4 The market

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Introduction

4.1. This chapter considers the markets within which Interbrew[1] and Bass Brewers operate.

Demand for beer

4.2. Beer is a mature market, the total size of which has declined over the last 20 years. Figure 4.1 shows total consumption of beer (excluding duty-free and duty-paid personal imports which are estimated at about 5 per cent of consumption[2] in 1999). Figure 4.1 shows that consumption peaked in 1979. Consumption has fallen by about 15 per cent since then, or about 11 per cent if account is taken of personal imports which developed mainly after the start of the European single market in 1993. The demand for beer is expected to remain stable or decline slightly in the near future: the information memorandum issued by Bass prior to the sale of Bass Brewers indicated that Bass Brewers predicted, using Oxford Economic forecasting models, that overall consumption volumes would remain flat.

[1]In this chapter, Interbrew refers to both Interbrew SA and to its subsidiary, Interbrew UK Limited.
[2]The source for these figures is The Brewers and Licensed Retailers Association (BLRA). Duty-free personal imports from other EC countries ended on 30 June 1999.

4.3. Beer sold in the UK can be classified into two main types: lager and ale. Ale may also be divided into cask conditioned and keg (including smooth and nitrogenated) ale, while stout is often identified as a separate type (or subtype of ale). Beer is also classified according to alcoholic content (lagers over 4.2 per cent and ales over 4.1 per cent are classified as premium, others as standard) and whether it is sold to the consumer on draught or packaged (in bottles and cans). Beer is a branded product but the major brands of standard lager, premium lager and keg ale can be considered homogeneous products, with directly comparable prices, as they tend to have similar taste, appearance and alcohol content (around 4 per cent for standard lager, 5 per cent for premium lager and 3.5 per cent for keg ale). Cask-conditioned ale is not a homogeneous product—it is valued for its variation in taste—and additionally there are numerous specialist products including bottle-conditioned lagers and ales, wheat beers, no-alcohol beers, low-alcohol beers and super-strength lagers.

4.4. Figure 4.1 also shows that consumption of lager, especially premium lager, has expanded at the expense of ale. In 1999, lager accounted for 62.3 per cent, and premium lager 23.4 per cent, of total beer consumption by volume.

4.5. Figure 4.2 shows that beer bought for consumption off the premises (off-trade), ie from shops, has taken an increased share of the market at the expense of beer bought for consumption on the premises (on-trade) at pubs, clubs etc. The volume of beer consumed in the on-trade has decreased by 23 per cent since 1990 whilst off-trade consumption has increased by 41 per cent (53 per cent including personal imports) over the same period. In 1999, the off-trade accounted for 32 per cent of total UK consumption, or about 35 per cent if account is taken of personal imports.1 This compares to about 20 per cent in 1990 and about 10 per cent in the mid-1970s.

4.6. Within the on-trade, draught lager has expanded at the expense of draught ale. Within the draught ale category, cask-conditioned ale held its own until 1994[2] while keg ales declined sharply. Since 1994, this trend has been reversed with cask-conditioned ale declining sharply but keg ale holding a roughly constant proportion of the total market. We were told that this latter trend was due to the popularity of nitro-keg 'smooth' beers (beers kegged with a mixture of nitrogen and carbon dioxide) which had been introduced in the early 1990s.

4.7. The brand of beer is an important influence on consumers' choice regarding what to drink. As shown in Table 4.1 (which covers both on-trade and off-trade purchases), 52 per cent of ale drinkers said they were influenced by a well known brand name. In a similar Mintel survey of draught lager drinkers,[3] 65 per cent said they usually stuck to a well-known brand name.

TABLE 4.1 **Ale-purchasing behaviour**

	%
Well-known brand name	52
Brand(s) I always buy	35
Something on special offer	28
Real ale	23
Guest beer in a pub	22
Premium-quality beer	22
Authentic regional heritage	20
Authentic Irish heritage	18
New product I haven't tried before	17
Brand recommended by a friend	17
Alcohol content above 5% ABV	11
Has a widget to give a traditional head	10
Good to get drunk on	7
Any beer will do	7
Seen it advertised	5
Brand that sponsors my sport	2

Source: Mintel survey of 622 ale drinkers, February 2000.

Note: The question asked was: 'Thinking about choosing bitter, ales or stouts either for drinking at home, at a party or in a pub, which if any of these would influence what you buy?'

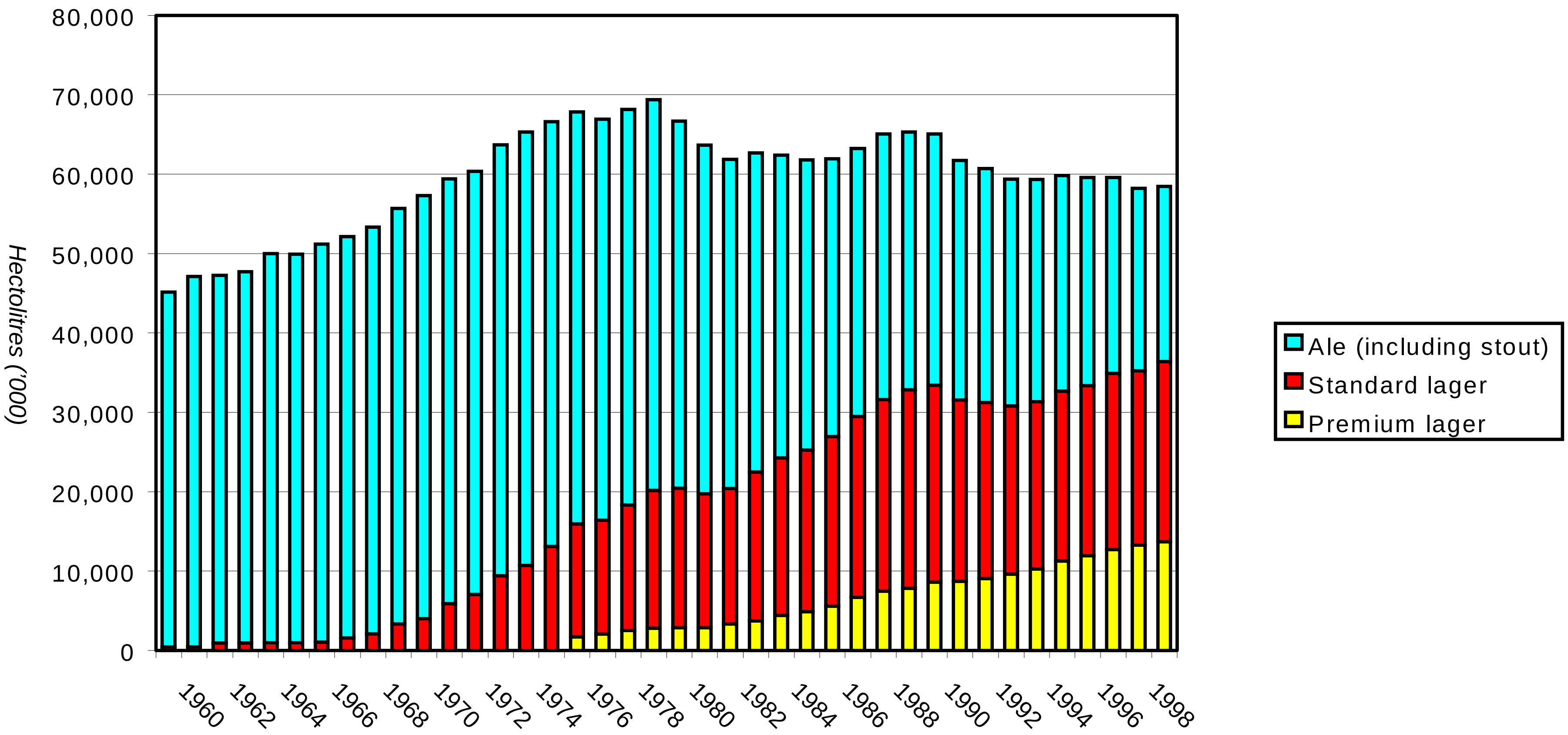
[1]Legal personal imports will obviously be consumed off licensed premises. A small proportion of personal imports is believed to be illegally supplied to the on-trade.

[2]Consumption of cask-conditioned ale was approximately constant as a proportion (17 per cent) of the total UK beer market.

[3]The survey was carried out in November 1999 and covered 546 lager drinkers. The figures we have quoted exclude the 34 per cent (186) who said that they did not drink draught lager.

FIGURE 4.1

UK beer market

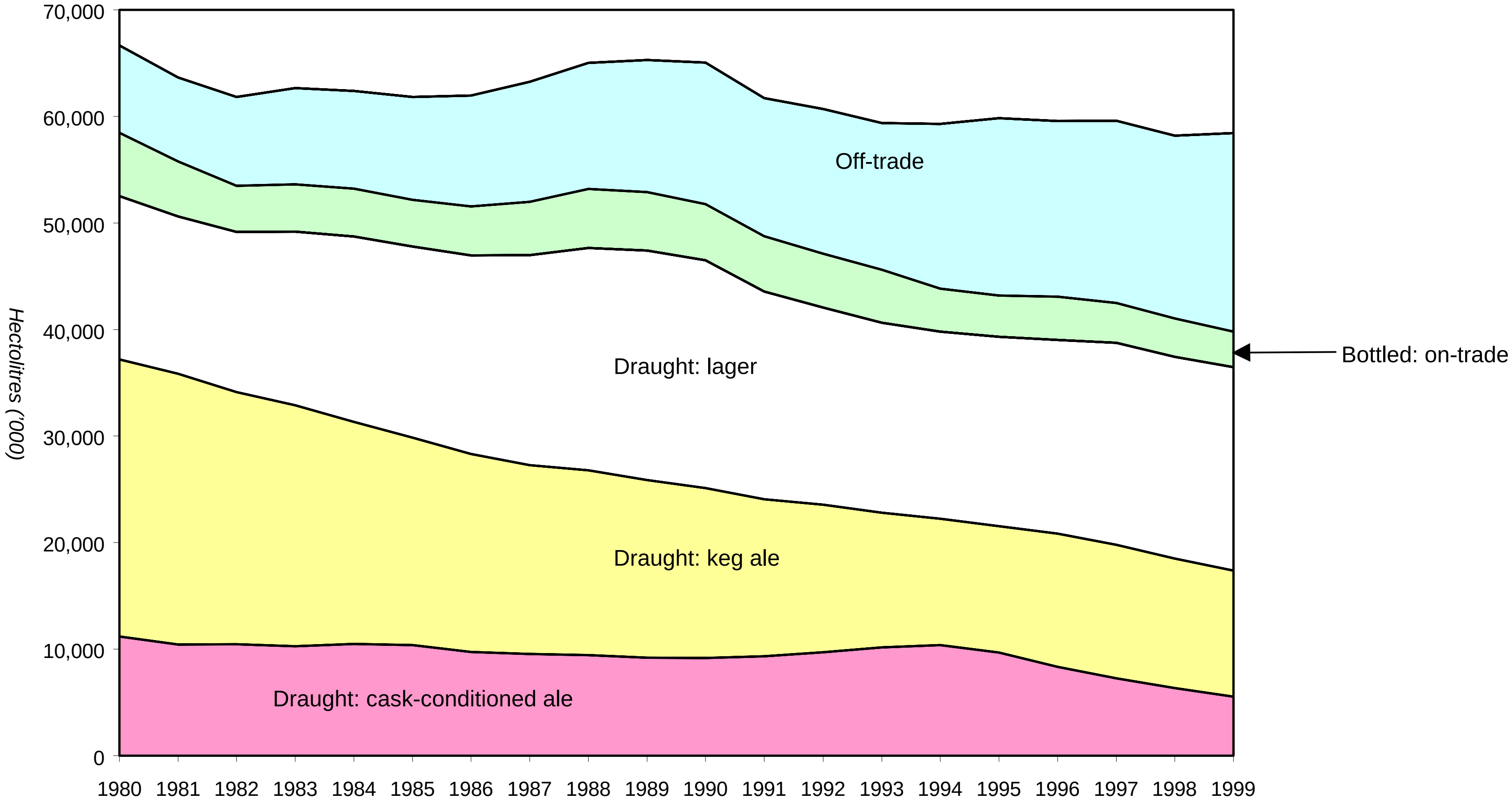


Source: BLRA.

