



UNILATERAL CONDUCT WORKING GROUP DECEMBER 2-3, 2010 WORKSHOP

Case Study – Loyalty Discounts & Rebates

Background

1. Cerveja is the largest brewer in ICNland with a national market share of 73% of all branded beer sales. It sells one brand of beer and has held a greater than 70% market share for the last 20 years. Cerveja is headquartered in ICNland and has annual global turnover of approximately \$1 billion.
2. ICNland is middle income country, with a hot climate, a few very large cities and large mainly rural regions with smaller towns and cities as centres for the largely agricultural and mining economic bases of the regions. It has three states: Urbania, Mineralia and Agrilandia.

Beer Sales Market(s) & Distribution

3. In ICNland there is a downstream retail beer sales market, consisting of two main types of sellers. (1) Seventy percent of ICNlandian beer is sold in unrefrigerated bottles or cans by large supermarkets. (2) Thirty percent is sold in chilled bottles in small retail outlets, most of which double up as bars. A very small proportion (<1%) is sold in high end pubs and restaurants, including some served from kegs 'on tap'.
4. For decades, Cerveja has been the most popular brand of beer in ICNland, with widespread consumer appeal. As a result, sellers in both distribution channels have generally maintained around 70% to 80% of their stocks as Cerveja brand beer. This reflects local taste, as reflected in historic demand for Cerveja beer. Smaller outlets have generally stocked a higher share of Cerveja than the supermarkets.
5. Cerveja and other beer manufacturers sell their products directly to the two categories of downstream outlets. Existing ICNland health regulations prevent the commercial importation of beer brewed abroad, meaning that all beer sold in ICNland is brewed within the country.
6. Based on industry data, the national market share of Cerveja and its competitors in the downstream distribution of beer to all retailers is the following:

Table 1

Company	2007	2008	2009
Cerveja	80%	76%	73%
Hollandia	18%	23%
Pappabeer	13%
Others	7%	6%	4%

7. Hollandia’s share growth has mostly occurred in sales to supermarkets as opposed to sales in smaller outlets.

The competitors to Cerveja are the following:

8. **Hollandia** is a leading international brewer and distributor of beer, with operations in 20 countries, including in ICNland. It entered ICNland in 2008 through its acquisition of **Pappabeer**, which traditionally was the second largest brewer and distributor of beer in ICNland. Hollandia’s annual global turnover is around \$10 billion, ten times the size of Cerveja’s global turnover. Hollandia rebranded Pappabeer’s one and only brand as “Hollandia Brew” in 2008, and grew its market share by more than one third – from 13% to 18% -- within a year. Since its acquisition of Pappabeer Hollandia as invested \$50 million in modernizing Pappabeer’s existing brewing facilities, in addition to building two new modern brewing facilities within ICNland. (Cerveja has not made a major investment in its beer production facilities since 1990, other than incremental expansions to existing facilities and routine maintenance.) In 2008 Hollandia also announced that it will be looking for “new up and coming” local beer brands to “grow its portfolio” in ICNland. .
9. The “**Others**” are comprised of around 30 small local breweries located throughout ICNland. No small brewer has an annual turnover of more than \$50 million. The number of small local breweries has been contracting over the past 20 years, and few new brands have been introduced during the last 5 years. The local brewers products have a shorter shelf life and do not have the same type of distribution networks meaning they cannot provide the same guarantee as to frequent deliveries and deliveries on short notice. The smaller brewers generally have had a larger impact in the small retail outlets, compared to supermarkets. Specifically, no new small brewer has been able to penetrate the supermarket sector in the past 5 years, nor have existing small brands carried by large supermarkets been able to raise their small market shares during that time.
10. Retail beer sales markets are local in ICNland. Consumer prices vary in different retail markets, depending upon income levels, number of competitors (some localities have many small outlets and supermarkets, others very few), local taste, and other factors. Within a local market, prices per unit of beer sold are the lowest in supermarkets, with small outlet prices somewhat higher; differences between supermarket and small outlet prices vary according to the local market. Large supermarkets are in middle and upper income areas, in the bigger cities, along with many smaller outlets, that also stay open much later.

11. Since its entry into ICNland in 2008, Hollandia has focussed mostly on growing its sales of Hollandia Brew through large supermarkets. It has done this through national marketing campaigns and promotions. Its sales of Hollandia Brew in the other sectors have been more limited so far.
12. Traditionally, distribution through small retailers and bars has been critical to the introduction and market growth of new small beer brands. New small brands initially do not have the capital to support the national media advertising campaigns, large-scale distribution networks, or favourable shelf space placements to induce large supermarkets to carry them. Moreover, the small retailer channel is viewed as important to build consumer recognition and loyalty. No new brand has entered the large supermarket channel in over 5 years, nor have existing small brands carried by large supermarkets been able to raise their small market shares during that time. Indeed, very few new brands have entered the market in recent years.
13. Cerveja, which is carried by all large supermarkets, negotiates individual contracts with different supermarket chains.
14. A cost breakdown for Cerveja, as given by Cerveja in a presentation to investors in 2008, is as follows, as % of revenue net of all rebates and discounts:
 - Brewing and bottling: 50%
 - Advertising and marketing: 15%
 - Distribution (done by Cerveja through network of depots and contracted freight and delivery companies): 15%

Loyalty Program

15. Cerveja established in 2009 a loyalty program called “So Hoppy Together.” This “two facet” program applies only to small retailers. Small retailers are eligible for rebates under both facets if they meet the specified qualifications. A retailer must have qualified for a cash rebate under the first facet for 4 consecutive quarters to be eligible for a rebate under the second facet rebate for that year.
16. First facet. Cerveja will grant each small retailer a cash rebate on a quarterly basis, as a percentage of all the retailer’s Cerveja sales over the quarter, if the retailer hits targets as follows: (1) 2% if the outlet has the same dollar sales volume as in the same quarter the previous year; (2) an extra 1% if it achieves at least a 5% growth in sales volume over the same quarter the previous year; (3) an extra 1% if it achieves at least a 10% growth in sales volume over the same quarter the previous year. Thus, under the first facet, a small retailer can achieve a cash rebate of up to 4%.

