Is the German brewing industry at risk?
Author: Alle Ypma

The decreasing sales trend in the German beer market stabilized somewhat in 2011. The brewers still do not have much to be happy about because the pricing war has grown fiercer. Right now more than two-thirds of the overall volume, and therefore more than twice as much as 10 years ago, were sold by way of price campaigns. It has not been possible to pass cost increases in the areas of raw materials, energy, and personnel to the consumer and/or the marketing intermediaries. In addition, the advertising and promotional expenses continue to increase in many places. The consequences are obvious: The yields achieved in the German brewing industry are low compared to other European countries, and many brewers are increasingly facing financial challenges.

Hope for better times in the near future is futile. It is certain that beer consumption will continue to decrease due to a steadily decreasing and aging population as well as changed consumer behavior. To what extent it will decrease is still unclear: If consumption were to decrease over the next five years, however, by 2% per year, the industry would lose more than an additional 8 million hectoliters and the surplus, which is currently estimated at 30 million, would increase at the same rate. Those figures are not encouraging!

The volume pressure for German brewers is accordingly high. Overcapacity is expensive and has a strong negative impact on returns in an industry that is so capital intensive. In such a situation, the temptation to sell additional volume at a lower margin and/or barely above cost is tempting. If everyone were to take the same approach, however, no additional volume or revenue would be generated, but the earnings would simply be less for the same or even less volume. To explain: If the average price per 20x0.5 liter is EUR 1, the industry would be destroying a value of more than EUR 400 million based on the annual volume. What industry can afford such destruction of value in the long run?

Brewers have invested hundreds of millions of euros into advertising, sales promotion and individualized bottles. In spite of all that, significant discounts are necessary to slow down the decrease, or, in the best case scenario, stabilize the decrease in volume. Apparently, the industry is not able to create added value compared to low-cost or store brands in spite of massive investments in the brand. Or did the German consumer get used to the low beer prices and simply refuse to pay an 80-100% higher price for a premium beer?

The situation looks somewhat better for wheat beer brewers. The price hammer has not yet hit as hard here, and non-alcoholic wheat bear is very successful. The volume temptation is beckoning and some Pilsner brewers have discovered a new opportunity for growth in this category. The central question is whether the traditional Bavarian wheat beer brands have enough authenticity strength to justify an added value in the long run.

The German beer market is the biggest, but also the most fragmented market in Europe. The three biggest brewery groups only have 30% of the market share, while in other European countries, the top two/three together have a market share of 70-99%. The food retail industry is strongly concentrated and the number of discounters is high. In addition, German brewers have very little legal leeway to differentiate themselves from the competition. The German beer market is struggling with a massive overcapacity, which is increasingly difficult to decrease with an emotional product such as beer, and which bears the risk of a negative consumer reaction to the brand. Together with the decreasing consumption, these aspects make it difficult to break the downward price spiral.

The question of all questions is which strategy should be pursued for a sustainable, economically profitable position in the beer market, which is just as large as it is fragmented. Not an easy task.

There are several starting points that can be generated by the dynamics of the market or by the individual selection of the strategy. Below are a few strategic scenarios:

Cold Restructuring

This scenario can develop, if the brewers were to use the pricing policy tool more aggressively than today in order to strengthen their own (volume) position. The perspective is anything but enticing: Only the strongest can win, which are those that can maintain this strategy for some time thanks to their excellent cost structure and strong balance sheet. The weaker players are pushed out of the market. It's Darwinism in its purest form. The entire industry is pushed into the red and the question is whether the survivors, once the fight is over, will be able to rebuild a sustainable, profitable business from the shambles. By then, consumers will have grown accustomed to cheap beer, and beer will most likely have lost the image of a quality product and the status of a brand product.

This scenario can take a long time. The German brewing industry predominantly consists of family-managed businesses and the focus is rather continuity than revenue. Publicly-traded companies feel the rough wind of the shareholders and analysts much faster when the expected revenue is not generated. Therefore, they are quicker to decide to restructure loss-generating segments or to sell them.

Concentration

Usually, the "cold restructuring" scenario seamlessly transitions to the "concentration" scenario. A few big companies play it safe and merge or sell their business. A few big players emerge and the chances for a reasonable competitive climate increase. The international brewing giants can (once again) come into play here. A stronger market position can be bought at a reasonable price that guarantees sustainable profits, because the market outlook is more favorable. At the end of this scenario, the German beer market will have become a market with three or four big domestic and a few small regional players, but the costs as well as the value destruction on the way there were high.