Note: Split between standard and premium lager only available from 1976.

FIGURE 4.2

UK beer market: additional data



Source: BLRA.

4.8. Price appears less important than branding as an influence on consumer purchasing behaviour. Table 4.1, covering both on-trade and off-trade purchasing, shows that only 28 per cent of ale drinkers were influenced by whether or not the product was on special offer. In the draught lager survey, which by definition covered only on-trade purchasing behaviour, only 9 per cent of respondents said that they would switch from their regular brand if another brand was on special offer or promotion.

4.9. The brand and type of beer offered is not, however, the most important reason for choosing which retail outlet to visit. The most important factors in determining consumers' choice of pub appear to be: cleanliness, friendliness of the staff, quality of food, value for money it offers for an evening out and atmosphere/comfort (see Tables 4.2 here and Table 4.22 of the 1997 report). As noted in the 1997 report, the importance of food quality has increased over time.

TABLE 4.2 **Consumers' choice of pubs**

	%
Good quality food	52
My type of atmosphere	35
Pleasantlandlord/staff	28
My type of people go there	23
Local/within walking distance	22
Can normally get a seat	22
Real beer/good selection of beer	20
Non-smoking area	18

Source: NOP/Mintel survey of 1,788 adults in April 2000 (results provided by Interbrew).

4.10. The information memorandum sent out to purchasers of Bass Brewers noted that the UK beer market was increasingly polarized into two distinct segments:

(a) high-volume widely-recognized brands that appeal to a wide variety of consumers across a broad range of occasions; and

(b) smaller brands which target specific consumer segments and occasions.

4.11. As shown in Table 4.3, the top ten brands have increased their share of total sales in the last ten years from 32 to 50 per cent, with most of the increase occurring in the last four years. The main reasons for this include:

(a) the reduction in the number of pubs owned and/or managed by brewers following the Beer Orders (see Appendix 3.8), which has increased the number of pubs that can sell the most popular brands and prompted a shift in brewers' focus towards brand development and marketing;

(b) the recent decline in sales of cask-conditioned beer, where brands tend to be regional or local rather than national; and

(c) consolidation among brewers and subsequent increased emphasis by some brewers on one ale brand: for example S&N has emphasized John Smiths at the expense of Webster's Yorkshire Bitter and Bass Brewers has emphasized Worthington (number 12 brand in 1999) at the expense of Stones.

Although the share of the leading brands has increased, it remains lower than in most other countries including the USA (but not Germany). Following Interbrew's acquisition of WBC and Bass Brewers, it and S&N control the top three brands, four of the top five brands and six of the top ten (five of the top ten if Heineken is excluded). Interbrew and S&N also control all of the number 11 to 19 brands,[1] giving them 15 of the top 20 (14 if Heineken is excluded).

[1]On Canadean Limited figures the numbers 11 to 19 brands are: Kronenbourg 1664 (S&N), Worthington (Bass Brewers), Boddingtons (WBC), Miller Pilsner (S&N), Stones (Bass Brewers), Beck's (S&N), Caffrey's (Bass Brewers), McEwan's (S&N), Grolsch (Bass Brewers). On A C Nielsen figures (for the year to July 2000), Bass Brewers has one more brand in the top ten and one fewer in the top 20.

TABLE 4.3 **Top ten beer brands in 1989, 1995 and 1999**

Position	*1989*		*1995*		*1999*	
	Brand	*Share %*	*Brand*	*Share %*	*Brand (1999 brewer*)*	*Share %*
1	Carling	5.4	Carling	7.0	Carling (Bass Brewers)	10.7
2	Heineken	4.3	Fosters	4.9	Fosters (S&N)	8.2
3	Guinness	3.8	Guinness	4.1	Stella Artois (WBC)	5.8
4	Fosters	3.7	Heineken	3.7	Guinness	5.2
5	Carlsberg	3.5	Carlsberg	2.8	John Smiths (S&N)	4.2
6	Tetley	2.5	John Smiths	2.8	Carlsberg (Carlsberg-Tetley)	4.1
7	Tennent's Lager	2.2	Tetley	2.4	Heineken (WBC)	3.8
8	Castlemaine	2.2	Stella Artois	2.3	Budweiser (Anheuser-Busch)	2.8
9	Stones	2.0	Tennent's Lager	2.2	Tennent's Lager (Bass Brewers)	2.8
10	Skol	2.0	McEwan's	1.9	Tetley (Carlsberg-Tetley)	2.4
Total share		31.6		34.1		49.9

Source: CC based on information supplied by Interbrew. 1999 market shares are based on Canadean Limited's estimates of brand sales as a percentage of total beer sales in Great Britain and differ slightly from AC Nielsen estimates of brand shares.

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*Nine of the 1995 brands are the same as the 1999 brands and in each case the brewer is the same; the brewer of the other brand (McEwan's) was S&N. Seven of the 1989 brands are the same as the 1999 brands: the brewers are the same except that the 1989 brewer of Fosters was Courage (subsequently acquired by S&N) and the 1989 brewer of Tetley was Allied-Lyons (subsequently amalgamated with Carlsberg's UK business to form Carlsberg-Tetley). Of the other three 1989 brands, Castlemaine and Skol were brewed under licence by Allied-Lyons and Stones was brewed by Bass Brewers.

Note: All brands shown are lagers except Guinness, John Smiths, Tetley and Stones. Stella Artois and Budweiser are considered premium lagers; the others are all standard lagers. Market shares refer to one particular brand and not the whole brand family (for example, Carlsberg market share is for Carlsberg Lager and excludes Carlsberg Export, Carlsberg Special etc.)

Supply chain for beer

4.12. Three main stages in the supply of beer to the consumer can be distinguished:

(a) brewing;

(b) wholesaling and distribution; and

(c) retailing.

We consider each of these in turn. The supply chain for beer is extremely complicated and the following description is a simplification intended to outline its most significant features.

4.13. In this chapter we define brewing to include packaging (in kegs, casks, bottles or cans) and marketing of the beer as well as the actual brewing operation itself. More than one company may be involved at this stage:

(a) In some cases, a beer is brewed and sold in the UK under licence from an overseas brewer. The significance of this type of arrangement has reduced in the past 12 months as Interbrew (the licensor of the Stella Artois brand) acquired most of the brewing interests of Whitbread (licensee of Stella Artois) and S&N (the licensee of the Kronenbourg brand) acquired the brewing interests of Danone (Kronenbourg's licensor). Also Holsten has taken full control of its brands in the UK, as did Anheuser-Busch earlier in the 1990s, and Whitbread's licence for Heineken will end no later than [✄] (see paragraph 3.29) although it could be re-licensed to another brewer. The Fosters and Miller brands are still brewed by S&N under licence and a number of regional brewers brew beer under licence from overseas brand owners.

(b) Packaging and, in some cases, brewing may be contracted out to another company. An example of such an arrangement is that between Carlsberg-Tetley and Bass Brewers. Following the sale of Carlsberg-Tetley's Burton brewery to Bass Brewers, around [✄] per cent of Carlsberg-Tetley's production was initially contracted to Bass Brewers on a transitional basis while Carlsberg-Tetley restructured its own brewing capacity. This transitional arrangement involves decreasing volumes and expires in [✄].

Generally in this chapter, we define the brewer as the company marketing the beer in the UK ie the brand owner or licensee or exclusive distributor. This reflects the fact that this is the company selling the beer to the retailer or wholesaler, and also the significance of barriers to entry associated with marketing (see paragraph 4.37).

4.14. Associated with the sale of beer from one party to another is the need for invoices to be issued and cash collected and for credit to be controlled. Associated with distribution is the need for orders to be conveyed from the point of sale to the manufacturer (usually via a telesales operation, although electronic means may be increasingly used in future and is becoming the norm in the off-trade). Invoicing, cash collection and order-taking are sometimes described as wholesaling functions.

4.15. Distribution can be divided into primary and secondary distribution. Primary distribution means delivery from the brewery or packaging centre to a regional depot, while secondary distribution means storage at the depot and onward delivery to the point of sale. Primary distribution is almost always carried out by the manufacturer or by the manufacturer's contractor, reflecting the need for it to be coordinated with brewing and packaging.

4.16. In this chapter we describe the distributor as the company carrying out the secondary distribution: this will not necessarily be the same one as the company carrying out the primary distribution or the one doing the order collection or other wholesaling functions. The distributor may be the brewer, the retailer, an independent contractor (employed by either manufacturer or retailer) or an independent wholesaler.

4.17. Retail outlets may be divided into on-trade and off-trade outlets. Off-trade retailers include the large grocery chains, specialist retailers of alcoholic drinks and smaller shops with a licence to sell alcoholic drinks. On-trade retail outlets may be divided into three main types:

(a) *Leased/tenanted outlets.* The owner of the outlet (almost invariably a pub) leases or rents it to a lessee/tenant who is required to purchase beer from the owner. The owner usually charges a relatively low rent for the property but a relatively high price for beer supplied to the outlet. Prior to the Beer Orders (see Appendix 3.8) the owners were brewers supplying predominantly their own beer to their tied outlets. Subsequently the majority of the large brewers' leased/tenanted pubs were sold to pubcos who continue to operate on the same basis but usually supply beer from a number of manufacturers. The main owners of leased/tenanted pubs are:

(i) pubcos (around 25 per cent of pubs and clubs are in this category),[1] and

(ii) vertically-integrated brewer/retailers (around 5 per cent of pubs and clubs are in this category).[1]

(b) *Multiple managed outlets.* The company managing the outlet purchases beer from whichever supplier offers the best terms, although may opt to purchase from only one supplier to obtain the keenest terms on beer prices or a loan at favourable rates. Following Interbrew's acquisition of the brewing interests of Bass and Whitbread, the main operators of managed on-trade outlets are:

(i) multiple retailers, including pubcos, nightclub and hotel groups (around 15 per cent of pubs and clubs are in this category);[1] and

(ii) vertically-integrated brewer/retailers, comprising S&N and a number of regional brewers (around 5 per cent of pubs and clubs are in this category).[1]

The largest outlets are in this category and hence it accounts for over 20 per cent of on-trade beer consumption.

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[1]CC estimate based mainly on data supplied by Interbrew.

