

HOCKLEY VALLEY BREWING CO. INC.

Ian Dunn wrote this case under the supervision of Elizabeth M.A. Grasby solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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It was late June 2013 and John Miles, shareholder and operations manager at Hockley Valley Brewing Co. Inc. (Hockley), located in Orangeville, Ontario, Canada, had just returned from a summer celebration in Orangeville. Miles and company founder, Tom Smellie, were surprised by Hockley's beer sales at the festival. Orangeville residents had always supported the local brewer, but this festival saw Hockley's lighter beers far outsell its dark and amber ales. Hockley had experienced great success with its dark beer and had only recently introduced lighter ales into its product mix. The growing popularity of light beers, as revealed through this festival's sales, gave Miles pause — should he reconsider Hockley's product mix? Should Hockley launch a new light beer? If so, how and where should the brewery promote it?

THE BEER INDUSTRY IN ONTARIO

The Ontario beer industry was dominated by two of North America's largest brewers, Molson and Labatt. These internationally recognized companies offered a wide variety of beers for nearly all consumers. They were also majority owners of The Beer Store. Under Ontario's provincial legislation, The Beer Store was the only non-government-owned retailer permitted to sell beer (excluding bars, restaurants and the breweries' storefronts). Molson and Labatt each owned 49 per cent of The Beer Store, with Sleeman's, a large brewer owned by a Japanese brewing company and located in Guelph, Ontario, owning the remaining 2 per cent.¹ For decades, these large companies had little competition from local brewers. All other beer sales were through the Liquor Control Board of Ontario (LCBO). The LCBO was a government-owned agency that operated over 634 retail stores throughout the province.² It was one of the world's largest buyers and sellers of beverage alcohol and offered a variety of beer, wine and spirits from all over the world.

Brick Brewing Company, launched in Waterloo in 1984, was Ontario's first microbrewery.³ A microbrewery was a small brewery that produced "craft beer." Microbreweries often relied on local

¹ www.thebeerstore.ca/about-us, accessed March 17, 2014.

² <http://lcbo.com/aboutlcbo/index.shtml>, accessed March 17, 2014.

³ www.brickbeer.com/our_brewery/, accessed March 17, 2014.

products, such as barley and hops, as well as equipment and labour from the surrounding communities. Other independent microbreweries had since entered the market, and there were now hundreds of different brands of craft brew available in Ontario. In 2012, craft beer sales amounted to \$210 million in the province.⁴ The Ontario Craft Brewers (OCB) was an association that represented 31 different craft brewers who sought to increase consumer awareness of Ontario craft beers, to promote the excellent quality of the beers produced and to promote the dedication of each brewery to the quality of their beer(s).⁵

Many consumers believed that craft brews were of higher quality than imported beer, often because of their freshness. Beer consumers had become increasingly discerning in recent years, seeking a variety of flavours and brewing techniques in high-quality beer. This trend in the market helped drive the growth of microbreweries. In 2002, Ontario craft brewers represented 2 per cent of Ontario's total beer volume. By 2013, craft brewers' market share had more than doubled, and Ontario's microbreweries accounted for 5 per cent of the beer volume sold in the province.⁶ Craft beer sales growth was the highest in LCBO stores, since the LCBO marketed itself as a shopping experience that catered towards those consumers seeking different premium beer brands. Across all retail channels, craft beer averaged a 10 per cent growth rate annually.⁷

Light beer was the best seller of beer in Ontario and North America. In 2012, Bud Light, Coors Light, Budweiser, Miller Lite and Natural Light were the top five best-selling domestic beer brands in North America. All but Budweiser were categorized as light beer. The top two brands, Bud Light and Coors Light, accounted for 27 per cent of total beer sales in North America.⁸ The economic downturn in 2008 had resulted in consumers shifting away from some of the more expensive imported brands to the less expensive domestic light beers.⁹ It was also common for dark beers to be sold in lower volumes since they were a heavier beverage and enjoyed most in cold wet climates. Light beer brands experienced higher sales volume in the summer months; hence, the summer season was used as an opportunity for the promotion and introduction of new products.