If the current volume strategy of the German brewers continues, the industry will become more concentrated. This can still take a long time. Even though revenues are already relatively low, the financial difficulties are apparently not great enough yet. Many family owners still have high expectations about the value of their companies. In addition, the takeover strategy of large brewers has not been very successful so far. Often, they were unable to maintain the volume and the revenue of the breweries they had taken over. The desired domestic market position was also often not achieved. The largest German brewery group has a market share of 14%: This is definitely too small to become a true national player with the power to impact the market and negotiate with a highly concentrated food retail industry.

Back to the Basics

"Beer needs a home." According to a study commissioned by the German brewers, the brewery industry is strongly connected to its origins. Consumers have an increasing need for authenticity and quality. There are breweries, of course, that are successfully and fully leveraging their regional strength. Many large breweries, however, are pursuing their growth goals on the basis of a national growth strategy, even though the sales focus is often still the original region. In fact, there are no strong national players in Germany like there are in many neighboring countries such as Brau Union in Austria. Even though the majority of sales has regional ties, the marketing and sales costs are characterized by a national orientation. This makes the costs per hectoliter relatively high. In addition, there is the risk that the specific regional needs of consumers are neglected by an over-focus on national expansion.

For an emotional product such as beer, a consumer's preference for a certain brand cannot be forced by an aggressive expansion strategy. Rather, a state of mind for a certain brand needs to be fostered in the consumer. And that takes time, patience, money for high investments in the brand, and consistency in the strategic implementation. Maybe it is more profitable for some breweries to focus on the original regions with lower marketing, sales, and logistics costs. Maybe the hectoliter loss can be balanced out by better revenue and a lower, regionally focused volume. Of course, the marketing activities should be customized for the regional customers and consumers in order to strengthen the regional emotionality for the brand. Clever use of social media could possibly ensure that the target groups can be reached in a cost-effective and efficient manner.

Forward Integration

Many breweries have invested millions to acquire beverage wholesalers to ensure their sales. It is not clear whether these investments have produced the desired revenue or whether the strategic objectives were reached. Market and competition mechanisms, notwithstanding the legal issues, cannot be ignored in a functioning market. It only makes sense to purchase a beverage wholesaler if the producing company has a high market share in that wholesaler's distribution area. Otherwise, the results of the beverage wholesaler are, and will continue, to remain very dependent on the sales of the competition. In the event of an acquisition, the risk that these sales are channeled to other "competition-friendly" beverage wholesalers increases.

More Exports

German beer seems to be popular in other countries. With an export volume of 15 million hectoliters and a growth of 4%, Germany is an increasingly important beer exporter. The global market is big and tempting for the volume-hungry brewers. A successful and sustainable export business model means more than selling over capacity abroad for dumping prices. A professional export organization, longterm investments into the development of the brand and global trade marketing are important prerequisites for finding the right niche in the global beer market and to remain successful in the long run. Companies have no chance without a very flexible production and logistic organization that can deliver small and varying volumes for acceptable costs. Countries have different legal requirements and consumer behavior is different than in Germany. Conclusion: Exports can be an attractive option to create additional volume and revenue. It is not, however, a shortterm solution. It took Heineken more than 50 years to develop the global position of the Heineken brand.

The forecast for the German beer market is difficult. Many brewers do not have any viable chances for long-term survival. But there is also some good news. Those who are courageous enough to creatively forge ahead, and not just use special offer prices as a short-term volume generator, can build a sustainably profitable business.

Autor:

Alle Ypma has more than 30 years of experience in the consumer goods industry – most recently as General Manager with a focus on Turnaround and Change Management with breweries in Poland, Croatia, Hungary and Germany. Since 2009, he is senior partner with Forell & Ypma partnership for corporate consulting in Hamburg.

Forell & Ypma partnership was established at the beginning of 2009 by two experienced top managers – Meik Forell and Alle Ypma. Forell & Ypma is a management consulting firm specialized in the fast-moving consumer goods industry and retail – particularly the beverages industry. Our service range in the special fields of strategy and leadership, performance and result optimization as well as mergers and acquisitions covers all situations, topics and phases. For further information please check our website www.forell-ypma.com.

Forell & Ypma Partnership
Management Consulting
Neuer Wall 80
20354 Hamburg
Telefon: +49 (0)40 822 138 276
Telefax: +49 (0)40 822 138 450
info@forell-ypma.com
www.forell-ypma.com