(c) *Independent outlets.* The individual outlet purchases the beer directly from whichever supplier he/she wishes. Some pubs come into this category, as do most members' clubs (accounting in total for around half of pubs and clubs but a smaller percentage of on-trade beer consumption). Independent outlets may join consortia to enable them to benefit from increased discounts on their purchases.

In the first case, there are two retailers involved: the pub owner and the lessee/tenant. In this chapter we refer to the pub owner as the retailer. This reflects the fact that we are considering a merger of two companies which manufacture, wholesale and distribute[1] but do not retail beer. They sell to pubcos and other retailers and therefore it is the pubco, not the lessee/tenant, that is in the first instance potentially affected by the merger.

4.18. Retailers usually do not own the equipment for dispensing draught beer: instead this is usually owned and maintained by the manufacturer supplying the main brands of beer sold in the outlet.

4.19. Figure 4.3 shows a simplified illustration of the supply chain.

4.20. Figure 4.4 shows the approximate contribution of each of these stages, and also of tax, to the average 1999 price of draught beer (£1.85 per pint). The major contributors are retailing and tax. The activities of brewing and distribution, with which we are mainly concerned, are less significant as a percentage of the draught beer price but are nevertheless important markets, worth about £2,400 million and £300 million respectively in 1999.

Market definition

4.21. As indicated above, the vertical supply chain has three main stages: brewing, distribution and retailing. Associated with this are three separate markets:

(a) the supply of beer by brewers to retailers and wholesalers;

(b) the supply of wholesaling and distribution services either on a contract basis or bundled with beer by manufacturers or wholesalers; and

(c) the supply of beer by retailers to consumers.

The first two are the markets directly affected by the merger.

Product market

4.22. On the demand side, possible alcoholic substitutes for beer include cider, FABs[2] and wine. Studies have shown that the demand for beer is price inelastic (the long-run price elasticity of demand has been estimated to lie between –0.5 and –0.75).[3] On the supply side, the production processes for cider, FABs and wine are different from those for beer, as are the brands (the main UK brewers do produce FABs but not cider or wine). Consequently, there are compelling reasons for treating beer as a separate product market. In its decision referring the merger to the UK, the European Commission confirmed its findings in previous cases that beer is on a separate product market from other beverages (the European Commission's decision, and our terms of reference, are limited to the UK supply of beer and do not cover the UK supply of FABs—see Appendix 2.1).

4.23. As mentioned above, beer is a branded product and consumers are likely to have a preference for particular brands. As discussed in paragraph 4.3, brands are grouped together into product segments (standard lager, premium lager, standard ale, premium ale, stout). Table 4.4 shows the percentage of total sales accounted for by these segments and the leading brands in each. Some of those giving evidence to

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[1]Bass Brewers distributes through its associate, Tradeteam, in which it has a 49.9 per cent shareholding (see paragraph 3.43).

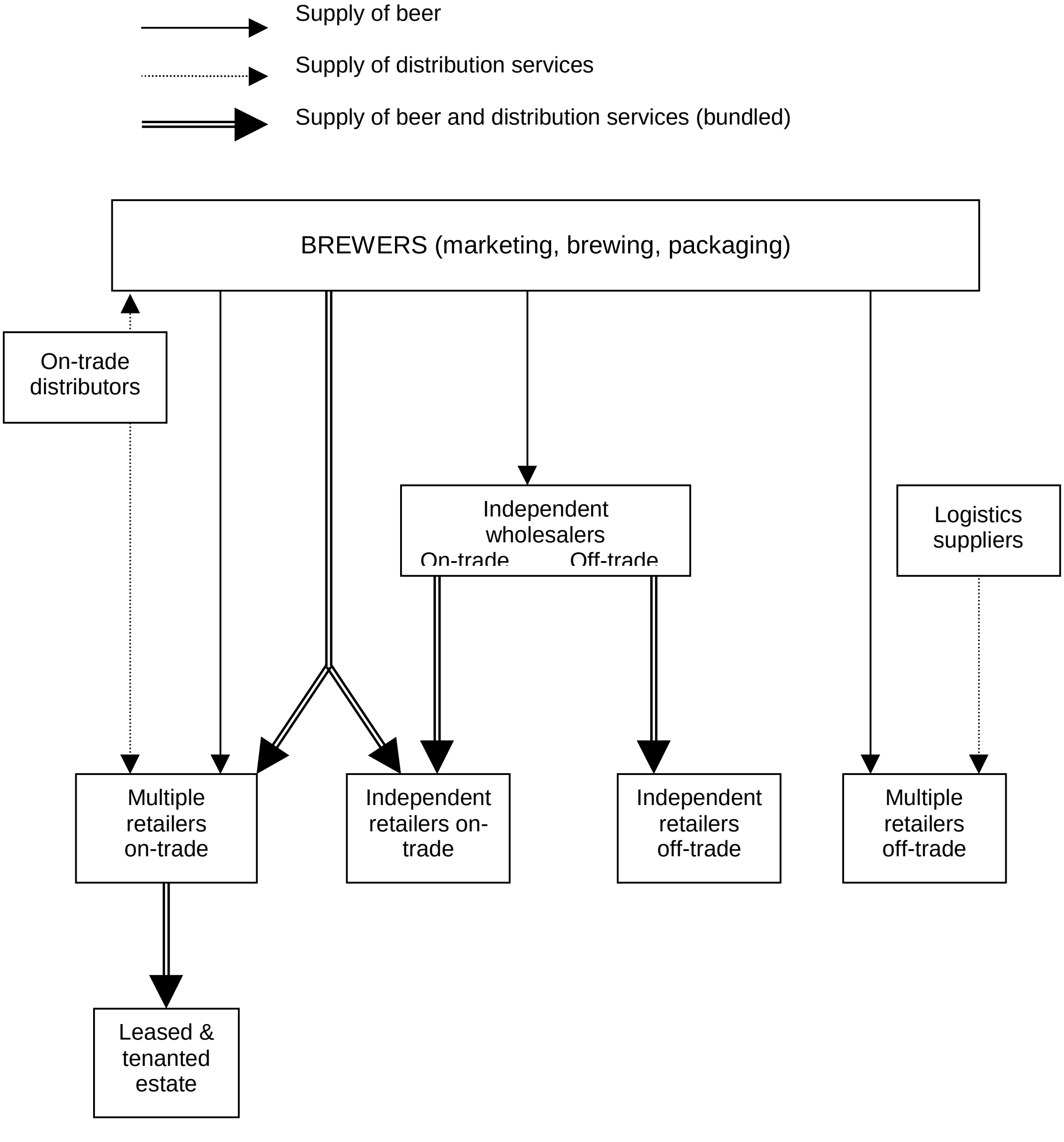
[2]These are a mixture of alcohol or branded spirits and carbonated or non-carbonated drinks.

[3]Chambers, M J (1999), *Consumers' demand and excise duty receipts equations for alcohol, tobacco, petrol and DERV*, GES Working Paper no 138 and Tanner, S (1999), 'Alcohol taxes, tax revenues and the Single European Market', *Fiscal Studies*, 20:3.

us argued that each of these segments was a separate market, while others, including Interbrew, argued the opposite. No one, however, argued that the different segments were so distinct (price cross-elasticities so low) that it was invalid to consider beer as a whole a relevant market. We did not carry out a detailed analysis to assess whether a hypothetical brewing monopolist in each of the market segments would be able to raise price significantly above the competitive level (the usual test for whether there is a separate market). Such an exercise would be of limited value since the largest brewers, including Interbrew and Bass Brewers, compete across all the main segments.[1] We have calculated brewers' market shares for the different segments as well as the overall market share for brewing.

FIGURE 4.3

Illustration of supply chain for beer

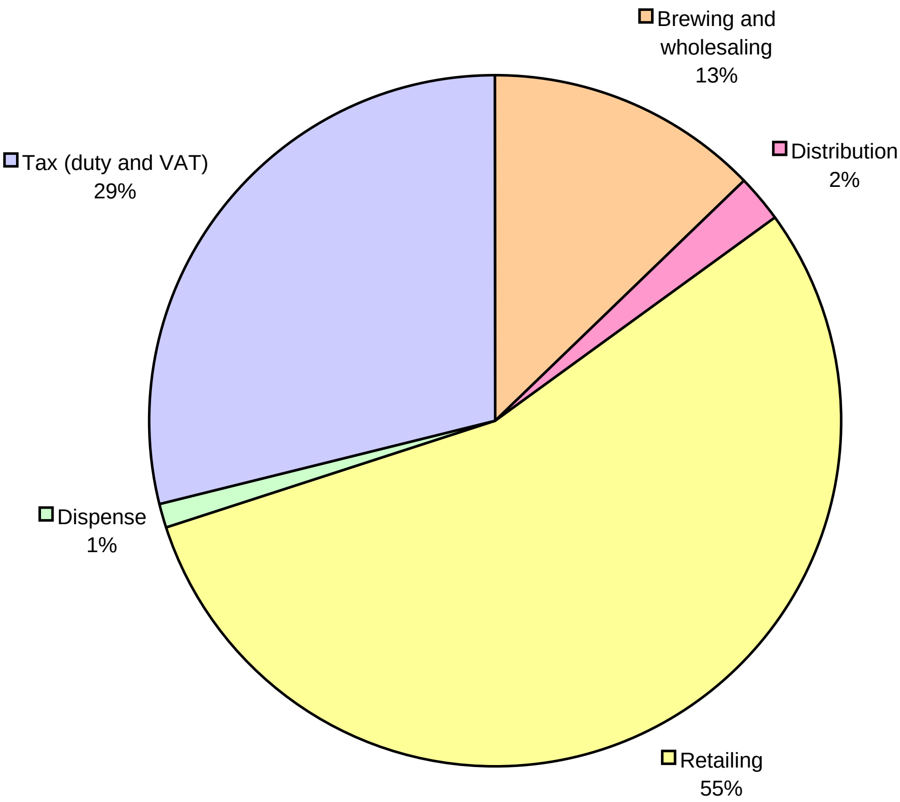


Note: This is a simplified illustration and does not show relationships between brewers, licence owners, contract packagers etc. It also does not show other services including telesales and those associated with dispensing equipment in on-trade outlets. The extent of vertical integration, for example, between brewers and on-trade distributors and multiple retailers, is also not shown.

[1]Bass and Interbrew do not brew stout although they do wholesale it.

FIGURE 4.4

Breakdown of draught beer price in 1999



Source: CC.

Note: These are estimated average figures for all channels. Wholesaling and distribution costs will be higher for independent retailers and additionally brewing profits are also higher (see paragraph 4.70). Hence retailing percentage will be lower for independents.

TABLE 4.4 **Market segments and leading brands in each segment, 1999**

per cent

Market segment	*Segment's share of beer volume*	*Leading brands (1999 brewer)*	*Brand's share of segment*	*Brand's share of total market*
Standard lager	38.9	Carling (Bass Brewers)	27.6	10.7
		Fosters (S&N)	21.1	8.2
		Carlsberg (Carlsberg-Tetley)	10.5	4.1
Premium lager	23.4	Stella Artois (WBC)	25.0	5.8
		Budweiser (Anheuser-Busch)	12.0	2.8
		Kronenbourg 1664 (S&N)	9.5	2.2
Standard ale	25.7	John Smiths (S&N)	16.5	4.2
		Tetley (Carlsberg-Tetley)	9.4	2.4
		Worthington (Bass Brewers)	8.5	2.2
Premium ale	6.0	Caffrey's (Bass Brewers)	16.1	1.0
		Bass (Bass Brewers)	8.9	0.5
		McEwan's Export (S&N)	8.8	0.5
Stout	6.0	Guinness	86.4	5.2
		Murphy's (WBC)	9.6	0.6
		Beamish Black (S&N)	1.3	0.1

Source: CC estimates based on BLRA and Canadean Limited data.

