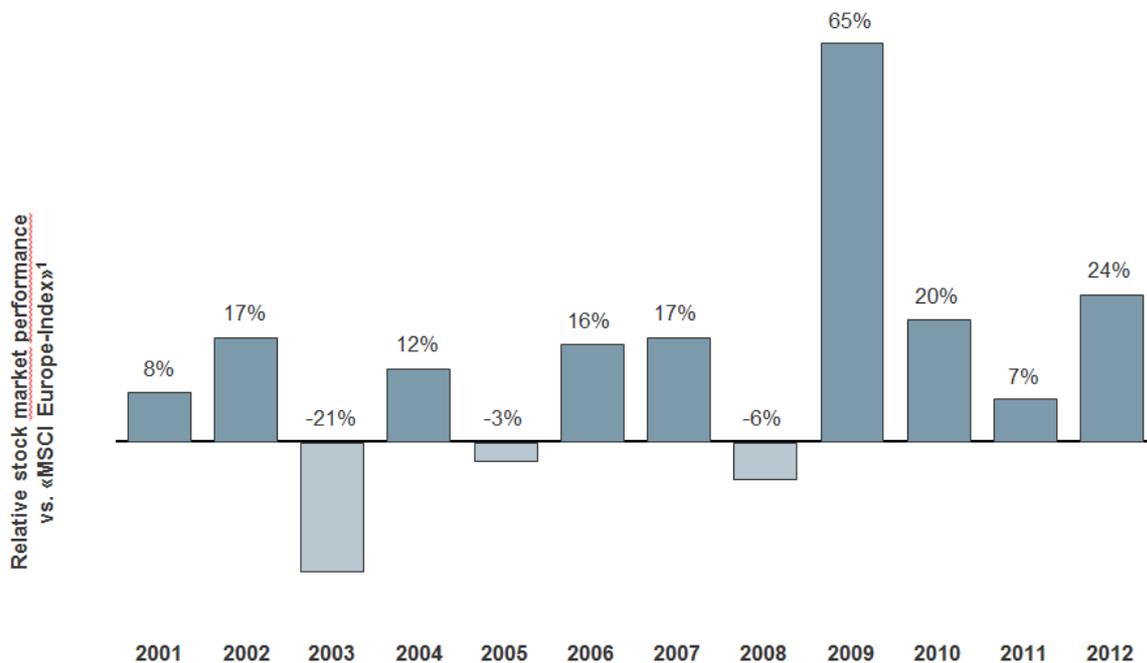


The European beer market: current position and future prospects

Despite all the progress, many European countries still battle against a vicious circle of excessive debts, structural problems, declining economic data and extensive austerity programs. There are no doubt widespread signs of improvement. Nevertheless, new bail-out packages are still on the agenda in numerous countries. The crisis has still not been overcome.

The leading European brewery companies have so far successfully confronted the crisis. With the exception of Carlsberg, the "big four" have increased their sales in the past business year, in some cases quite considerably. The market value trend was 24% better than the European stock market in 2012 alone and was 11% better on average over the last ten years. Breweries are regarded as welcome, relatively safe havens in what remains a stormy and turbulent sea.

