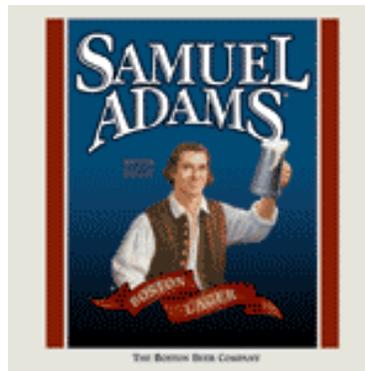


The Boston Beer Company



BEM106 Final Project

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Overview

The Boston Beer Company has had amazing success in its transition from a small scale microbrewer to a large scale national brewery. Almost all of the company's success is due to the Samuel Adams Lager product line, which has hardly changed from the founding of the company in 1984, to the IPO in 1995, to the present day. In fact, much of the appeal of Samuel Adams comes from its microbrew image and the founder, Jim Koch's, commitment to the brewing process and a premium beer. In recent years, however, the company has implemented a new strategy for growth which has included introducing a light beer that will have more mainstream appeal. While this has increased profits for the company, it has also left the company vulnerable to entry by diluting its brand name. For this reason, the company's strategy for the immediate future has to make a significant shift, from a strategy of growth to a strategy of protection. It must focus on maintaining its current profits by preventing entry both from small breweries looking to copy the BBC's strategy and from large breweries looking to use their expansive resources to steal some of BBC's market share.

History of Boston Beer

The Boston Beer Company began as a microbrewery in Boston, Massachusetts in 1984. Its first cases of beer were only sold to Boston bars, but the company quickly branched out geographically. Fueled by awards and recognition from prestigious beer festivals, Samuel Adams Boston Lager was available on much of the East Coast by the late 1980's and nationally by 1992. The company went public on the New York Stock Exchange in 1995.

The Boston Beer Company's strategy for growth was one of differentiation. The company created a higher quality beer than the majority of American beers by using more expensive ingredients and less water, and it used its packaging and its commercials to advertise this commitment to quality. In fact, because of its use of only barley, hops, yeast, and water as its ingredients, Samuel Adams won the honor of being the first American beer to be sold in Germany, a distinction that helped its image in America even more.

One business strategy that the company employed as it started to grow was using extra brewing space in other company's breweries to brew their beer. Since the company was growing at a double digit rate, it didn't have a lot of extra capital to build its own breweries, so this was a good strategy for them during their period of growth. And, since these breweries were distributed throughout the country, this strategy allowed the Boston Beer Company to maximize the freshness of the beer it sold. In fact, the now famous practice of printing a freshness label on bottled beer was started by the Boston Beer Company on its Samuel Adams Boston Lager. The company ensured quality production in these dispersed breweries by hiring experienced brewmasters to oversee the contract brewing. The company also brewed some beer on its own property, both in Boston and later in a plant they purchased in Cincinnati, Ohio.

In 2002, the company took a risk by introducing Sam Adams Light, a light beer version of their Samuel Adams Lager. They had never produced a light beer before, and it was Koch's stance that the company couldn't brew a light beer that would be up to their standards of flavor. The expanded customer base that the company would target with the sale of a light beer was too lucrative a market to ignore, however, and the light beer market was almost devoid of any Better Beers, so after three years of development Sam Adams Light was born. The advertising expenditures for 2002 increased by 25.7% or \$20.6 million over 2001 due to the promotion of Sam Adams Light², which magnified the financial risk of producing and selling it. The new beer had the short term effect of attracting new consumers to the Samuel Adams brand, although the long term effect has yet to be seen.

The growth of the Boston Beer Company was very impressive, and can be attributed to a superior product, good business strategy, and an unsaturated market for high-quality beer. But now there are new challenges facing the company. There are always new fads in the beer industry; current trends are low-carb beers and fruity-flavored malt beverages. The Boston Beer Company needs to decide which of these trends to respond to, and how to respond to each. Above all the company needs to continue its strategy of differentiation that allowed it to achieve its current profitability. It is its image for quality above major American beers like Budweiser, Coors, and Miller that allows it to keep its prices, and its profits, high.

Current Industry Analysis

The Boston Beer Company's product is a "better" beer. A better beer is defined as either a craft beer or an import, and is characterized by higher prices and quality. A craft beer is defined as one which is brewed with 100% malted barley as its grain. The major American beer companies typically use a mixture of malted barley along with other grains such as rice or corn, since these are less expensive and have less full-bodied flavors. Rivals in the better beer industry include such foreign companies as Corona, Heineken, and Guinness, as well as domestic companies such as Sierra Nevada, Pete's, and a number of microbreweries around the country. While the beer industry overall is very rivalrous, the better beer industry is not so, as evidenced by high profit margins (the Boston Beer Company routinely posts profit margins of over 50%). The rivalry that does exist tends to revolve around quality competition rather than price competition.