4.24. Over 90 per cent of on-trade sales are of draught rather than packaged beer. Draught (keg and cask) beer is much heavier than packaged beer and is distributed by a small number of companies with specialist expertise (which also distribute other beverages, including draught cider, but generally not other products) to on-trade outlets. This suggests that there may be a separate market for the distribution of draught beer (and cider) to on-trade outlets.

4.25. At the retailing level, on-trade and off-trade outlets can be considered to be different markets. Competition at the retail level tends to be across all products sold, not just beer. However, our concern is with retailers as purchasers of beer not with the other products.

Geographical market

4.26. The European Commission decision stated that the relevant geographic market was no wider than the UK.

4.27. Guinness and Bass Brewers, between them, have over 80 per cent of the Northern Ireland market and both these companies manage their operations in Northern Ireland separately from those in Great Britain. This contrasts with the position within Great Britain where Bass Brewers operates its five breweries on an integrated basis. We received evidence that prices are higher in Northern Ireland than Great Britain but, despite this, S&N has an overall share of only about 5 per cent (entirely due to off-trade sales) while the other two large British brewers, Interbrew and Carlsberg-Tetley, have shares in Northern Ireland of less than 1 per cent. Interbrew has a negligible share of the Northern Ireland market and market shares are unchanged by the merger. In the light of these factors, we have treated Northern Ireland (which accounts for only about 2 per cent of UK beer consumption) as a separate market and the remainder of this chapter deals only with Great Britain.

4.28. It was put to us that, because of their different brand heritages, Scotland, Wales and the English regions could also be regarded as separate markets. We have dealt with this in a similar way to product market segmentation: by considering market shares on both an overall and segmented basis.

4.29. At retailing level the markets served by particular pubs are local in nature, although larger retailers operate throughout Great Britain. As noted above, our concern is with retailers as purchasers of beer and we do not need to consider local markets.

Barriers to entry and expansion

Brewing

4.30. A potential entrant to brewing requires access to its own or subcontracted production facilities, an ability to market the beer and access to retailers (including distribution). We consider each of these in turn and then consider recent entry history.

Production

4.31. The technology of brewing is well established and small-scale entry into production is relatively easy. It is also possible to enter the UK market by importing from abroad. However, small-scale UK producers are at a cost disadvantage as brewing and packaging are subject to economies of scale,[1] while importers also tend to be at a cost disadvantage due to the extra transport costs (see Appendix 4.1). Importers' relative cost position will also be affected by exchange rates. Another possibility for an entrant would be to concentrate on marketing the beer and contract out production either to a specialist contract producer or to a regional brewer.

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[1]The 1989 MMC report stated that the brewing industry had long been regarded as a classic example of the operation of the 'laws' of economies of scale (*The Supply of Beer: a report on the supply of beer for retail sale in the United Kingdom*, HMSO, Cm 651, March 1989 (the 1989 report)).

4.32. Construction of a new efficient scale brewery would involve large sunk costs. Sunk costs tend to represent a barrier to entry since, in the presence of sunk costs, a potential entrant must plan on the basis that exit is costly and must take into account the response to entry of existing suppliers. However, the need for an entrant to incur sunk costs is much reduced if a brewery can be purchased, secondhand, or leased from an existing producer (albeit any such brewery might have above average operating costs). As noted above, the demand for beer is declining and the industry has tended to be characterized by excess capacity. Although a large number of breweries have been closed over the last ten years, the balance of evidence indicates that there is still excess capacity which might be purchased by a hypothetical entrant. Table 4.5 shows capacity utilization at the larger brewers. There is also excess capacity at regional brewers. Interbrew told us that there was approximately 5 million hectolitres spare capacity in the hands of regional brewers. However, Carlsberg-Tetley told us that any such excess capacity was widely dispersed among small breweries and largely for ale products; consequently it was likely to be cost inefficient and unsuitable for any new entrant wishing to brew large quantities of high-quality lager products.

TABLE 4.5 **Capacity and capacity utilization: large brewers**

'000 hectolitres

	Number of plants 1990	*Number of plants 2000*	*Capacity 1990*	*Capacity 2000*	*Production* 2000*	*Utilization 2000 %*
S&N	10	6				
Bass Brewers	12	6				
WBC	9	3				
Carlsberg-Tetley	7	2	✄	†	✄	†
Guinness	2	1				
Anheuser-Busch	0	1				

Source: CC based on data from companies.

*Estimate based on twice production for Jan to June 2000.

†Filtration capacity is smaller than this and current capacity utilization based on filtration capacity is 91 per cent.

Marketing

4.33. Turning to marketing, a very small scale entrant (micro-brewer) may rely on word of mouth while a small scale importer may utilize its overseas reputation or may develop awareness through niche strategies (for example, ethnic restaurants). However, an entrant on a significant scale would have to develop brands in Great Britain (or else be limited to supplying retailers with their own label beer). Brand development requires expenditure on advertising and promotion which represents a sunk cost that can not be recovered if entry generates strong price competition and the entrant subsequently wishes to exit. Figure 4.5 shows that there has been some tendency for advertising expenditure to increase over time despite static or decining sales—the trend rate of increase is about 2 per cent a year[1] (annual figures may be affected by fluctuations in the price of advertising). Table 4.6 shows the level of advertising expenditure by the large brewers. Figure 4.5 and Table 4.6 reflect only advertising expenditure and not expenditure on other types of promotion.

[1]Compound growth rate estimated by linear regression of the natural logarithm of advertising expenditure on time.

FIGURE 4.5

Advertising expenditure on beer (£ million at 1995 prices) compared with beer volume (million hectolitres)

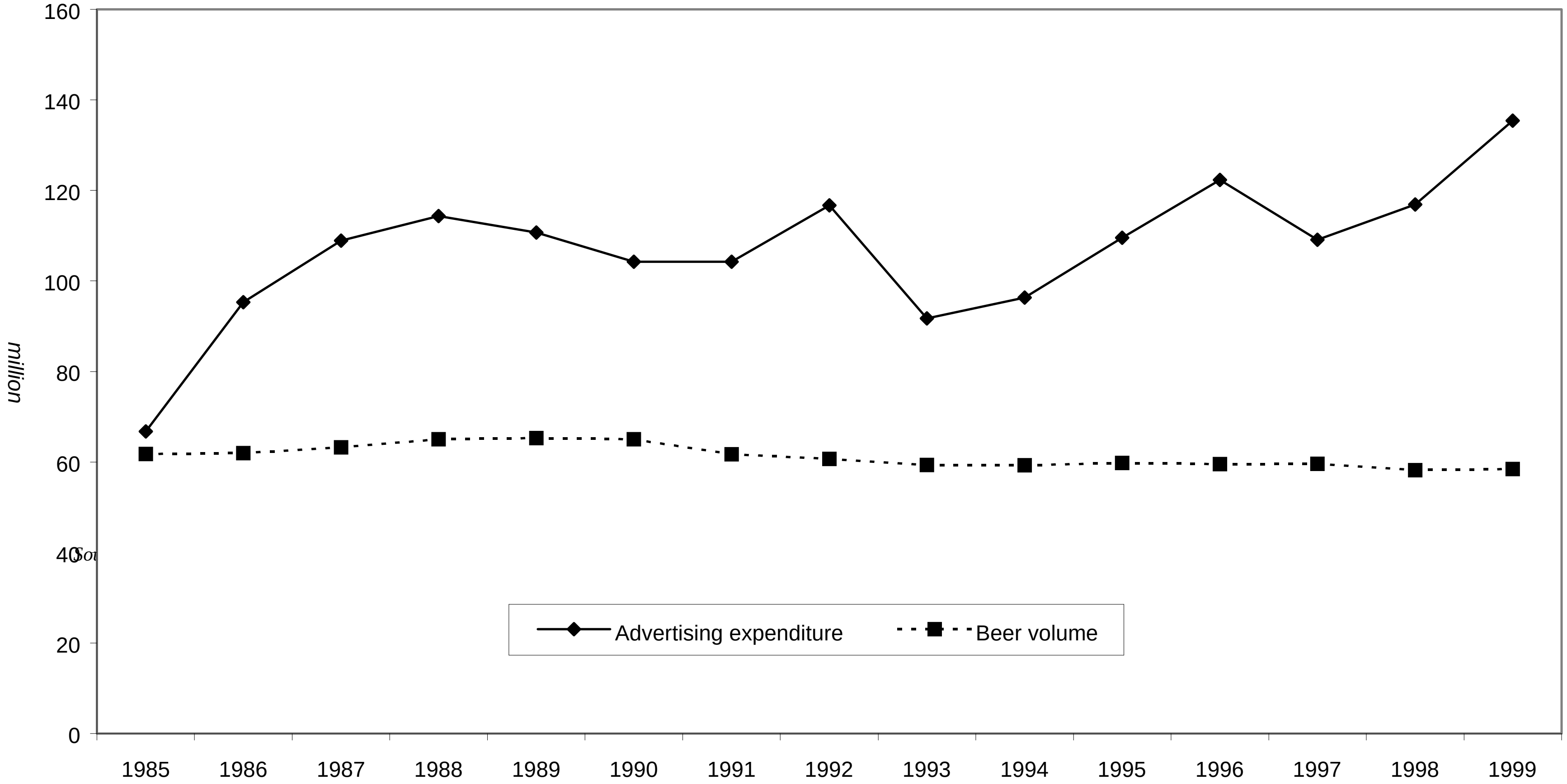


TABLE 4.6 **Total advertising expenditure on beer by large brewers, adjusted to 1995 prices**

	S&N		*Bass Brewers*		*WBC*		*Carlsberg-Tetley*		*Guinness*		*Anheuser-Busch*	
	£m	*%*	*£m*	*%*	*£m*	*%*	*£m*	*%*	*£m*	*%*	*£m*	*%*
1992	16	14	33	28	19	16	13	11	20	17	6	5
1993	19	21	14	15	17	18	9	10	15	16	5	5
1994	18	19	10	10	19	20	12	12	11	11	8	8
1995	23	21	15	14	18	16	15	14	10	9	9	8
1996	29	24	21	17	22	18	7	6	13	11	11	9
1997	27	25	15	14	16	15	12	11	14	13	11	10
1998	23	20	19	16	21	18	13	11	14	12	11	9
1999	31	23	16	12	22	16	20	15	20	15	14	10

Source: A C Nielsen.

4.34. In addition to being sunk costs, other features of marketing expenditure may add to the difficulties faced by entrants:

(a) It takes time to build a brand's image and market share. Interbrew told us that it could take up to 20 years to establish the leading brand, although an innovative brand which captures consumer demand can gain an appreciable market share in a relatively short space of time (examples include Caffrey's and many FAB products).

