

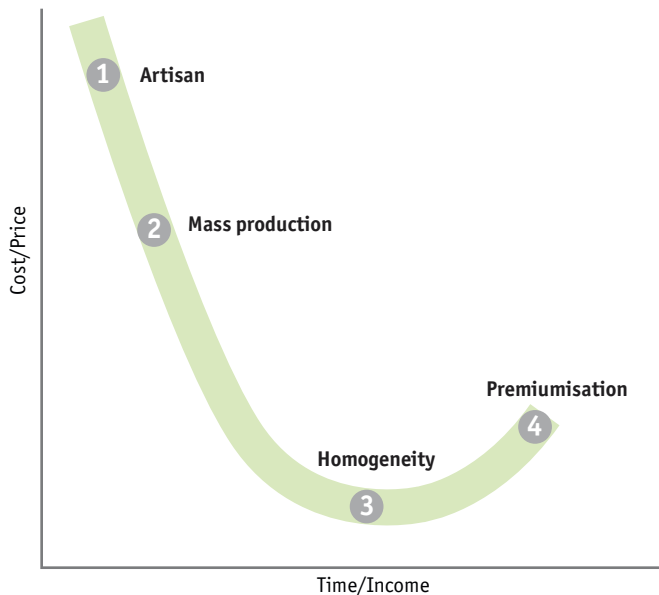




## REVOLUTIONS ARE BUILT ON HOPS

The global implications of the craft beer revolution for major brewers

### J-Curve conceptual framework



The J-Curve explains how consumer goods markets develop over time. We divide a market's life cycle into four stages.

1. **Artisan.** The product is made and sold locally. For beer, the artisan stage was characterised by small batch production by local brewers in the 18th century.
2. **Mass production.** Industrial manufacturing improves the product's quality while simultaneously lowering its price. Innovation during the industrial revolution streamlines production and increases quantity available.
3. **Homogeneity.** Companies become maximally efficient at making the product, but consumers become bored of the limited number of product options. Clear lagers become synonymous with beer and companies compete primarily on advertising.
4. **Premiumisation.** Wealthier consumers pay more for "premium" products. "Premium" can mean artisanship, higher-quality ingredients, local production and an overall appearance of authenticity. The value proposition of products is higher than those in the homogeneity stage. In the US, the development of premium began with global imports like Heineken and Stella Artois, subsequently shifting to craft beer.

Traditional pricing models suggest that companies should regularly reduce their products' prices by leveraging manufacturing efficiencies. But the J-Curve framework shows that both product differentiation and higher prices can spur growth within efficient markets.

The emergence of craft beer in the US provides an example of an industry's transition from the homogeneity stage to the premiumisation stage. Its development was driven by changing values within affluent consumers, new technology and social media that allowed brewers to talk directly to customers, as well an advantageous route to consumers through an open distribution system.

During the early 2000s the US beer market consisted primarily of standardised light lagers that were produced by major manufacturers. Premium beers during this period were personified by global imports like Heineken and Stella Artois capitalising on a sentiment of globalisation and quality of bottle presentation. The liquid formulations were not fundamentally different to local lagers in terms of flavour.

Eventually, the standard lager offering no longer satisfied consumer needs as the share of premium imports in the US peaked around 2008. Tired of the lack of variety and quality, demand increased for locally produced artisanal beers that boasted a wide variety of styles and exciting new flavours. Consumers were willing to pay more for products that were locally sourced, produced with quality ingredients and resonated as authentic. Demand developed in cities with wealthier populations where brewpubs or tap rooms could viably be maintained. A 2012 survey on the craft drinker profile found that 74% of craft drinkers earned more than US\$50,000 per year.<sup>6</sup>

### Craft enablers

While craft beer growth has been driven by this shift in consumer preferences, there are several market factors that have been fundamental to its success.

1. **Open distribution system.** In the US, distributors are primarily independent from brewers. This allows craft brewers access to more outlets at a lower cost per case than if they were required to develop their own distribution network.



2. *On-premise outlets.* Craft breweries have an additional route to consumers through tap rooms and brewpubs on the premises of the brewery. This new channel for consumption resonates with the consumer’s preference for local production and authentic products. The brewpub or tap room extends the consumer experience and connects the drinker with the brewer while excluding the larger commercial brands from this new and growing sales channel.

3. *Social media marketing.* The emergence of social media platforms like Instagram, Facebook and Twitter coincided with the craft beer boom and reduced the cost of marketing. Brewers could develop direct relationships with consumers.

These factors have helped the craft industry build a widespread reputation for authenticity with its consumers, as well as supporting a route-to-market for its products. Signalling authenticity has been critical in appealing to changing consumer values and the success of craft. While authenticity can be difficult to measure, it usually falls into one of two categories: “type” authenticity and “moral” authenticity. Type authenticity means that a product fits well within its product category. For example, homebrews made

from local ingredients are often considered more “real” than national brands. Moral authenticity, on the other hand, means that consumers believe a company acts in a distinctly ethical way.

Craft breweries satisfy both authenticity categories in the US. American consumers not only view craft beers as more “real” than national brands, but they also see them as a force for public good. In major cities like Portland, Oregon, craft breweries are believed to help neighbourhoods by fostering pride in local artisanship.<sup>7</sup> Small towns may gain even more from craft breweries, since these companies can serve as social hubs, create new jobs and increase tourism.<sup>8</sup>

The power of such authenticity is difficult to overstate. A recent survey found that one-third of American consumers will pay at least 10% more for the “craft” version of a product. This preference gives small breweries a huge pricing advantage over bigger companies (which are often deemed inauthentic). Furthermore, because these large-scale competitors cannot easily attack the authenticity of craft beers, this competitive advantage is likely to remain in place.

**A global trend**

The trend for consumers to pay more for authentic and differentiated products extends beyond beer and into a broad range of other consumer markets, from handmade soap to craft toothpaste. This trend has also spread into other sectors of the alcohol industry. Spirits have experienced a proliferation in craft offerings, following the lead of craft beer.

Tito’s Handmade Vodka, which is produced in Texas, captured the US’s latent demand for an American-manufactured vodka. The brand was founded in 1997 but began to grow significantly at the end of the 2000s following the push for local and authentic offerings. In 2016 sales of Tito’s increased by more than the next ten largest vodka brands combined.<sup>9</sup>

The premiumisation of the beer industry through craft is far from limited to the US. The trend is well established in northern Europe<sup>10</sup>, and elsewhere markets are moving along the J-Curve towards premiumisation.

**What is authenticity?**



“When people are attracted to your moral authenticity, it gives them a unique attachment to your product or service, because your identity is inalienable. Nobody else has your story, and no one can take it away from you. That’s the ultimate strategic position a firm can have.”

Glenn Carroll, *Authenticity’s Paradox* (August 2016)