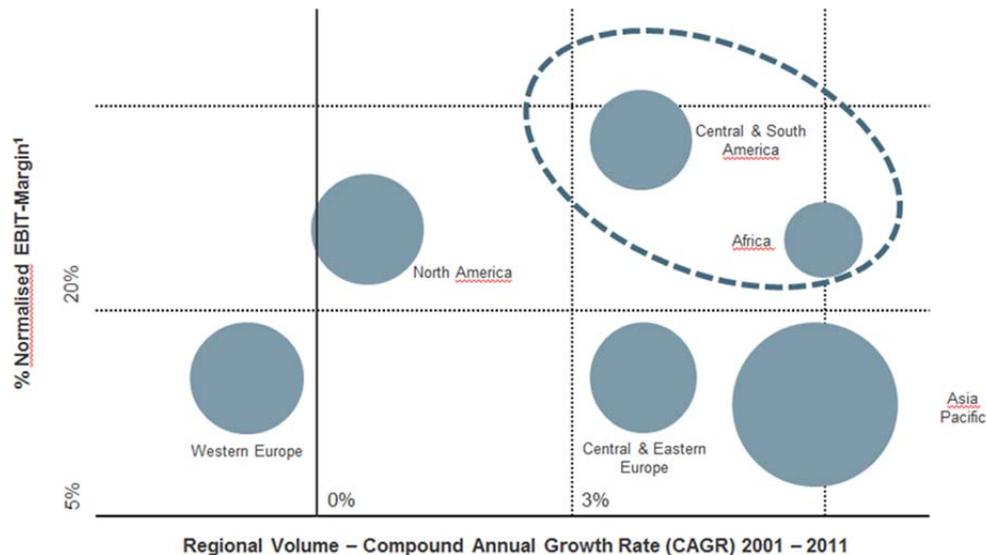


1 «big four» = AB InBev, Carlsberg, Heineken and SAB Miller (Scottish & Newcastle 2001-2007)
Quelle: Bloomberg; [presentation adjusted by Forell & Tebroke Partnership](#)

Can it be deduced from this that the European beer market is intact and breweries that are primarily active on the old continent can be more reassured looking to the future? Undoubtedly not!

Consumption in Western Europe has declined steadily over the past 10 years. At the same time, brewers have been struggling with substantially higher costs, which could not always be passed on to the consumers. Many markets are characterized by cut-throat competition. Especially in countries with a large number of providers, price wars and a prevalence of special offers are the order of the day. The "German angst" is rampant not just as regards price policy: Cheap, discount brands are becoming increasingly popular, while consumers prefer to drink beer at home than in pubs, bars and restaurants. This is certainly not primarily attributable to the most recent crisis. Having said that, the trends have no doubt been enhanced by the high level of unemployment among young people – one of the primary target groups for premium beers. Sadly, in many European countries, unemployment rates of over 50% among 18 to 25-year-olds are now common.

In many places the bearer of hope, Eastern Europe, has become a problem case due to government intervention and the recession. The annual growth rates achieved after the turn of the millennium have been a thing of the past since 2011. Even in a global comparison of margins, Europe – Eastern and Western Europe alike – is lagging behind most other regions.



¹ Normalised EBIT margin = EBIT adjusted for exceptional items
source: SAB (via company data, Plato; Bernstein Research); presentation adjusted by Forell & Tebroke Partnership

The "global players" are already concentrating on the growth regions of Africa, Latin America and Asia. High margins are also achieved in North America. Europe is becoming more and more of a "cash cow", also thanks to the still significant market volume. On the old continent, the positive results are remaining stable, mainly due to programs to increase efficiency and rigid cost and cash management. At the same time, in light of the declining volumes and rising or at least volatile costs, the "big four" are pinning their hopes on a combination of focusing on premium brands and a value-oriented price policy.

The development of Anheuser-Busch InBev is especially conspicuous. The global market leader only sells 13% of the total market volume and generates less than 10% of its EBIT in Europe. Not long ago, EBIT in Russia increased by 10% within the space of one year in spite of volume declines in the double-digit percentage range. Such results can frequently only be achieved through drastic, short-term measures. Anheuser-Busch InBev's course of action in this regard is as legendary as it is controversial among market participants. At least the short-term success would appear to prove the world's largest brewery group right.

The socio-demographic, economic and beverage-market-specific developments and trends are clear: There are difficult times to come on the European beer market. Thanks to their coverage and broadly diversified portfolios, globally active beer giants have for the time being found a solution; albeit a rather unimaginative one. For many regional and national providers the search for the "Egg of Columbus" would appear to be significantly more difficult.

Small glimmers of hope can be seen in selected countries and segments. The craft beer trend that has crossed the pond from the USA is also becoming evident in Europe. Does this mean that a cure-all has been found? This is at least highly doubtful. In recent years however, many hopefuls that have been prematurely praised, have proven to be a flop or flash in the pan. Thus, for example, the hype in

Germany surrounding the beer-based beverages, which only a few years ago were lauded as “saviors” and initially boasted considerable growth, has meanwhile abated significantly. Despite major investments, some market participants have largely left this meanwhile shrinking segment or have at least redefined their priorities.