(b) Unit costs have a tendency to decline with sales volume. Interbrew told us that, beyond a certain point (approximately £8 million for a beer brand), there was little return (for example, in increased brand awareness) to additional advertising expenditure. It follows that advertising expenditure will tend to be lower per unit of volume for a high-volume brand. Figure 4.6 shows that there is some tendency for total marketing spend per hectolitre on a brand to decline as market share increases.[1] Figure 4.6 also shows a wide variety of results for different brands reflecting many factors including different marketing strategies and brand histories and that market share reflects the quality as well as the quantity of marketing expenditure. Two brands (Stones and Courage Best) received very little marketing expenditure: as noted above, their owners (Bass Brewers and S&N respectively) concentrated marketing expenditure on alternative ale brands.

4.35. The need for expenditure on marketing for a UK brewer is reduced where an overseas brand owner shares in the advertising costs. Likewise if the overseas brand owner terminates the licence of a UK brewer and itself markets its brand in Great Britain (in these circumstances, the brand owner benefits from the UK brewer's previous marketing expenditure). Such entrants include Anheuser-Busch in 1995 and Holsten in 1999. With the exception of Heineken, the importance of brands brewed in Great Britain under licence is now more limited than hitherto (see paragraph 4.13) as, consequently, are future entry opportunities by the overseas owners of these brands.[2]

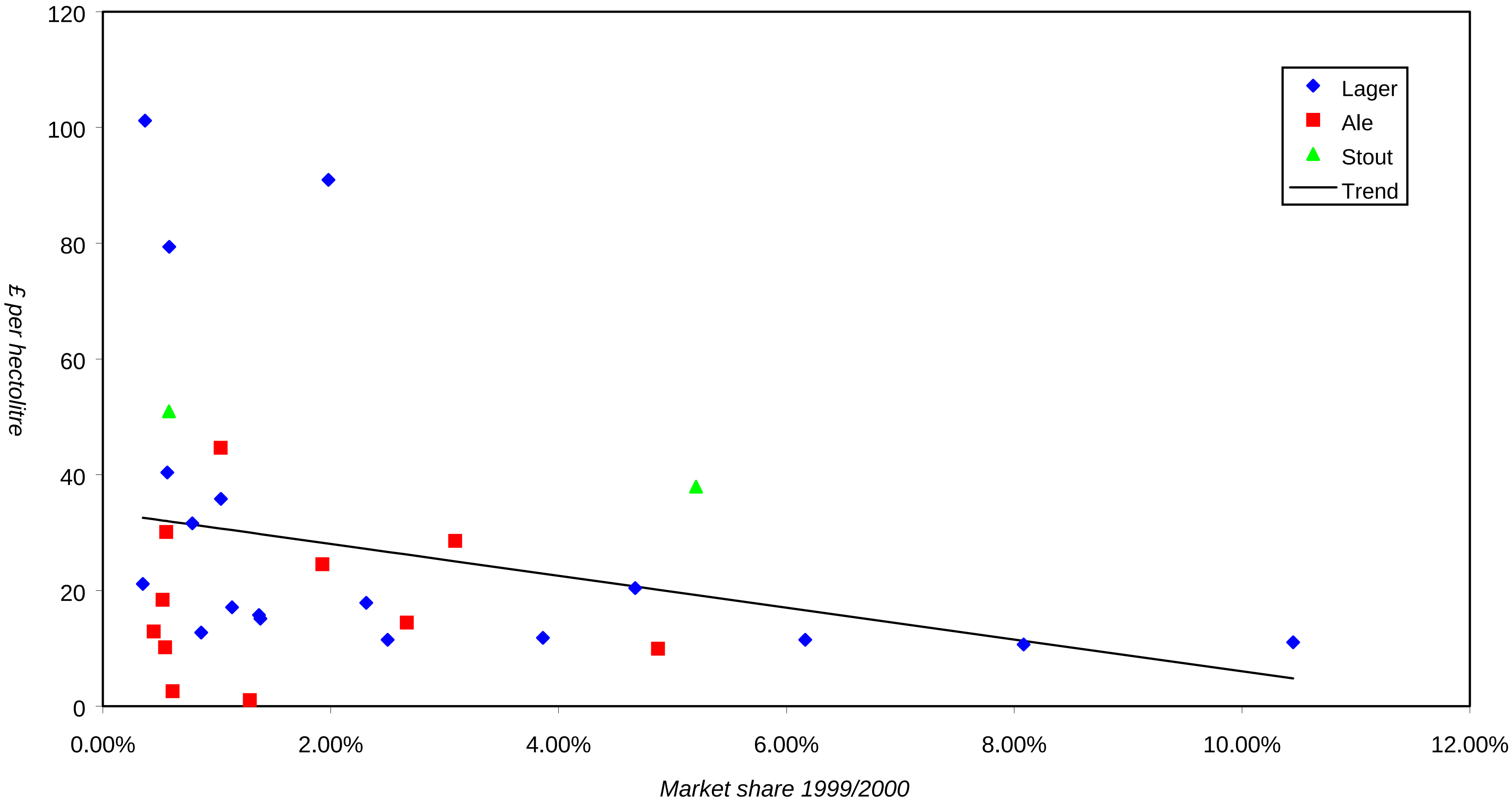
4.36. While entering with a look-alike brand that competes directly with existing brands of existing suppliers appears unattractive, new products may offer an opportunity to entrants. With new products, there is not the same problem of competing against existing suppliers who have already incurred the sunk costs of advertising and promotional expenditure. Hence entry is likely to be easier in markets where new products are introduced frequently ie where tastes and technology change rapidly. This does not seem to be the case in the British beer market. Table 4.3 shows that seven of the 1999 top ten brands were in the 1989 top ten. Furthermore, the other three (Stella Artois, John Smiths, Budweiser) were all available in 1989. Moreover, it has been suggested that the growth in the position of John Smiths is at least in part due to consolidation by S&N of its ale brands. The growth of the other two brands appears attributable to the expansion of the premium lager sector. Although innovative new brands and, brand extensions have been introduced (examples include 'Ice' and 'Lite' beers and, before that, nitrokeg beers), their overall impact on the beer market has been modest. We are also aware of innovations in respect of packaging and brand dispense. A large off-trade multiple retailer told us that there was little dynamism apparent in

[1]All brand-specific marketing expenditure over 1996 to 1999 is included (present value adjusted to 1999 prices using the RPI and a real discount rate of 8 per cent). The downward trend is not statistically significant at the 5 per cent level.

[2]S&N has indefinite European rights to the Fosters brand.

FIGURE 4.6

Brand marketing spend over 1996 to 1999 compared with 1999/2000 market share



Source: CC based on information supplied by companies and A C Nielsen market share data for year to July 2000.

the marketplace with brewers increasingly relying on established brands; it believed that further consolidation would mean that brewers would be even less inclined to innovate.

4.37. Overall, the need to invest in advertising and promotional expenditure represents an important barrier to entry into the beer market.

Access to retailers

4.38. A new entrant also requires access to retailers. There appears no difficulty in obtaining access to retailers in the off-trade, since distribution is carried out either by multiple retailers themselves (or their contractors) or by independent wholesalers and cash-and-carry operators. We therefore concentrate on the on-trade. Potential barriers include vertical integration between brewers and retailers and brewers' control of distribution.

4.39. Up to 1990, a majority of pubs were owned by integrated brewer/retailers. The 1989 report noted that vertical integration, combined with licensing restrictions, made successful new entry into brewing very difficult. As shown in Table 4.7, following the Beer Orders, the extent of integration has fallen especially among large national brewers. The sale of Bass Brewers to Interbrew has removed the link between Bass Brewers and BLR and thus contributed to the reduction in vertical integration and, in this respect, to a reduction in entry barriers (as also did the earlier sale of WBC to Interbrew). S&N is now the only large brewer which is vertically integrated into retailing: it has about 2 per cent of fully-licensed on-trade outlets, including clubs (and a slightly higher percentage of on-trade sales).

TABLE 4.7 **On-licence ownership, 1989 to 2000 (approximate)**

	1989	*January 1999*	*September 2000*
*Large brewers**			
Tenanted	22,000	2,600	350†
Managed	10,000	6,400	2,300†
Total	32,000	9,000	2,650†
Other brewers			
Tenanted	9,000	6,700	5,900
Managed	3,000	3,600	3,500
Total	12,000	10,400	9,400
Retail chains			
Tenanted	N/A	19,500	23,000
Managed	N/A	4,000	9,000
Total	0	23,500	32,000
Independent pubs	16,000	15,700	16,000
Total pubs	60,000	58,600	60,000
Clubs	32,800	29,500	N/A
Other full on-licensed	23,000	28,800	N/A
Total of above	115,800	116,900	N/A
Restricted on-licences‡	32,400	32,200	N/A
Total on-licensed	148,200	149,100	N/A

Source: CC based mainly on information supplied by Interbrew.

*S&N, Bass Brewers, WBC, Carlsberg-Tetley and predecessors.
†S&N.
‡Mainly restaurants.

4.40. Looser forms of vertical links include supply contracts and loan tying:[1]

(a) Most larger on-trade retailers purchase beer from one or more suppliers on three- to five-year non-exclusive contracts often with minimum purchase obligations (or other terms which encourage a high volume of purchases from the contracted supplier): Interbrew has [✄]-year contract with Whitbread and Bass Brewers has a [✄]-year contract with BLR, albeit with declining volumes (see paragraphs 3.30 and 3.8). The terms of such contracts may make it difficult for an entrant or a rival to gain large sales with a particular retailer except when contracts are renewed

[1]The practice of offering loans in exchange for supply of beer is known as loan tying. Under the Beer Orders any such loan must be repayable within three months.

or renegotiated following deal activity involving the retailer. However, different retailers' contracts will expire at different times and we received evidence that contracts were sometimes renegotiated within term as well. Consequently, potential entrants and expanding companies may be expected to have a succession of opportunities with different retailers. Supply contracts are clearly less of a barrier than full integration between brewer and retailer.

(b) A significant but declining number of smaller on-trade retailers receive loans from brewers at favourable rates in exchange for an exclusive contract or one minimum purchase obligations. Under the Beer Orders such loans must be repayable within three months freeing the retailer of purchase obligations. In the light of this it seems doubtful that such loans in themselves now act as a significant barrier to entry.

4.41. To access the on-trade, an entrant's beer has to be delivered to the point of sale. Three main types of contractual arrangement can be distinguished:

(a) Some of the larger on-trade retailers have separate supply and distribution contracts with all beer delivered to regional depots for onwards transport to the retail outlets, while brewer/retailers themselves usually deliver all beer (both their own brands and any beer bought from third parties) to their outlets.

(b) Other larger on-trade retailers have arrangements whereby a brewer supplies its beer to their outlets under a combined supply and distribution contract and also delivers other brewers' beer for a (per hectolitre) 'porterage' fee. These contracts give retailers the option of negotiating directly with other brewers on price and volume (subject to any minimum purchase obligations in their main contract). [*Details omitted. See note on page iv.*][1]

(c) Most of the smaller pub chains and independents purchase beer and distribution on a bundled basis, ie they pay a delivered price covering both beer and distribution.

4.42. Distribution to the outlets of retailers in the first of these categories is similar to that to off-trade outlets and presents no problem (although all such contracts have been awarded to companies associated with the large brewers). This also applies to some extent to outlets of retailers in the second category (depending on the level of the porterage charge). In order to obtain distribution to on-trade retail outlets in the third category, an entrant would have the choice between arranging its own distribution, using independent wholesalers and selling to existing brewers, which also act as wholesalers. We consider each of these briefly:

(a) Distribution costs fall sharply with drop size (see Appendix 4.2). So it would tend to be cost-effective for an entrant to arrange its own distribution (on a contracted out basis) only if each outlet takes a reasonably large quantity of beer. This would require the brewer to be able to supply a wide brand range. This seems unlikely as marketing barriers and the brand-specific nature of marketing costs mean that entrants are most likely to enter with a narrow brand range (see paragraph 4.36).

