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One of the most sensitive topics for beer distributors and brewers are "carve out" exceptions to state franchise laws. Basically "carve outs" allow suppliers that represent less than a certain percentage of a distributors business to move their brands to another distributor without cause at a fair price. We believe the percentage of business should vary from state to state. Different criteria and combinations should be negotiated by all parties involved. A good example is New York. Brewers and distributors worked together to pass a "carve out" law that allows brewers that do less than 300,000 barrels globally and represent less than 3% of a distributor's volume to change distributors at fair market value.

Most distributors have been adamantly opposed to "carve outs". I think most of us are from an era where we had fewer suppliers, and distributors were more dependent on them for success. Most were afraid of unjustified termination and interference from big, aggressive brewers. This fear was justified at that time. Small, family owned distributors needed to be insulated from very powerful suppliers. These distributors were, and many still are the backbone of their community. But there is no longer fear of termination at the distributor level. The cost, time, energy and exposure of litigation is more than its worth, for brewers to terminate. We can primarily thank the Maris family for that. This allows distributors, even the best, to under perform at times with little concern of repercussions. We don't give enough credit to the distributors that do fabulous work and we don't do enough about the ones that fail to earn the margins they receive. Our poor performers get magnified and a chain is no stronger than its weakest link.

Suppliers share part of the blame for this attitude. Too often supplier's reps accept poor performance because they are afraid of being criticized by their bosses, penalized by distributors or both. Pointing out performance weakness at the distributor level is often hazardous to their career. The old adage "we expect what we inspect" comes to mind. In my opinion supplier follow-up on distributor in-outlet execution is inconsistent at best. If suppliers want better execution from distributors they should invest more in people that are qualified to help distributors improve performance, then give them the time, resources and longevity in one location to help accomplish better execution. If their input is honest, accurate, and constructive distributors will respect the supplier and improve to their expectations. Suppliers could also be more consistent in what they want. Some supplier's expectations change whenever a new rep arrives. Therefore, decisions on distributor changes should be made by senior management and must be based in reality and not on emotions.

I started in the beer industry in 1971 in Knoxville, Tennessee in the Budweiser distributor's warehouse. There were 5 distributors in the market. All class acts (AB, Miller, Stroh, Schlitz, and Pabst) all successful and basically dependent on one or two suppliers with roughly 30 SKU's. Now there are 2 with over 500 SKU's and numerous suppliers. Both are very strong, well capitalized businesses that provide excellent service, work very well with their suppliers, and contribute tremendously to the community. If there was a "carve out" law in place my guess is not a single brand would move and if they did it would not harm either distributor very much. Across the country this example is true more often than not. My point is we have changed at the distributor level from small, family businesses that needed protection to larger multi-category distribution businesses that can take care of themselves. Even our small distributors are profitable and well capitalized. In fact one could argue that most suppliers are more dependent on distributors than distributors are on them. I have observed and actively participated in this transformation. I have argued for complete franchise protection in the past. But change is inevitable. Whether we like it or not the world does not stand still. We have gone from an industry of 4,000 distributors and 100 breweries selling 100 million barrels to an industry of 1,000 distributors and 3,000 breweries selling 200 million barrels. The top 5 suppliers currently do over 90% of industry volume. The remaining brewers do 10%. We have gone from a very limited number of SKU's to over 8,400. You do the math. Large, multi-brand distributors now dominate the landscape and are growing larger every month. Craft Brewers now have bricks-and-mortar facilities in 412 out of 435 legislative districts and are growing stronger and more aggressive at the state and federal legislative level. The numbers are against the status quo on franchise laws.

The best industry comparison that comes to mind is the former AB's exclusivity incentive program. This rigid, myopic, exclusive approach initially helped them grow volume but ultimately harmed them and their distributors. It caused AB to be so focused on limiting competition within their distribution system they lost sight of a bigger picture. The more successful they were the more they could not see beyond themselves. They didn't change and missed what the rest of the world was doing. They won the battle with over 70% of their volume exclusive but were forced to sell the entire business. By being so rigid in opposition to "carve out" laws distributors could ultimately lose all franchise protection. We could stifle change until change stifles us. Let's recognize that certain suppliers deserve a chance to get out of what they consider a bad relationship just as much as you deserve protection from drastic changes to your business. Pressure to perform will strengthen everyone. Competition makes us better. The fear of losing is often as motivating as the desire to win. When your performance improves, everyone wins.

Brewers need to do their part in seeking compromise solutions. For example brewers should consider "stand still" periods for distributors. We think 1 – 3 years would be appropriate. In other words, when a distributor is assigned suppliers brands they could not change for a specified period of time. The point is brewers and distributors need to look for compromises that will facilitate change. Right now many distributors have a change nothing attitude and many brewers are over reacting. This split is causing friction at a time when we desperately need to be together to fight the wine and spirits industry, alcohol equivalency tax rates, state tax increases, and other issues that we could lose if we are not united.

Why would a brewer want the right to move to another distributor? For the vast majority of brewers, their assortment of brands is all they have. Distributors have several suppliers which gives them more stability. If one small brewer moves using the “carve out” exception chances are pretty good that their sales force will pick up the slack. Distributors can also pick-up something else to replace what was lost. But, if a distributor does not perform on a brewer’s portfolio the brewer has no other option under the current rules of engagement. They just lose. In other words a brewer wins if they pick the right distributor and pay a big price if they pick wrong. Unfortunately some brewer’s selection processes are very much like speed dating. They only get a snap shot of what their partners are like and yet the date is forever. Just as distributors needed franchise laws to protect them from large brewers in the past, some brewers need the ability to change distributors at a fair price if they are unhappy and can do so without irreparable harm to the distributor.

Beyond the discomfort of losing a supplier to a competitor, especially in a two distributor market, is the complicating factor of compensating the distributor that loses that supplier. Invariably, the distributor giving up the brands thinks the value is greater than does the distributor receiving the brands. One issue inherent with current “carve out” laws is the use of fair market value as the standard for determining the price. The basic problem with that standard is, by definition, fair market value is defined as a willing buyer and a willing seller not under duress. When the “carve out” law is used, the seller may or may not be willing to give up the brands. The regulatory solution is usually arbitration or litigation and invariably only the lawyers win in these situations. To help avoid this potential conflict distributor associations and brewers in each state could develop criteria to establish value. Their guiding principle should be that regardless of cause a distributor should be fully compensated for losing contribution to margin; but, should not receive punitive damages or be rewarded for poor performance.

So what ultimately brought me to the conclusion to support the concept of “carve out” laws? The difference maker for me is the firmly held belief that the possibility of losing a supplier will increase the pressure to perform. Better performance increases value. We believe reasonable “carve out” laws will help distributors, brewers and ultimately our entire industry return to growth. IBG is the leading consolidation firm in the beer industry and we know the monetary value, as well as the emotional value, of franchise protection. But, at its core the real worth of your distributorship is your ability to deliver value to suppliers, retailers and consumers. Simply stated, when you improve your performance you improve your value. My opinion is that “carve out” laws will strengthen the three tier distribution system nationally by strengthening distributors individually. My fear is without more flexibility to accommodate the reality of today beer distributors could lose all franchise protection. If this occurs distributors, brewers, retailers and consumers will suffer. By working together to solve this issue we will strengthen the bonds of the three tier system.