Despite gloomy prospects, there is distinct hope for the future. The major brewery groups' strategy of focusing on individual regions in itself opens up opportunities for small and medium-sized breweries. However, a fundamental shift in thinking is necessary. The consistent adherence to surplus capacities and the volume-centric approach will sooner or later lead to changed business models and new competitors. Notwithstanding a passion for brewing, some companies from both related and unrelated industries have shown that it is possible to be highly successful, even without production expertise. Red Bull isn't the only company to have become huge and highly profitable, above all because of its excellent, unique marketing activities. Brewers persistently disregard this risk as unfounded due to what they perceive to be the uniqueness of beer and the emotions associated with it. Who knows, maybe they will turn out to be right; then again, maybe not! Even multinationals have largely vanished in no time owing to their persistent adherence to existing structures and their disregard for trends and imminent risks; take Nokia and RIM (Blackberry), for instance! The telecommunication industry cannot of course be compared to the beverages industry, but fundamental market mechanisms can never be entirely invalidated.

On principle, brewers should, however, heed at least three rules:

The war is won on the top line

In a receding market, rigid cost and cash management is an absolute prerequisite in the long term. However, this alone is no guarantee of lasting success, but at best creates more room to maneuver. The stabilization or, where possible, improvement of sales and contributions are the decisive factor. In this context, the volume-centric approach should finally be a thing of the past and be replaced by value-oriented management. Some medium-sized breweries have already been brave enough to embrace risks and have implemented price increases at the expense of production and sales volumes. In Germany, for example, the Störtebeker Brewery has demonstrated that it is quite possible to increase profits, provided that supporting measures exist to bolster the price policy. Within the framework of a strategic realignment, key success factors include conviction, speed, sustainability and persistence. Red Bull serves as a positive example in this regard, too: According to preliminary market research, the product should never have been launched. But within the space of only a few short years, the forecast flop became an immensely valuable brand and a vast company with a virtually global coverage.

Success is only possible by means of focused differentiation

Unfortunately, there is a long tradition of “me too” strategies in the brewing industry: Genuine innovations are a rarity. Instead, all trends or glimmers of hope are exploited to the full, no matter how small they may be; in other words, they are directly “translated” into new products. This basic approach will not be crowned with lasting success, but merely delays the inevitable. In an environment defined by cut-throat competition, success is only possible by means of focused differentiation. It is better to persistently pursue an individual goal-oriented strategy than to waste one's time on numerous opportunistic measures. While this is easier said than done, there is nevertheless no alternative! Even if hope springs eternal, the brewing industry must accept that it cannot win the “war of talent”, whether it likes it or not. Exciting though our industry may be for us, other industries are often more attractive for good personnel for a variety of reasons. Thus, in times of permanent cost pressure small breweries especially are finding it more difficult than ever to keep a firm hold on to specialist expertise and skills for strongly diversified and undifferentiated strategies.

Every market participant needs to find its own way

How to distinguish one's self? Not every opportunity is open to everyone! Nevertheless, the market does offer numerous starting points: exports, specialties, craft beer, new products, innovative business models... the list goes on and on. However, there is no cure-all in sight.

A stronger and more targeted focus on exports may make sense for some breweries. Paulaner, Kulmbacher, Weihenstephan or Eichbaum ... several small or medium-sized companies have proven that exports are not only able to compensate declining domestic sales, but can also open up new prospects. On the other hand, there are a lot more examples of more or less unsuccessful export activities. Relatively speaking, the small nation of Belgium is significantly more successful in terms of exports than its big neighbor Germany. In addition to the strategy, the responsible team and the network, it is above all the brand and the product that are decisive – unfortunately, in many cases this is not in itself an ideal basis for a sustainable export strategy.

Export is just one example and ultimately serves to make one thing clear: There is no use moaning about the weather, customers who are on the wagon and adverse socio-demographic conditions. These are all problems common to many industries in countless countries. It's not enough to go with the flow and jump on every available bandwagon. Every market participant must find their own way in keeping with their opportunities and limitations and above all else, look ahead. Finding the right strategy is one of the, if not the single most important responsibility of any good manager. In many places it's high time that managers hark back to this basic rule again.

Author:



Meik Forell, Managing Partner, Forell & Tebroke Partnership Management Consulting

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