There are numerous substitutes for better beer. All alcoholic beverages are substitutes for the Boston Beer Company's product, although the two closest substitutes are major American beers and flavored malt beverages; wine and spirits are less relevant substitutes for the purposes of this analysis. Budweiser, Coors, and Miller are all large brand name beers which have low prices and low quality compared to better beers. Price sensitive consumers typically buy these beers. Smirnoff Ice, Skyy Blue, and Bacardi Silver are all similarly priced to the better beers, but they have fruitier flavors and therefore appeal to consumers with a different taste preference.

The suppliers for the Boston Beer Company are similar to the suppliers for any brewery. Supplies that must be purchased include the ingredients like water, barley and hops, the equipment for brewing, and the transportation for distributing beer around the country. The ingredients are actually very inexpensive compared to the other two costs, and suppliers of barley and water don't have a lot of bargaining power since these industries are fragmented. The hops industry, however, is more centralized. In order to ensure adequate hops supplies at prices known in advance the company regularly purchases hops futures. The company also employs an aggressive contract brewing strategy. Under this policy almost 60% of the company's products are brewed at non-company owned breweries. By utilizing the excess capacity of geographically distributed

breweries, the company can keep equipment and transportation costs low while providing a fresher and thus higher quality product. This brewing approach carries inherent risks by giving potential rivals some control over the company's production capacity. Indeed the company is currently involved in a lawsuit with Miller after Miller's attempt to back out of a brewing contract early. To protect itself from these risks the company enters into contracts with a diverse set of brewers for a much larger amount of beer than they actually produce. This redundant capacity is meant to shield the company from any number of contract brewers defaulting on their contracts.

Buyer bargaining power doesn't have significant influence on the Boston Beer Company since their buyers are grocery stores and bars. The grocery industry and the bar industry are both fragmented, so each store or bar that buys from the Boston Beer Company comprises a very small amount of total company sales, and the loss of any one buyer won't significantly hurt the company.

Complements in the better beer industry include the popularity of bars, snack foods like pretzels and nachos, and sporting events like football games. While the Boston Beer Company doesn't provide any of these complements, they do provide some amount of customer education. Customer education includes advertising awards the company has won, advertising their brewing processes, and calling attention to their premium ingredients. This serves to convince people of the superior quality of Samuel Adams, thereby convincing them to pay a premium price. Customer education is a fairly clever and successful strategy for a number of beer companies, but it benefits better beers more than lower quality beers, so the Boston Beer Company could probably take advantage of this by focusing more on customer education. The BBC also has an advantage over small high-quality breweries because its economy of scale allows more customers to be reached per dollar spent on customer education.

Any company in the beverage industry has the potential to enter Samuel Adams' market, and it is always crucial for a company to be aware of possible entry from all sides. Companies that make wine, spirits, or malt beverages could all enter the market, and we have actually seen in recent years that spirits companies have been expanding into new markets by producing malt beverages under the name of the parent spirits company. However, the most dangerous potential entrants would be other beer companies. Other

craft breweries that sell their beer on a small scale might attempt to copy the BBC's strategy to grow into a national brand and steal some of BBC's market share. Also, major American breweries could use their expansive resources to brew high quality beers that could compete with Samuel Adams on a national level. A third, and even more threatening possibility, would be the combination of these two forces; a major brewery could buy a high quality microbrewery and use their national advertising and distribution infrastructure to market the microbrew to the public on a large scale. Given the Boston Beer Company's high profit margins and the relatively low level of rivalry within their market, it is very likely that entry will occur and erode away at BBC's profits if BBC is unprepared. We believe that responding to this possibility should be at the forefront of the company's business strategy for the immediate future.

The Boston Beer Company's Strategy: Using Reputation as an Entry Barrier

The BBC's initial strategy was one of growth. This was fitting for it when it was a microbrewery looking to gain national and international sales. During its expansion in the early 1990's, the company took advantage of the fact that consumer demand for craft beers was increasing, while there were few other companies doing the same. Since the new market was unsaturated, the Boston Beer Company was able to earn an inexpensive reputation for its Samuel Adams brand name by being the first large scale mover into the national craft beer market. By the late 1990's, the BBC's growth rate had begun to decline. In an effort to keep up growth, the company switched to a strategy of trying to increase the demand for craft beer. It did this through large scale advertising, and most significantly through the introduction of a light beer that brought light beer drinkers over to the better beer market.