(b) Independent wholesalers are a way around the high costs of own distribution. However, independent wholesalers have a small share of distribution (see Table 4.12) and appear to be weaker competitors in the sale of beer to pubs and high-beer-volume clubs than to other types of outlet where beer volumes are lower (for example, restaurants, wine bars, golf clubs). The reasons for this appear to include their small scale of operations and consequently higher distribution costs. Some wholesalers told us they were supplied with leading brands on unfavourable terms, in particular by Bass Brewers and S&N. They also said that the terms and support offered by WBC were the best of the large brewers.

(c) The existing brewers do wholesale third parties' beers but have little incentive to promote sales of products that compete directly with their own.[2] Carlsberg-Tetley told us that the large brewers

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[1][*Details omitted. See note on page iv.*]

[2]As brewing is subject to economies of scale, cost recovery requires price to exceed marginal cost even under conditions of strong competition. If a brewer sells a third party beer rather than its own, it loses the difference between price and marginal cost.

did not regard the wholesaling of third party beers as a business activity in its own right, and that brewers only wholesaled third party beers in order to make up for gaps in their own portfolios. S&N similarly said that, when making sales to retailers, brewer/wholesalers tended to focus on their own brands (including brands for which they hold the UK licence). Table 4.8 shows that the large brewers' sales are primarily of their own brands.

TABLE 4.8 **Large brewers' on-trade sales of other brands and their own brands, 1999**

per cent

	*Other brands**	*Own brands*	*Market share†*
S&N			26
Bass Brewers			24
WBC	✂	✂	13
Carlsberg-Tetley			13
Wolverhampton & Dudley			4
Greene King			1

Source: CC analysis of information provided by brewers.

*Figure represents brewer's volume purchases of other brands as a percentage of its sales to on-trade retailers (excluding any sales where the brewer did not carry out secondary distribution).
†Brewer's share of on-trade (see Appendix 4.3).

4.43. Access to on-trade distribution continues to act as a barrier to entry and expansion especially of draught products (packaged products can be distributed with other drinks and food products). Nevertheless the development of retailer contracting in the on-trade, together with the expansion of the off-trade at the expense of the on-trade, suggest that distribution may be gradually declining in importance as a barrier to entry into brewing.

4.44. As noted in paragraph 4.18, the brewers own and maintain much of the equipment installed in pub cellars for dispensing draught beer. The four largest brewers (S&N, Bass Brewers, Interbrew and Carlsberg-Tetley) and two large cider manufacturers are party to an agreement under which ownership is compulsorily transferred when there is a change in the main supplier of beer to the outlet (this facilitates the switching of suppliers by retailers). It was suggested that these arrangements could act as a barrier to entry (see paragraph 6.286*(c)*) but Interbrew told us that other brewers and drink providers had an open invitation to participate in the scheme.

4.45. Although brewers' ownership and control of on-trade retailing and wholesaling is probably of declining importance as a barrier to entry and expansion in brewing, it remains of significance:

(a) Around 20 per cent of on-trade beer is still sold by integrated brewer/retailers, albeit the significance for entrants is reduced by the fact that most of this is accounted for by regional brewers which buy in most or all of the lager for their retail operations.

(b) Around 50 per cent of beer is retailed by smaller pubcos and independents which do not have separate distribution contracts presenting the difficulties for entrants set out in paragraph 4.42 above. Additionally the two largest on-trade retailers (BLR and Punch) do not have fully separate distribution contracts.

Entry history

4.46. There have been a large number of very small-scale entrants to brewing in Great Britain: the number of microbreweries expanded from 180 in 1990 to 425 in 1999. The majority of branded imported beer is marketed in Great Britain by existing brewers. However, HP Bulmer (the cider manufacturer) and independent wholesalers are also active in marketing imported beer and, additionally, there are specialist houses which focus on providing a route to market for imported brands, particularly into the cafe/fashion bar sector and may be the starting point for wider distribution of those brands (an example is Budvar which has about 0.1 per cent by volume of the British market, but which has gained widespread distribution with two large pubcos). Examples of overseas brewers entering with their own brands include South

African Breweries with its Castle beer and Birra Peroni with Nastro Azzuro. None of these entrants have, however, achieved a penetration level as large as 1 per cent of the British market.

4.47. More significantly, some overseas brewers have entered by taking over the marketing of their brand from a UK brewer. The most important example is Anheuser-Busch, which took control of its Budweiser brands in 1995 and started operating its own British brewery, leased from S&N. Anheuser-Busch has spent heavily on marketing and now has a market share of about 3 per cent. Other overseas brewers taking over the marketing of their brand from a British brewer include Coors (1998) and Holsten (1999). However, Anheuser-Busch's is the most significant entry into the British market in the last ten years and it required extensive marketing and advertising spend to reach just a 3 per cent share.

Distribution

4.48. This section considers barriers to entry into distribution, as opposed to distribution as a barrier to entry into brewing, which was considered in the previous section.

4.49. The distribution of draught beer appears to involve some elements of special expertise. Distribution is characterized by economies of drop size and, to a lesser extent, of density (see Appendix 4.2). Economies of density imply that entry would need to be on a fairly large scale to be cost competitive with existing suppliers. Additionally, an entrant would need to operate over a wide geographical area in order to bid for pubco business since the larger pubcos' outlets tend to be dispersed over several regions at least of England and Wales. However, the assets involved in distribution (depots and vehicles) have value in alternative uses and consequently sunk costs in distribution appear low.

4.50. Large logistics companies[1] lack specific expertise but otherwise appear to be plausible entrants into on-trade beer distribution. We were told that Wincanton had for a time provided distribution services to Greenalls (prior to the sale of its managed pubs to S&N) and that Wincanton and at least one other company had bid (unsuccessfully) for retailer distribution contracts in competition with the established distributors.

4.51. A large retailer (Punch) told us that it had considered the cost of establishing and operating its own distribution network. It told us that it estimated the initial capital cost at £9.50 per hectolitre, of which £6.00 would be start-up and warehousing costs which it considered irrecoverable sunk costs. (We noted above, however, that a retailer would not necessarily need to purchase the assets to avoid reliance on existing brewers for distribution—alternatively it could contract with a logistics firm.) The retailer also told us that the operating costs of its hypothetical distribution business would be higher than those of the existing brewers due to lower volumes.

4.52. Overall, distribution is characterized by economies of scale but sunk costs appear to be modest. There has been relatively little entry. This appears to reflect: brewers' desire to maintain their own operations (apart from Bass Brewers which has subcontracted to Tradeteam); the fact that most beer distribution is still bundled with beer supply and thus carried out by brewers; and also that, where distribution has been purchased separately by multiple retailers, bidding for contracts has been vigorous.

4.53. There would appear to be minimal barriers to entry into wholesaling activities (order taking, invoicing and credit control).

Market shares

Brewing

4.54. Table 4.9 shows estimated market shares over the period 1996 to 1999. Appendix 4.3 shows separate figures for the on-trade and the off-trade: Bass Brewers and Carlsberg-Tetley are stronger in the on-trade while Whitbread is stronger in the off-trade. Over the four years shown, the share of the four

[1]Exel already operates Tradeteam as a joint venture with Bass.

largest brewers declined from 78 to 75 per cent. Carlsberg-Tetley's share declined from 15 to 12 per cent while S&N also lost market share but both Bass Brewers and WBC gained share.

TABLE 4.9 **Concentration in British brewing**

per cent

	1996	*1997*	*1998*	*1999*
Market share by brewer: all beer*				
S&N	27.8	26.7	25.6	26.0
Bass Brewers	21.9	23.0	22.0	23.4
WBC	13.5	13.8	14.2	14.5
Carlsberg-Tetley	15.4	14.6	13.2	11.8
Guinness	6.0	5.7	5.7	5.6
Anheuser-Busch	2.5	3.0	3.4	3.2
Wolverhampton & Dudley	1.3	1.7	2.8	3.1
Greene King		0.6	0.6	0.9
Others	11.5	10.9	12.6	11.5
Total	100.0	100.0	100.0	100.0
HHI	1,720	1,691	1,566	1,625
Notional post-merger analysis (including Heineken brands):				
Interbrew share† (%)		36.8	36.2	37.8
HHI		2,325	2,190	2,301
Change in HHI		634	624	676
Notional post-merger analysis (excluding Heineken brands):				
Interbrew share† (%)		31.6	31.5	33.2
Heineken share (%)		5.2	4.6	4.6
HHI		1,997	1,898	1,996
Change in HHI		306	332	371

Source: CC based on questionnaire responses by brewers.

*The brewer is the brand owner or British licensee.

†Interbrew's post-merger share excludes beer brewed by Interbrew's Dutch subsidiary and marketed in Great Britain by others (primarily retailers' and wholesalers' own label beers but also Oranjeboom which is marketed by Shepherd Neame). This accounted for 0.6 per cent of the British market in 1999.

Note: Excludes personal imports.

4.55. Together with Guinness and Anheuser-Busch (which are heavily concentrated on single brands—Guinness and Budweiser respectively), the four largest brewers are responsible for all the leading brands. Other suppliers include:

(a) Wolverhampton & Dudley, an integrated brewer/retailer based in the West Midlands which expanded by acquisition in 1999. It brews mainly ale and some lager and, reflecting the importance of its retailing activities, its on-trade share is considerably greater than its off-trade share.

(b) Greene King, based in East Anglia, which is also an integrated brewer/retailer that expanded by acquisition in 1999. It brews only ale and its on-trade share is also considerably greater than its off-trade share.

Wolverhampton & Dudley and Greene King are the only companies remaining out of the 11 regional brewers identified by the MMC in the 1989 report. The others either exited brewing to concentrate on on-trade retailing (and thus are now classified as retailers) or were acquired by Wolverhampton & Dudley.

(c) Other smaller traditional integrated brewer/retailers such as Youngs, Fullers and Shepherd Neame. These companies tend to mainly brew ale and are likely to be stronger in the on-trade.

(d) Branded imports (other than those marketed in Great Britain by companies already mentioned), which are almost all sold in packaged rather than draught form.

(e) Imports and contract production for retailers' own label brands, predominantly of packaged products for the off-trade.

(f) Micro-brewers, brewing very small quantities of specialist products.

4.56. In assessing post-merger market shares, we have taken into account the contractual position regarding the Heineken owned brands, as described in paragraphs 3.28 and 3.29. Until the contract between Heineken and Whitbread is terminated, Whitbread is responsible for marketing the Heineken brands [*Details omitted. See note on page iv.*]. When the agreements terminate, the Heineken brands will continue to benefit from their current awareness with consumers and previous marketing, and there seems no reason why they should not maintain their current market share in the off-trade (which accounts for [✂] per cent of the Heineken brands' sales). In the on-trade, however, Interbrew would in principle be able to encourage retailers to replace the Heineken brands with alternative brands: this applies in particular to supplies to the Whitbread outlets[1] (which alone currently account for [✂] per cent of the Heineken brands' current sales). Future market shares are speculative, but as a guide to what would happen after the termination of the contracts assuming everything else was the same as in the past, we consider it appropriate to look at a notional post-merger market share for Interbrew in between that including and that excluding the Heineken brands. On this basis, Interbrew would have a post-merger market share of 33 to 38 per cent.