HOCKLEY VALLEY BREWING

Tom Smellie launched Hockley on December 22, 2002 out of a building previously known as the town's general store in Hockley Village, Ontario. Smellie wanted to create a brewery that would help give the small village some recognition. Since the beginning, Smellie and the brewmaster, Andrew Kohnen, decided to produce beers with more depth and character than many of the popular North American lagers. Kohnen was from a German family who had a history of brewing beer, so brewing flavourful quality beers was something in which he strongly believed and which came naturally to him. Smellie spent a great deal of time researching other microbreweries, craft beer consumers and retailers.

For the company's first 18 months of operations, a light ale called Hockley Gold was its only product. Hockley was the first microbrewery in Ontario, and only the second in Canada, to produce its craft beer in cans. Smellie believed cans were more environmentally friendly, easier to move and store, superior in maintaining freshness and faster to chill. Another benefit was that Hockley would not have to source its bottles through The Beer Store, which controlled the supply of bottles to Ontario breweries.

⁴ www.ontariocraftbrewers.com/pdf/media_IndustryFactSheet.pdf, accessed March 17, 2014.

⁵ Hockley was not a member of the OCB.

⁶ www.mri.gov.on.ca/obr/?p=1440, accessed March 17, 2014.

⁷ www.ontariocraftbrewers.com/pdf/media_IndustryFactSheet.pdf, accessed March 17, 2014.

⁸ www.cnn.com/id/100935860, accessed March 17, 2014.

⁹ www.agr.gc.ca/eng/industry-markets-and-trade/statistics-and-market-information/by-product-sector/processed-food-and-beverages/the-canadian-brewery-industry/?id=1171560813521, accessed March 17, 2014.

Kohnen's desire for a dark ale, unlike anything available at the time in Ontario, resulted in the creation of Hockley Dark in 2004. Within one year, Hockley's dark ale was outselling its light ale. Hockley Dark continued to gain in popularity and became the best-selling dark craft beer in Ontario. It was named the Best Dark Ale at the Canadian and Ontario Brewery Awards in 2008.¹⁰ The company had quickly been recognized as a premium microbrewer of dark beers. Another key to Hockley's success was the strong relationship Smellie had built with the LCBO. He considered the LCBO a valuable partner and had fostered this relationship by focusing on how Hockley could best help the LCBO.

Building on the success of the dark ale, Hockley introduced a stout in 2006. Hockley Stout was the first stout available all year round from an Ontario microbrewer. A Black and Tan brand, which combined Hockley's Stout with its lighter ale, was also created around this time. Due to the increase in its additional brands, Hockley retired its Gold product in 2008 when it began brewing Georgian Bay Beer, a blonde lager.¹¹ Georgian Bay Beer was sold in the geographic region surrounding Georgian Bay, located in Ontario on the eastern edge of Lake Huron, and was originally available only during the summer. This beer was not branded as a Hockley product.¹² Also in 2008, Hockley outgrew its location in Hockley Village and moved to Orangeville, a short 15-minute drive away. The Orangeville brewing facility had six medium-capacity fermenting tanks. It was located in an industrial complex and, as a result, did not have a brewpub. Minimal sales were made at the brewery storefront.

In 2012, Hockley Amber was launched. This was the same year of an ownership change when a new majority shareholder joined the business. The new shareholder also owned a real estate company and a newspaper publishing company. As an entrepreneur, this shareholder brought a diverse range of experience to Hockley.

By summer 2013, Hockley was offering five products: Dark, Amber, Black and Tan, Georgian Bay and Hockley 100. Production of Georgian Bay Beer became year-round in 2013, but the product continued to be sold only in its specific geographic region. Hockley 100 was launched at the start of June 2013 and was Hockley's lightest ale to date. In addition to these products, Hockley also offered a taster pack, which contained three tall cans. It originally contained one can of the Dark, Stout and Black and Tan brands. In 2013, the taster pack was revised to include Dark, Amber and Hockley 100. See Exhibit 1 for Hockley's product list and prices. Hockley sold the vast majority of its beer through the LCBO, but its products were also available in certain The Beer Store locations and through the Alberta Gaming and Liquor Commission, Manitoba Liquor Control Commission and Prince Edward Island Liquor Control Commission.

For most of Hockley's existence, the company had been able to sell as much beer as it could produce. With the intention of further growing the business, Miles and Smellie had made operational improvements to the brewing process and capital investments at the Orangeville location. In the summer of 2013, Hockley was operating at about 50 per cent of its capacity. The company's goal was to double its output and sales by the end of 2014.

