



## **Participating in a New Competitive Reality**

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The purpose of this paper is to discuss what IBG believes are some of the underlying issues that are fueling the current “slump” the beer business finds itself in today. We hope to create a dialogue on rarely discussed principles that will lead to long-term solutions. IBG feels strongly that as an industry directional shifts are required. If we fail to act aggressively we will continue our current “death by 1000 cuts” trend. We could see our industry change so suddenly and dramatically that everyone will be shocked.

We are dealing with a complex consumer and living in a rapidly changing world. There is nothing about anyone’s life or business that is stagnant or simple. There is not a magic pill that will cause everything to be like it was in the past. There is nothing we can do to stop the world around us from evolving. What we can do is participate in the exciting process of change. However, before we can participate we must remove some of the walls we have built that separates us from today’s reality.

We will leave the most common reasons offered as explanations for poor performance to others. Things like weather and disposable income tend to be cyclical in nature and will always be around. We believe they are only symptoms of bigger problems. For the first time in a very long time we are under direct attack from major retailers, consumers are exiting the beer category and the courts are looking over our shoulders. IBG feels we need to ask ourselves why, and honestly look for solutions that allow us to prosper.

The beer industry by its very design was uniquely built to separate the three-tiers, mostly suppliers from retailers. It was also set up to keep certain groups out especially organized crime. It was designed to collect taxes, and provide consistent service to all licensed retailers. It has worked magnificently. Unfortunately, our structure can cause us to think we are special and different. It can cause us to believe we are insulated from the impact of today’s rapidly changing

world. As an industry, we are hindered, or helped, depending on your view, by 50 different sets of state laws, supplier contracts that grant exclusive territories for perpetuity and a mentality that fights to stay exactly the same. This worked in our favor for a long time, but our current industry struggles indicate that we need a revitalized approach. We need compromises that increase competition. IBG believe s that if the beer business attacks that current situation with historical methods we will be forced into a world we may not like. We can't approach today's problems with yesterday's solutions. We not longer have the luxury of time. Retailers and consumers are telling us that the time for change is now.

Are we suggesting that some of the laws and contracts that control the beer industry are antiquated and need to be changed? Yes! We believe a flexible and open-minded approach is needed. Ask the tobacco industry, the automobile industry or the airline industry what happens when industries (This was off the page). We can't keep today's consumers or retailers in our old box. Since our (Off the page) Let's look at examples of existing supplier programs, state laws, and attitudes that speak to our point.

Anheuser Busch has a voluntary program designed to maximize wholesalers focus on their brands. While it has worked for A-B they may have paid a hidden price. This program in some way may have put them on a long, slow, slippery slope that could end in mediocrity. One by-product of exclusivity is safe, unchanging, non-passionate, boring, methodical behavior. Does this sound like a path to the hearts of today's fickle consumer? You become your own worst enemy. A few Microbrewers and Importers felt this program would hurt them by limiting their distribution opportunities but what it really did is help them. It made them work harder to be better suppliers and today they are prospering beyond their own expectations.

While there is no official policy against consolidation at SAB/Miller there appears to be an attitude of obstruction toward any combination that puts Molson/Coors with SAB/Miller. We feel this attitude is related to a virus that permeates our industry. Avoidance of competition. It appears that given a change they would rather not compete with Molson/Coors at the wholesale level. We feel the sooner they learn to compete successfully against Coors Light in the same warehouse the better they can compete effectively against Bud Light in the market.

Other suppliers do the same thing. Molson/Coors has a section in its wholesaler's contract that gives them the right to exclusively negotiate for all of a wholesalers business for 120 days. When you are confident you can compete on a level playing field you do not need a contractual advantage. Similarly, Corona wants to avoid Tecate, Heineken tries to stay away from Stella, and Beck's dodges St. Pauli Girl. We could city many more examples, but you get the point.

Our thought is that guaranties, regardless of how hidden or helpful they appear, will eventually create more problems than they solve. Some of our self-generated restrictions have reduced our competitiveness and made us fat and happy. As a result of our own complacency we have prompted consumers to seek other options.

Unlike the past they are finding the other options acceptable and even preferable.

Suppliers took a great industry design and to some extent did not recognize the potential damage their mandates would have on innovation and the overall competitive spirit. Avoiding competition leads to laziness and laziness leads to a lack of creative new approaches. This eventually reaches the consumer and they become bored with stale ideas and non-interesting products.