4.57. The HHI is a measure of concentration, calculated by summing the squares of the individual market shares, and Table 4.9 also shows values of the HHI before and after the merger. Depending on the treatment of the Heineken and Murphy's shares, the effect of the merger would be to increase the HHI by about 400 to 700 and the post-merger HHI would be about 2000 to 2300. By comparison, in the USA the Department of Justice and the Federal Trade Commission have issued joint guidelines under which a merger may be challenged if the change in HHI is more than 50 and the post-merger HHI is more than 1800.

4.58. Table 4.10 shows market shares over a longer period. Concentration has increased over time primarily due to mergers. Table 4.10 also shows that the share of the largest brewers (and their predecessors) has fluctuated little over the last 15 years.

TABLE 4.10 **Market shares over longer term**

per cent

	1985	*1991*	*1996*	*1999*
Largest brewers				
Grand Metropolitan*	12			
Courage*	9	21		
S&N*	10	11	28	26
Bass Brewers	22	22	22	23
WBC	11	12	13	14
Carlsberg-Tetley†	13	12	15	12
Total	77	78	78	75
Guinness	7	6	6	6
Anheuser-Busch			3	3
Carlsberg†	3	4		
Others	13	12	13	15
Total	100	100	100	100
HHI (pre-merger)	1,157	1,386	1,720	1,625

Source: The 1989 and 1997 reports and Table 4.9.

*Courage acquired the Grand Metropolitan breweries in 1990 and this busineses was acquired by S&N in 1995.

†Carlsberg acquired breweries of Allied-Lyons in a series of transactions over 1992 to 1997. The combined UK business was named Carlsberg-Tetley.

4.59. Table 4.11 shows Interbrew's and Bass Brewers's market shares and HHI indices by product segment and region.[2] Table 4.9 shows that the product and, to a lesser extent, regional strengths of the two companies tend to be complementary. There is no product segment where both companies have market shares above the average for Great Britain and the only TV region where this is true is the Harlech and Westward (Harwest) television region covering Wales and the West country. As a conse-

[1][*Details omitted. See note on page iv.*]

[2]Table 4.11 is based on A C Nielsen sampling data. Hence, market shares are not exactly the same as in Table 4.9, which is based on brewers' sales data.

quence, the weighted average of the increases in HHI at segmental or regional level is slightly less than the increase in the HHI for the total British beer market.

TABLE 4.11 **Product segments and regional data, 1999**

Market share

	Bass Brewers	*WBC (excluding Heineken brands)*	*WBC (including Heineken brands)*	*Total (excluding Heineken brands)*	*Total (including Heineken brands)*
Total market	21.8	10.5	15.2	32.4	37.0
Product segment					
Standard lager	34.5	2.0	12.3	36.5	46.8
Premium lager	9.7	27.5	29.8	37.2	39.5
Standard ale	19.4	11.4	11.4	30.8	30.8
Premium ale	22.9	6.7	6.7	29.6	29.6
Stout	0.5	1.3	10.9	1.8	11.4
Weighted average	21.8	10.5	15.2	32.4	37.0
Television region					
London	10.0	11.9	16.6	21.9	26.6
Meridian	12.3	14.0	23.2	26.3	35.5
Anglia	14.5	12.3	17.5	26.8	32.0
Harwest	27.6	11.6	17.7	39.2	45.2
Central	31.6	7.5	11.7	39.1	43.4
Granada	19.0	15.9	22.1	34.9	41.1
Yorkshire	24.5	8.5	12.6	33.0	37.0
Tyne Tees	21.9	4.2	6.4	26.1	28.3
Scotland	37.3	3.0	4.1	40.3	41.4
Weighted average	21.8	10.5	15.2	32.4	37.0

HHI indices of concentration

	Pre-merger	*Post-merger (excluding Heineken brands)*	*Post-merger (including Heineken brands)*	*Change on pre-merger (excluding Heineken brands)*	*Change on pre-merger ((including Heineken brands)*
Total market	1,545	1,906	2,209	361	664
Product segment					
Standard lager	2,524	2,620	3,374	96	850
Premium lager	1,684	2,091	2,262	407	578
Standard ale	1,466	1,909	1,909	443	443
Premium ale	1,193	1,501	1,501	308	308
Stout	7,530	7,506	7,541	-24	11
Weighted average	2,290	2,546	2,882	256	592
Television region					
London	1,775	1,900	2,107	125	332
Meridian	1,617	1,703	2,190	86	573
Anglia	1,272	1,500	1,778	228	506
Harwest	1,610	2,111	2,584	501	974
Central	1,661	2,071	2,403	410	742
Granada	1,462	1,870	2,302	408	840
Yorkshire	1,763	2,110	2,377	347	614
Tyne Tees	1,978	2,145	2,259	166	281
Scotland	2,469	2,684	2,772	215	304
Weighted average	1,718	2,014	2,323	296	605

Source: CC calculations based on A C Nielsen data.

4.60. As part of our survey of on-trade retailers (see Appendix 4.4), we asked respondents to name the three closest alternatives to seven leading brands of Interbrew and Bass Brewers. This again showed the complementary nature of the two companies' brand ranges, with products of the other merging party appearing only as third most popular alternative in the case of three out of the seven brands (see Table 3 of Appendix 4.4). In six out of seven cases, an S&N brand was the most popular alternative.

Distribution

4.61. Table 4.12 shows market shares for on-trade distribution over 1996 to 1999. The four largest brewers also have the largest shares of distribution, although WBC's share as an on-trade distributor is considerably lower than its share as a brewer. This reflects its weaker on-trade than off-trade share, that it has not gained any contract distribution business and also, we were told, WBC put more emphasis on distribution through independent wholesalers. By contrast, reflecting their strength in the on-trade, Wolverhampton & Dudley, Greene King and smaller brewer/retailers have a larger share of on-trade distribution than of brewing. Although, Carlsberg-Tetley's share as a brewer of the on-trade is in decline (see Appendix 4.3), it has sustained its share as a distributor at about 12 per cent by winning contracts to distribute for multiple retailers. Nevertheless Carlsberg-Tetley's share is less than half that of S&N and Interbrew (post-merger) and its unit costs are consequently likely to be higher as costs decline with volume (see Appendix 4.2).

TABLE 4.12 **Concentration in British on-trade beer distribution**

per cent

	1996	*1997*	*1998*	*1999*
Market share by distributor: on-trade*				
S&N	25.6	25.8	26.4	26.4
Tradeteam		22.1	22.2	23.3
WBC	10.5	10.2	9.5	9.4
Carlsberg-Tetley	12.0	12.4	11.4	12.0
Wolverhampton & Dudley	2.3	2.9	4.6	5.2
Greene King		1.5	1.6	2.1
Independent wholesalers†		6.3	6.2	5.9
Others‡		18.9	18.1	15.7
Total	100.0	100.0	100.0	100.0
HHI		1,419	1,436	1,504
Notional post-merger analysis				
Interbrew share§		32.3	31.7	32.7
HHI		1,869	1,857	1,944
Change in HHI		449	421	439

Source: CC based on questionnaire responses by brewers.

*The distributor is the company carrying out the secondary distribution. Contract distribution is included.
†Based on sales to wholesalers by the eight brewers shown in Table 4.9. Excludes any distribution by wholesalers of other beer and consequently may be an underestimate.
‡Includes distribution by smaller brewer/retailers and distribution of packaged beer by non-specialist distributors.
§Including Tradeteam.
Note: Figures cover all distribution to on-trade, not just distribution of draught beer and exclude draught cider distribution. However, draught sales are more than 90 per cent of on-trade sales and cider sales are less than 10 per cent of beer sales.

4.62. Independent wholesalers are estimated to have a share of about 6 per cent: about half of this is accounted for by three national independent wholesalers:

(a) The Beer Seller, recently purchased by HP Bulmer, the leading cider manufacturer;

(b) Matthew Clark Wholesale, also part of the same group as a cider manufacturer which was purchased in 1998 by Constellation Brands, a Canadian company; and

(c) Tavern Group Limited (Tavern), owned by De Vere (formerly Greenalls): De Vere has said that it is actively pursuing the sale of Tavern and that Tavern made a trading loss of £2 million in the most recent six months (this is about half the loss in the previous two six-month periods).

The remainder is accounted for by smaller regional wholesalers. Some e-commerce-based wholesalers have established operations in Great Britain but they have not yet obtained significant market share.

Retailing

4.63. Table 4.13 shows our rough estimates of beer sales by the main categories of on-trade retailer. We estimate that the five largest pubcos together have just over 21 per cent of on-trade sales. This is less than the individual share as a brewer of S&N and Bass Brewers (see Appendix 4.3).

TABLE 4.13 **Approximate share of on-trade retailers, 1999**

	Per cent of beer sales
Largest five pubcos	21
Other pubcos	14
Total pubcos	35
Integrated brewer/retailers	20
Independent pubs	10–15
Clubs	20–25
Other licensed outlets*	10
Total	100

Source: CC.

*Includes hotels, leisure sites, restaurants not owned by pubcos or brewer/retailers.

Competition

Supply of beer

4.64. We believe purchasers can be divided into four main categories:

(a) on-trade brewer/retailers;[1]

(b) other on-trade multiple retailers;

(c) on-trade independent retailers including independent pubs and registered clubs, sometimes referred to as the independent free trade; and

(d) off-trade.

We consider competition in each of these in turn.

4.65. As shown in Table 4.7, the number of retail outlets owned/managed by integrated brewer/retailers has dropped considerably over the last ten years. Nevertheless, brewers still own or manage about 13,000 pubs, of which S&N accounts for about 2,700, and have around 20 per cent of on-trade beer sales. We found no evidence that these integrated brewer/retailers make their brewing operations compete for their retail business. However, most smaller brewer/retailers do not brew lager. Instead, they purchase it from the other brewers, in some cases in bulk rather than kegged.

4.66. On-trade multiple retailers, of which the most important are pubcos, typically purchase beer under supply agreements, often of three to five years' duration.[2] These agreements are non-exclusive but often have minimum-volume obligations and usually incorporate volume-related or over-rider discounts. There may be provisions enabling prices and/or volumes to be renegotiated during the term of the agreement. When negotiating a new agreement, retailers are able to seek quotes from a number of different manufacturers and to promote competition between them. Evidence suggests that the bargaining strength of managed pubcos, which can offer/withdraw access to all their outlets as part of the negotia-

[1]There are now no brewer-owned off-trade outlets.

[2]The former estate of Allied-Domecq (now owned by Punch and BLR) had a ten-year supply agreement with Carlsberg-Tetley. This was put in place as part of the fallback arrangements following the failure of the merger between Bass and Carlsberg-Tetley and now has seven years to run. Interbrew has five-year agreements with BLR and Whitbread plc.

tions, is greater than the bargaining strength of tenanted pubcos which have to take into account their tenants' wishes (see Appendix 4.4). Other factors relevant to retailers' bargaining strength include: their total volume of sales (the greater the volume of sales the greater the pain/gain to suppliers on losing/gaining a contract); the importance of specific brands to the retailers' customers (the more important are specific brands the greater the costs to the retailer of switching supplier); separate distribution and supply contracts (this brings suppliers with a narrow brand range directly into the negotiations[1] and limits the ability of suppliers to use powerful brands to leverage weaker brands).