¹⁰ orangevillebusiness.ca/business/hockley-valley-brewing-company/, accessed March 17, 2014.

¹¹ A blonde beer was pale or light in colour and the taste was often balanced on the side of the malt.

¹² Georgian Bay Beer packaging made no mention of Hockley Valley Brewing Co. nor did the Hockley website include Georgian Bay Beer as one of its products.

THE COMPETITION

Hockley competed with the nearly 150 different brands of craft beer sold in Ontario. Some microbreweries produced only a single product or limited their distribution to the communities surrounding their brewery. Others sold across the province and the country, with many offering a variety of beers and special seasonal brews. Two well-known craft brewers who had experienced success since their inception were Mill Street Brewery (Mill Street) and Steam Whistle. If Hockley launched a more mainstream light beer, it would compete directly with the flagship brews from these two competitors, both of which produced and sold a much larger quantity of beer than Hockley in 2012.

Mill Street Brewery

Mill Street opened in December 2002 in Toronto's historic distillery district. The company's flagship product was its Original Organic Lager, which accounted for almost 80 per cent of its sales. Mill Street also produced about 40 other varieties of beers, which were sold through the LCBO, The Beer Store and the company's own brewpubs. Since its inception, Mill Street had moved its large-scale brewing operations to Scarborough, Ontario and offered brewpubs at the original Toronto location, in downtown Ottawa and the Toronto Pearson International Airport. Mill Street was named Canadian Brewery of the Year in 2007, 2008 and 2009 at the Canadian Brewing Awards.

Steam Whistle

Steam Whistle was founded in 2000 by three former employees of the Upper Canada Brewing Company. It was located in downtown Toronto in the John Street Roundhouse, a national historic site near the CN Tower and the Rogers Centre.¹³ Steam Whistle's slogan was "Do one thing really, really well." The brewery produced only one product, a premium pilsner. This beer was sold in The Beer Store and LCBO, as well as in the company's brewpub.

ORANGEVILLE'S 150TH BIRTHDAY BASH

When the town of Orangeville celebrated its 150th anniversary on July 6, 2013, festival organizers asked Hockley to be the sole beer supplier at the event. Miles and the rest of Hockley's management team had reviewed the sales figures from the birthday bash and were surprised by the sales dominance of the Georgian Bay and Hockley 100 brands. In fact, for every dark beer sold, Hockley sold nine of these two lighter brands. They recognized that light beers were the most popular beer in the Ontario market, but this event's sales made them question whether Hockley should alter its product mix, essentially its strategic focus. Smellie considered Hockley Dark the brand that put Hockley "on the map" and the company's "workhorse"; accordingly, he vowed Hockley would never stop making it. Although Hockley Dark had been successful, the dark beer market sold in smaller volumes than light beers and lagers. Management wanted to achieve further growth for the company and saw the most potential in the craft lager market. They wondered if Hockley should launch another brand that could compete in that market.

¹³ The Rogers Centre is an entertainment stadium with a retractable roof in Toronto, Ontario. It is home to the Toronto Blue Jays baseball team and the Toronto Argonauts football team. The stadium has over 46,000 seats and welcomes over 3.5 million visitors every year.

THE HOCKLEY CLASSIC

Production

If Hockley chose to produce a new product, management wanted to launch a craft lager called “Hockley Classic.” The proposed product packaging for Hockley Classic lager is in Exhibit 2. A lager needed more time fermenting than the ales the company currently produced. The additional fermenting produced a lager that had more head,¹⁴ a crisp flavour and a more predominant malt.¹⁵ Most ale, like Hockley Amber, fermented for 10 to 14 days. A lager, like Hockley Classic, would need to ferment for four to six weeks, which would increase the company’s production time and costs. Miles believed the direct costs for the lager would be quite similar to the current ales produced, but the factory production costs would be approximately 50 per cent higher. See Exhibit 3 for the direct costs to produce a can of Hockley’s current ales.

Given the increased brewing time for Hockley Classic, Miles and Smellie believed the company would need to retire one of its other brands. In addition, it was easier to secure space in LCBO stores for a new product if a company replaced one of its own products. The Black and Tan beer was the lowest volume seller in the past year, so it would be the brand to discontinue. By dropping Black and Tan, Hockley would have the production space and time to create Hockley Classic, as well as keep up with the increasing demand for its other light beers.