The Boston Beer Company's strategy was an effective one for many years, and enabled it to become the profitable national company that it is today. However, if the BBC wants to maintain its profitability, it will need to find a way to protect its market share from entrants, and this will require a shift in the company's strategy back to increasing its share of the Better Beer market rather than of the mainstream market. The biggest threats to the BBC are the major American beer companies, which have massive resources that would allow them to compete with the BBC. The BBC's two advantages

over these major companies are experience and reputation, and the major companies could easily gain experience by buying an existing craft beer company and utilizing its brewing procedures. Therefore, the BBC must protect its reputation at all costs, since its reputation is the only formidable entry barrier preventing Budweiser, Coors, and Miller from successfully invading Samuel Adams' market. The company's best strategy would be to slow their growth in order to work on strengthening their Samuel Adams Boston Lager brand name. Additionally, if the BBC diminishes its focus on growth, it could very well have the effect of reducing the incentive for these three major companies to enter the craft beer market, since the BBC will not be seen as so significant a threat. While there is a risk that slowing growth will leave the company vulnerable to entry by smaller companies, it is the large companies that have the most resources to compete with the BBC, so reducing the incentive for large companies to enter is worth the possible risk that more small companies will enter.

The uniqueness and integrity that allowed the Samuel Adams brand to gain popularity are starting to be overshadowed by the company's attempts to gather more mainstream consumers, and this is hurting the company's brand name. The strategy for the future needs to focus on building back customer loyalty for the company's core product line, i.e. Samuel Adams Boston Lager.

First and foremost, the Boston Beer Company needs to continue reducing its expenditures on Sam Adams Light. During the introduction of Sam Adams Light in 2001-02, revenues and gross profit increased, but expenditures on advertising Sam Light were extremely high, and much of the sales of Sam Light were thought to be due to cannibalism of Samuel Adams Boston Lager. In 2003 when advertising of Sam Adams Light was decreased, sales of the light beer dropped significantly. Although Samuel Adams Boston Lager sales increased during the period between the fourth quarters of 2002 and 2003, overall shipments dropped 6% during this period³ because of the lowered demand for Sam Light after the decline of the Sam Light marketing campaign. However, even though sales were lower, net income was higher after the end of the marketing campaign⁴. The company should therefore continue to keep its advertising levels for Sam Adams Light low.

In addition to the high financial cost of advertising Sam Adams Light, it is likely that the large-scale marketing of Sam Adams Light could hurt the company in the long run by diluting the Samuel Adams brand name. The purpose of Sam Light is to appeal to mainstream beer drinkers, but the company's consumer base is comprised of individuals who pride themselves on drinking a beer that is not mainstream. With potential entrants looming from above and below, the Boston Beer Company can not afford to lose its reputation for uniqueness. Still, Sam Light is a good revenue stream as a supplement to Samuel Adams Boston Lager, but it should cease to be the company's main focus.

The "Twisted Tea" and "Hard Core" products are malt beverages that the company produces on a small scale. These brands are unnecessary for the company's success, and if the company adopts a strategy to focus on Samuel Adams Boston Lager then it would be advantageous to eliminate these products. While the products dilute the company's brand name in a similar way to Sam Adams Light, they don't provide nearly the revenue that Sam Light does. By either selling or closing down these brand names, the Boston Beer Company can distance itself further from the malt beverage industry and improve its positioning as a Better Beer company. Dumping these products would help the BBC's image of integrity in the eyes of their consumers, and this image will be crucial if the company is to protect its market share from entrants.

There have been a number of attempted entries into the Sam Adams market which demonstrate the need for quality and reputation. Coors owns Killian's Irish Red and Anheuser-Busch owns Michelob and has a stake in Red Hook, all brands that have had poor success in the Better Beer Market. Most consumers are well aware of the fact that Michelob is just another domestic beer sold at a high price, and so it's a brand without much of a quality image. On the other hand, it's not well known that Coors owns Killian's since it's brewed in Canada and has an import label. While this label might signal some quality in many consumers' eyes, Killian's has no reputation and no customer base. Finally, Red Hook was a quality microbrew ale with a good reputation and customer base that was bought by AB. Since this purchase in 1994 the stock price of Red Hook has plummeted from ~30 to 2 and sales have been poor. While the reason for this is not exactly clear, it's possible that this failure is due to a loss of integrity that occurred when the microbrew became owned by a major domestic brewer, or that AB

simply wasn't able to operate that type of brewery. AB's failure in this attempt doesn't indicate that they will give up on entering the craft beer industry, however, especially if craft beers grow to be more of the national market.

With such high profit margins and a strong market position, the BBC might be tempted to increase sales by decreasing prices, but this strategy should definitely be avoided. The high prices for Samuel Adams Boston Lager and Sam Adams Light signal to consumers and other companies that these beers are of higher quality, and since demand in the Better Beer market is relatively inelastic, there would likely be no increase in net income if prices were reduced. Reducing prices would cause the BBC to appear more of a threat to the three major American beer companies, and could therefore expedite the entry of one of these companies into the market. Due to the nature of the Better Beer industry, the company needs to strive for quality competition over price competition.