4.67. Table 4.14 shows Bass Brewers and WBC have offered large average discounts to on-trade multiple retailers and earn low net margins on this business. This appears to reflect the bargaining strength of the larger multiple retailers and the strong competition, up to now, between the existing brewers to supply them. This situation has arisen despite the low market share of large retailers relative to large brewers and the existence of some switching costs for retailers (see Appendix 4.4).

TABLE 4.14 **Prices, discounts and net margins by customer channels, 1999**

£ per hectolitre

	Multiple retailers	*Independents*	*Other brewers*	*Wholesalers on-trade*	*Off-trade*
Bass Brewers					
Volume (%)*					
List price					
Discount					
Net price					
Costs					
Net margin					
WBC					
Volume (%)*					
List price					
Discount					
Net price					
Costs					
Net margin					

Figures omitted. See note on page iv.

Source: CC based on information supplied by companies.

*Own estate accounted for [✂] per cent (Bass Brewers), [✂] per cent (Whitbread) by volume.

4.68. Independent on-trade outlets account for a declining proportion of all on-trade outlets: the higher price they pay for beer (see Table 4.14) creates an incentive for outlets in private ownership[2] to sell to a pubcos (which should be able to generate higher profits from higher margins and/or higher volume through lower retail prices) and we were told such sales were taking place. Nevertheless, independent outlets continue to be an important part of the on-trade, accounting for about 35 per cent of on-trade beer sales.

4.69. Some independent outlets continue to be loan tied (see footnote to paragraph 4.40) but Interbrew told us that it estimated the value of loans by national brewers had nearly halved over the last seven years. As noted above, loans can be repaid within three months so that even loan-tied outlets can change supplier without too much difficulty. Other (not loan-tied) independent outlets do not usually enter into formal contracts but purchase on a less formal basis either directly from manufacturers or from wholesalers. While prices are negotiated, we were told that in negotiations independents tended to put more emphasis on credit terms and personal relationships with sales and delivery staff than did multiple retailers.

4.70. Table 4.14 shows that Bass Brewers' net on-trade prices (including duty) to independent outlets are [✂] per cent higher than to multiple retailers and that direct cost differences only reduce this to [✂] per cent. Table 4.12 also shows that independent wholesalers are unable to provide low prices to

[1]Where distribution is bundled with supply, suppliers with a narrow brand range face the difficulties set out in paragraph 4.42*(a)*.

[2]The incentive for member-owned clubs to sell out is less clear.

independent outlets: the price difference between pubcos and independent wholesalers is [✂] per cent and this increases to [✂] per cent after allowing for cost differences. The results in Table 4.14 are consistent with the suggestion that competition between large brewers to supply independent outlets is much less vigorous than to supply multiple retailers. Interbrew argued that they were equally consistent with the proposition that the power of large buyers meant that it was small buyers who were forced to carry the burden of paying for the fixed costs in brewing.

4.71. Sales of beer through the off-trade are predominantly through multiple grocers, off-licence chains and independent off-licences. In this sector of the market a wide range of brands is typically offered by retailers and the products of the large brewers face more competition than in the on-trade from branded imports and own label products, which may be manufactured overseas or by UK contract brewers. Off-trade prices and volumes are typically negotiated on an ongoing basis and it is not usual for there to be annual or multi-year supply agreements.

4.72. There was disagreement among those giving evidence about the extent of price transparency. Interbrew said that negotiations with retailers were highly confidential and that the terms obtained by individual customers were not known to other players in the market. Interbrew also argued that the complexity of pricing and supply agreements generally would make it impossible to establish another brewer’s prices. Punch argued that discounts offered by one brewer could become known to other brewers through the negotiating process (when one offered a discount, the pubco would look to the other brewer for a better offer). In this context Interbrew told us that there was increasing awareness among independent on-trade retailers of discounts, including from surveys published in the *Publican* newspaper. Punch also argued that, even if the brewers could not establish each other’s net wholesale prices directly, net price changes could be inferred indirectly through their effect on market shares. Market shares were observable through detailed figures published by A C Nielsen every two months and other means, including distribution contracts.

Distribution

4.73. As noted in paragraph 4.41, multiple on-trade retailers increasingly contract separately for beer supply and distribution. We were told that bidding between S&N, Tradeteam and Carlsberg-Tetley for distribution contracts had been vigorous, with WBC, independent wholesalers and entrants also bidding. We received evidence that successful bids were below average cost per hectolitre, probably reflecting economies of density and other fixed costs in distribution.

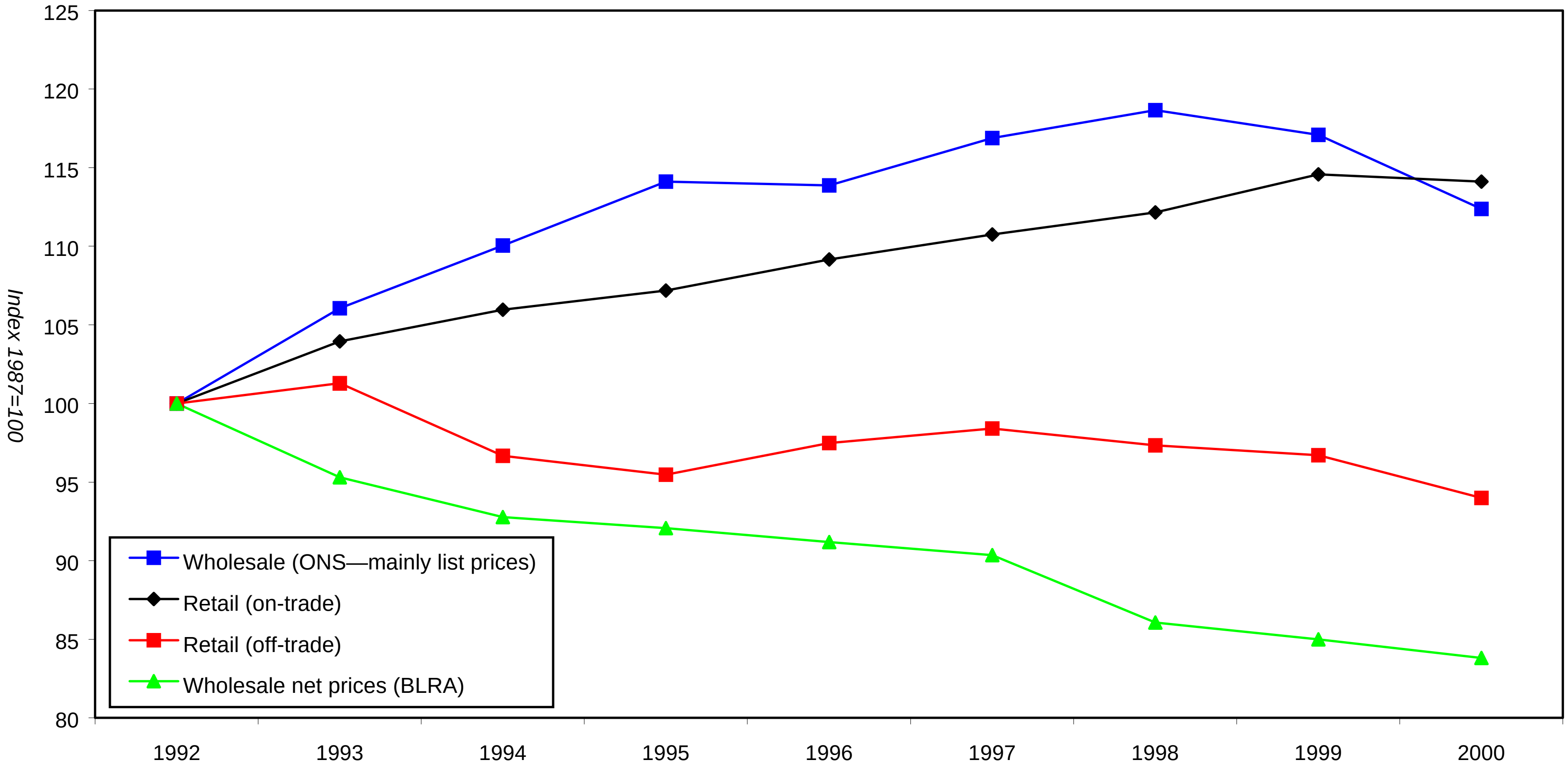
4.74. We received evidence from a number of sources that one large brewer (Bass Brewers), but not the others, had discouraged retailers from contracting separately for distribution by linking the price reductions for unbundling distribution from beer supply with the award of the distribution contract to its associate company, Tradeteam. Bass Brewers told us that this was due to the workings of its contract with Tradeteam (see Appendix 4.5). We were told, however, by one retailer that Bass Brewers charged it about £7.40 per hectolitre for distributing third party beers and we noted that this was more than [✂] the contractual payment it made to Tradeteam for actually distributing the beer (about £[✂] per hectolitre).

Price trends

4.75. Figure 4.7 shows that retail on-trade real beer prices have consistently increased more rapidly than off-trade prices (which have tended to decline). This is a long-standing trend and is likely to reflect improvements to on-trade accommodation and standards of service, rising wages of bar staff and the lack of potential for this to be offset by productivity improvements (the price of restaurant meals shows a similar tendency to increase faster than the RPI). Despite the rising real on-trade beer prices shown in Figure 4.7, there is some evidence to suggest that the retail market has become more competitive over the period. The increase in city centre pubs, at the expense of local pubs, has increased the proportion of occasions where drinkers have a choice of outlet and, additionally there has been a development of retail chains with a reputation for lower-priced beer (in particular J D Wetherspoon (Wetherspoon)).

FIGURE 4.7

Beer price trends (excluding duty, RPI adjusted), 1987 to 2000



Source: ONS (with CC adjustment to exclude duty from retail prices); BLRA.

Note: Figures for 1992 to 1999 are averages for calendar year. Figure for 2000 is average for June and July.

4.76. Figure 4.7 also shows ONS data on wholesale prices (until recently based on wholesale list prices): this suggests that wholesale list prices have increased faster than the RPI.[1] The BLRA index of net wholesale prices reflects trends in the average price paid by customers of the brewers (including tenants but not managed houses) and shows a decline relative to the RPI over the period since 1992. The BLRA index may overstate the decline in net wholesale prices due to the sale by the brewers of tenanted houses to pubcos (which results in the list price paid by tenants being replaced in the index by the discounted price paid by the pubco even though the tenant continues to pay the pubco the same list price previously paid to the brewer). Nevertheless there is no doubt that discounts (both to multiple retailers and independents) have increased over time and it is probable that net wholesale prices to the on-trade have declined relative to the RPI. It should of course be borne in mind that the prices of most goods do decline relative to the RPI (while prices of services tend to increase faster than the RPI): over the period 1992 to 2000, the Producer Price Index for all manufactured goods declined by about 2.5 per cent relative to the RPI while the index for all products of the food, beverages and tobacco industries declined by about 7 per cent relative to the RPI.

[1]The index now reflects net wholesale prices rather than wholesale list prices: this probably explains the decline in the last two years.