sales are commonly measured by barrels in America and hectoliters in Europe. The conversion is 1 hL = 0.852 barrel [U.S. beer]. AB InBev reported 233.7 million hL and 45.8 percent of the market in the 2016 20-K SEC filing. The Alcohol and Tobacco Tax and Trade Bureau Statistical Report for Beer in December 2015 shows production to be about 190.5 million barrels.

<sup>3</sup> "Beer Serves America: A Study of the U.S. Beer Industry's Economic Contribution in 2016." The Beer Institute and The National Beer Wholesalers

Association, May 2017, <http://beerservesamerica.org/> (accessed June 18, 2017).

<sup>4</sup> "World Beer Market—Opportunities and Forecasts, 2014–2020," [www.alliedmarketresearch.com/beer-market](http://www.alliedmarketresearch.com/beer-market) (accessed May 24, 2016).

<sup>5</sup> American Homebrewers Association, Homebrewing Stats, <https://www.homebrewersassociation.org/membership/homebrewing-stats/> (accessed December 17, 2017).

<sup>6</sup> Hop Growers of America 2016 Statistical Report, [https://www.usahops.org/img/blog\\_pdf/76.pdf](https://www.usahops.org/img/blog_pdf/76.pdf) (accessed June 17, 2017).

<sup>7</sup> AB InBev March 2016 20-F Report. Rounded to nearest percent.