With the introduction of Sam Light in 2002 the percentage of BBC's sales comprised of bottles vs. kegs increased since most Sam Light is sold in bottles, and since Boston Lager sales declined slightly. While revenues are lower per barrel of draft beer, profit margins are higher due to lower costs per barrel. Additionally, beer served on tap is usually able to retain a higher quality than beer served from a bottle. For these reasons and others, it would be a good strategy for the Boston Beer Company to increase its emphasis on selling its beer in kegs to bars. While most grocery stores already carry Samuel Adams Boston Lager, there are still a large number of bars that don't have Boston Lager on draft, and this deprives many consumers of being able to drink the beer in its highest quality form while also depriving the company of the added revenue that bar sales bring in. Since the company's new focus needs to be on emphasizing the quality of its beers, increasing the availability of its draft beer is in line with its strategy. An added benefit of increasing prevalence in bars is the opportunity for bartender education and consequent consumer education. The company should seriously consider providing literature about their beer along with the kegs that they sell to bars, since educating bar owners and bartenders about the premium ingredients and freshness standards that the company holds will have a trickle-down effect to the beer drinkers.

Continuing with this strategy of edging away from the mainstream, the Samuel Adams line should switch back to its original label. The current label is simple with few colors, similar to the major company labels, while microbrew labels typically have a more complex picture that distinguishes the brand. Switching back to the “Brewer-Patriot” label would signal to both new and old customers that the BBC is committed their roots and to quality.

Putting Excess Capital to Use

If the BBC continues to be successful in fending off potential entrants and if it maintains its high profit margins while staying away from a growth strategy, then it needs a plan for investing its profits. In the past, profits have been invested in growth or in stock of other companies, but in line with the new strategy of slow growth, there might be areas in which their money could be better invested. Some of the money could be used to fund the customer education programs mentioned earlier, but it might also be wise to start owning more breweries. Contract brewing proved to be efficient and successful during their growth phase. Up until the late nineties they were increasing sales by double digits each year. At this time it would have been difficult to impossible for production capacity to keep up with sales, not to mention for the company to secure the necessary capital. However, in the past 5 years growth has slowed, and consistently high profits have led to large amounts of excess capital. BBC has been keeping some capital liquid in short term bonds and mutual funds and using the rest of the capital to buy back company stock⁴.

There are several reasons why contract brewing makes less sense now. First, the BBC has run into situations in which being a contract brewer has hurt the company’s reputation. Anheuser-Busch used a dateline interview and ran a series of attack ads claiming Samuel Adams Boston Lager was no different from other domestic beers since much of it was made in the same breweries as these domestic beers⁵. The ads were eventually dropped when an advertising watchdog group found the ads to be factually incorrect, but the damage had been done⁶. Brewing all of their own beer would insulate them from such claims, reinforcing their reputation. Additionally Miller tried to back out of a large brewing contract⁷. BBC won in arbitration, but millions were lost in legal expenses and backup contracts which were never realized. The dispute also brought

more attention to the fact that some Samuel Adams is made by the majors, diluting their brand name more.

BBC already produces half of their own product, and sells excess capacity to other brewers. This indicates that the company already has the experience and know-how that it needs to operate their own breweries on some scale. With so much capital available and sales growth slow, BBC should purchase a few local breweries around the country to produce all of its product. Excess capacity in these breweries can be contracted out as is currently done in the company's Cincinnati plant. By owning and operating their own breweries, the BBC can avoid the damage to its reputation as well as the contract disputes that it has to incur by operating as a contract brewer.

Conclusions

The Boston Beer Company has shown that it has a successful business strategy for growth. The company's management now needs to show that it can maintain its profitability at its current level by adopting a strategy that creates barriers for entry into the national craft beer market. Many conventional entry barriers can be overcome by either regional microbreweries, which have the experience necessary to brew quality beers, or by major American breweries, which have the resources to market a new beer nation-wide. The one significant entry barrier that the Boston Beer Company still holds on to is its good reputation, which it gained both by being an early mover into the national craft beer market and by maintaining strict quality controls. As the company has matured it has drifted away from its reputation of uniqueness. In order for the company to maintain its hold on the American craft beer market, it will need to revive its reputation at all costs. Because the company's growth has slowed, it has an opportunity to use its excess capital to fund programs that help bolster its image as a high quality, high integrity brewer. If it continues to differentiate itself from major American breweries like Budweiser, Coors, and Miller, then despite the Boston Beer Company's smaller resources, it should still be able to hold its consumer base and protect its profits from entry into its market.

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