Now let's take the spotlight and shine it on the wholesale system. Wholesalers with their ability to sell, deliver, service, and especially market beer at store level are the backbone of this great industry. They deserve several of the protections they get from the investment they make. But wholesalers in effect have done the same thing suppliers did. By seeking protections that overreach the basics necessary for reasonable business security, wholesalers in some cases have gone too far. Let's see how they have built walls of protection that have reduced their competitive approach.

In some states when you reduce prices you must stay down from ?? to 360 days. This effectively eliminates tactical discounting which is great for wholesaler margin but look at this from the retailers and consumers point of view: Supermarkets are treated the same as the one case per month restaurant and consumers with high income are treated the same as the ones with low income.

Do you think the retailers and consumers will put up with this forever? In a world where Wal-Mart is king how do we convince ourselves that discounting is not good? How can anyone familiar with the economics of drop size argue against quantity discounts?

In other states it is illegal for chain supermarkets and chain convenient stores to sell beer. This restriction makes it easier and less expensive for wholesalers to do business but what about the retailers and consumers? How can we justify being against beer sales in supermarkets? Are we being progressive when we force consumers to buy beer in "home D's"? Think about turning your warehouse into a retail outlet and you begin to get the picture. How old fashioned do we look to consumers when we fight to keep their shopping experience less efficient and less comfortable? How do we tell busy consumers with no time to spare they can't buy our products at convenience stores?

Many states have laws that make it almost impossible for a supplier to move from one wholesaler to another regardless of performance. Again, this is good for the wholesaler but does it really make competitive sense? In many scenarios the wholesaler really doesn't want the brand; they just don't want a competitor to have it. This happens every day and is extremely frustrating to suppliers. This tactic as they go through the buy/sell/merge process. It absolutely drives small suppliers crazy. IBG realizes that there are financial considerations to be worked out and there may be a few situations where transferring brands could put someone out of business. However, in most cases wholesalers could accommodate the transfer of secondary brands instead of using state laws or contracts that allow them to under perform or complicate supplier consolidation. This restrictive approach could eventually cause wholesalers to lose some meaningful protections. Consumers pay with less performance. The suppliers become resentful towards the three-tier system.

Whether it's discounting restrictions that protect wholesalers, licensing boundaries that reduce the consumers shopping options or laws that protect bad wholesalers the result is the same: Poor performance at a higher cost, and a protective environment that allows underachievement to survive. In today's cost conscience and competitive world our consumers and retailers will not tolerate this behavior forever. Either the retailers will force the changes through litigation and legislation, the consumer will cause change by simply buying something else, or some significant supplier will become frustrated and end up going direct to retail. We may want to look around us because we are in the midst of a storm. The more we fight to protect the statue quo, the longer the storm could last.

IBG has come to the conclusion that the fundamental structure is becoming a casualty of its own success at an accelerating rate. We do not need to drastically change the three-tier system but we do need to make reasonable adjustments to accommodate current trends. At every level we have built walls of protection that separate us from today's competitive reality. We can't ignore the facts. Retailers are litigating against the three-tier system, consumers are telling us we are no longer fashionable, suppliers are blaming wholesaler performance and wholesalers are blaming suppliers marketing. "Houston, we have a problem". We need to start bighting back by removing barriers that our competitive spirit. We need to seek to compete, not seek to avoid competition. Beer has been around for 8,000 years and will always be a product consumer's desire. But how much they buy and are willing to pay will be decided by our ability to change. We are competing for the money and attention of consumers who have more options today than at any time in history. When we need to be at our competitive best we are struggling to perform because we have lost a lot of our passion to compete. Whether it is by policy, contract, practical application, or state laws, IBG feels that over time we have added restrictions to the basic structure that has undermined the principle of competition. To the extent we separate ourselves from today's reality we jeopardize our long-term viability. By holding on to the past we could lose the future. In the real world there are no guarantees.

We have spoken openly about issues we see at many levels. It would be presumptive of us to not include ourselves. This paper was written over 12 months ago but we were afraid to send it out for fear of reprisal. By reviewing select we have perpetuated the problem. We are but a small part of a great industry. We love the beer business with a passion. We are doing our part to help by speaking the ????. We at IBG are leaders in the evolutionary process of change. If we can be of service, please contact us.

Good luck and Good Selling! Your comments are always appreciated. Thank you for your time.