Price

Management would also need to decide a retail price for Hockley Classic. Breweries were given control over the price they wanted the end consumer to pay in the LCBO or The Beer Store, as long as all alcohol products were priced above a legal minimum set by the government.¹⁶ Hockley’s current products were priced between \$2.55 and \$2.75 for a 473-millilitre can, and management wanted to assess where Hockley Classic fit in the portfolio. They were unsure whether the price should reflect the higher production time and costs involved in brewing a lager or whether market factors were more important to the pricing decision.

Miles and Smellie had looked at the selling prices of similar competitors’ lager products. Mill Street Original Organic lager sold for \$2.85 for a 473-millilitre can in the LCBO. Steam Whistle Premium Pilsner was also priced at \$2.85 and was sold in 500-millilitre cans at the LCBO. Two smaller microbreweries, Muskoka Brewery and Lake of Bays Brewing Company, priced their lagers at \$2.65 for a 473-millilitre can. Miles also consulted with management at the LCBO, who recommended a price of \$2.55 for Hockley Classic to help the new product penetrate the light beer market.

Placement

Selling through the LCBO did not involve any listing fees or additional costs beyond the LCBO’s levy of approximately 11 per cent of sales. Brewers had to convince each individual LCBO store to stock their products. The LCBO based its decision on product testing and high quality standards, while also taking into account company history and previous relationships. Hockley had been successful to date in gaining

¹⁴ The head of beer referred to the frothy foam that tops a glass of freshly poured beer. It was caused as carbon dioxide rose to the surface and served to hold the aromatics within the beer.

¹⁵ Malt referred to the germinated grain, typically barley, used in brewing to provide the sugars for the fermentation process.

¹⁶ Ontario’s legal minimum price on a case of 24 bottles was \$25.95.

shelf space in the majority of Ontario's LCBO stores. In fact, Hockley sales representatives often discovered that LCBO representatives were already aware of the Hockley brand and its consistent sales records. Sales representatives reported that as long as the LCBO retailers were below their maximum number of products, they were willing to carry Hockley's beers.

Hockley offered its dark ale and its taster packs through the 50 "boutique-style" The Beer Stores in Ontario, which offered a self-serve shopping experience rather than the traditional set-up where all products were kept in the back room until ordered. Hockley management believed the company's target market enjoyed browsing for different varieties of craft beers and, as such, only distributed in these boutiques, most of which were in cities such as Toronto, Ottawa, London and Waterloo. The Beer Store charged a one-time listing fee of \$3,000 for each product and an additional \$275 for each of its boutique locations that sold the product. Miles wondered whether Hockley Classic, if positioned as a more popular lager, would be well-suited for these boutique locations. He would have to calculate the sales level needed to recoup the upfront listing fees associated with The Beer Store, assuming Hockley Classic was sold in the 50 boutique locations.

Promotion

If Hockley Classic was launched, management would need to develop a promotional plan for the new lager. In the past, Hockley had spent a minimal amount on advertising. The brewery had done some in-store advertising through the LCBO such as special displays and end-of-aisle positioning. After Hockley's ownership change in 2012, the brewery used half-page and full-page colour advertisements in smaller community newspapers across Ontario. See Exhibit 4 for samples of Hockley's advertisements for its current products. Since the shareholder's publishing company provided newspapers to rural communities across Ontario, reaching over 100,000 homes each week, Hockley was not charged for these advertisements, which were estimated to have a value of approximately \$200,000 annually.

If Hockley Classic were to be positioned as a more mainstream lager, Miles and Smellie wondered if more promotion would be needed to achieve the expected growth. Hockley Classic would also place the brewery in direct competition with larger microbreweries such as Mill Street and Steam Whistle. Should Hockley be promoting itself differently given the presence of these competitors?

Miles and Smellie had decided on an annual promotion budget of \$50,000 for Hockley Classic. Exhibit 5 lists their promotional ideas and associated costs. In Alberta, a microbrewer had placed wraps¹⁷ around bales of hay and left them on the edge of farm properties for drivers to see. Management wondered if this unique advertising would work in some of the rural communities surrounding the Hockley Valley area. Miles knew some farmers willing to allow the hay bale wrap on their property for no cost, while others would want to charge a rental fee from the brewery. Miles wanted to recommend the promotional methods that would be most effective to advertise Hockley Classic and the message Hockley should communicate to potential consumers.

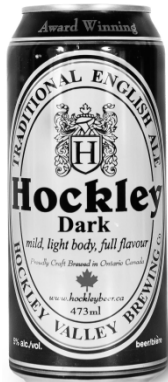
CONCLUSION

Miles and Smellie sat down to review Hockley's current product mix. Were the industry trends and the Orangeville Birthday Bash sales results enough for Hockley to alter its product focus? Hockley Classic had the potential to be the brewery's banner brand in the lucrative craft light lager market. Would the potential

¹⁷ These wraps were large replicas of a beer can's label.

growth be worth risking the brand image Hockley had developed as an award-winning craft dark beer producer? Miles and Smellie wanted to make their recommendations about launching Hockley Classic to the rest of the management team. These recommendations would include decisions on pricing, placement and promotional strategies. They cracked open a couple of cold cans of Hockley 100 and started analyzing their findings.

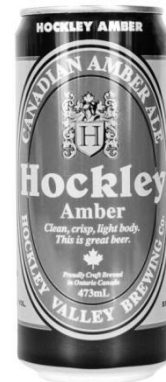
EXHIBIT 1: HOCKLEY PRODUCT LINE



Hockley Dark
\$2.75



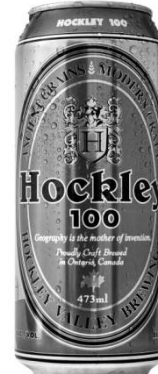
Hockley Black & Tan
\$2.65



Hockley Amber
\$2.65



Georgian Bay Beer
\$2.55

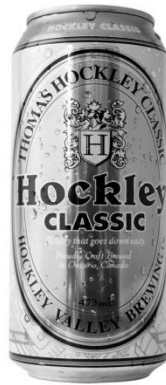


Hockley 100
\$2.65



Hockley Taster Pack
\$7.95

Source: Company files.

EXHIBIT 2: HOCKLEY CLASSIC PROPOSED PACKAGING

Source: Company files.

EXHIBIT 3: HOCKLEY CURRENT DIRECT COST BREAKDOWN FOR ALE

Item	Cost per can
Beer (ingredients)	\$ 0.33
Packaging	0.28
Factory production costs	0.70
Excise Tax	0.02
Provincial levy — LCBO, beer tax, environmental tax	<u>0.29</u>
Total	\$ 1.62

Source: Company files.

EXHIBIT 4: HOCKLEY ADVERTISEMENTS

MYSTERIOUS ADVENTUROUS LUXURIOUS



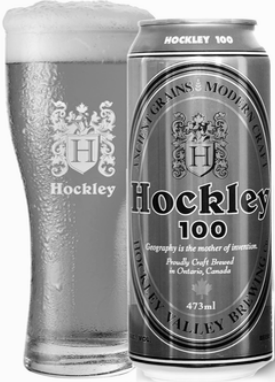
DELICIOUS.

THIS IS GREAT BEER

HOCKLEYBEER.CA
ASK FOR HOCKLEY AT YOUR LOCAL LCBO

**GERMAN BREWMASTER
+ LOCAL INGREDIENTS**

THE PERFECT CRAFT



THIS IS GREAT BEER

HOCKLEYBEER.CA

Source: Company files.

EXHIBIT 5: PROMOTIONAL ALTERNATIVES AND COSTS

LCBO in-store displays:	
One month, across all locations	\$ 6,500
Feature spot in LCBO magazine:	
One time, quarter page	3,000
One time, full page	7,000
One time, double-page spread	10,000
Newspaper advertisement in Toronto Star:	
One time, quarter page	8,000
One time, half page	16,000
One time, full page	30,000
Hay bale wraps:	
Creation of physical wrap	1,000
Compensation for farm owner	Varies
Billboards:	
One month, low traffic location	500
One month, high traffic location	10,000
<i>Toronto Life Magazine</i> — Eating & Drinking section:	
One time, quarter page	2,335
One time, half page	3,745
One time, full page	10,935
Festivals and Shows:	
Entry and staffing fees	5,000

Source: Company files.