17. Second facet. Cerveja will, at the end of every one year period under the program, grant each small retailer a 3% cash rebate for each case of Cerveja beer sold.
18. Cerveja has stated publicly that the “So Hoppy Together” program is open to all small retailers in ICNland.
19. Cerveja typically recommended a maximum retail price for smaller outlets which was around \$2.50 per case above the wholesale delivered price. If outlets were found to be pricing above the recommended price Cerveja might not provide signage, marketing and promotional materials. The outlets would also likely not be included in specials, where a discount might be run around an event such as a soccer final or public holiday, and outlets would be expected to pass on the discounts and not increase their margins.
20. On introducing the Hoppy program the wholesale price was increased, such that the recommended retail price was now just \$1 higher than the wholesale price. With rebates of around 5% to 6% the same margin as before would be earned by the outlets.
21. Cerveja has indicated to the outlets that it wants to reward performance, where outlets doing better in terms of growth get the benefit in their margin, and outlets performing on par with before should be no worse off.

The Complaints

22. Since Cerveja’s introduction of the So Hoppy Together program, the ICNland Competition Authority has received the following complaints:
 - Individual complaints from over 70 small retailers in ICNland that Cerveja has dropped them from the So Hoppy Together program. Many of these complaints share a common theme: that Cerveja isn’t providing adequate marketing and financial support to allow them to qualify for rebates.
 - A group complaint from 17 small local breweries that the So Hoppy Together program is an abuse of dominance having the effect of eliminating small local breweries that meet customer needs and preferences.

Loyalty Discounts & Rebates Case Study: Document Annex

1. Complaint from Small Retailers, attaching 3 emails
2. Complaint from Small Breweries
3. Cerveja memorandum
4. Small Retailers Association memorandum
5. Hollandia memorandum
6. Cerveja E-mail
7. Independent market analyst report
8. Excel Spreadsheet with data on costs, prices, market shares, over time

Summary of Complaint to ICNland Competition Agency from Small Retailers

The Cerveja brand is viewed as a “must carry” product by all retail categories, due to its strong public recognition supported by heavy advertising to consumers. Indeed, the brand identity of Cerveja is seen as aligned with that of the country.

While we applaud Cerveja for its position and role in supporting responsible drinking, we are concerned that its recent ‘So Hoppy Together’ is unfair in restricting the freedom of our members, a crucial part of Cerveja’s own route to market, to choose how to run their businesses. As you know, people buy their beers through the corner stores and bars on every block, that are part of our communities, where people can meet and catch up on the latest gossip.

As we all know, Cerveja is particularly strong in the mass of the population, who can get it wherever they are in the country. The rivalry posed by Hollandia is, in our view, mainly aimed at middle class drinkers in the big cities who like the international association of the Hollandia beers and either drink in up-market pubs or buy in large supermarkets.

Hollandia does not seem interested in our members who are more oriented to their local areas and need the freedom to offer, in addition to Cerveja, local beers. The importance of these beers differs a lot from area to area, reflecting local drinking habits. These beers may not be perceived as being of the same quality, do not have the same attractive labelling as Cerveja and tend to have a shorter shelf life, but they have generally also been cheaper!

The effect of the Hoppy programme is that our members must at minimum maintain their sales of Cerveja (this will get them a 5% rebate – adding the 2% from the first facet to the 3% from the second facet), and aim hard to grow by at least 5% per year. With the relatively slow growth in the economy, and the mature nature of beer as a product this means that our members cannot allow other brands to be attractive. Losing the Hoppy rebate would mean they would go out of business given the cut-throat margins! Where demand is declining because of depressed local conditions and/or the increased penetration of supermarkets, this means that the small outlets are even more at risk. We believe that Cerveja does not provide enough support and promotions for our members to meet these challenges.

We have attached two emails which illustrate that if retailers do not meet the targets they are cut out of the rebate programme. These outlets are currently struggling to stay alive. A third email shows what everybody in the industry knows - that Cerveja is scared about Hollandia and whether it gets the marketing space it needs to grow in our markets.

E-MAIL 1

From: Hernandez, Armand [A.Hernandez@cerveja.com]
To: Bessille, Tony [T.Bassille@gserve.net]
Date: 20 February 2010
Subject: So Hoppy Together Program

I regret to inform you that because of your decreasing sales of Cerveja during the calendar year 2009, you are no longer eligible for participation in the So Hoppy Together program. If your quarterly sales in 2010 meet or beat the sales for the same period in the previous year then you will of course get the relevant rebate and, if you qualify for each quarter over the year, then you would be again eligible for the annual reward at the end of 2010.

We wish to assure you of our confidence and support, and have no doubt that with your marketing skills you will perform well once again!

Best Regards,

Armand Hernandez
Regional Sales Manager 2
Cerveja S.r.l.

“Grab a Cerveja and have fun today”

E-MAIL 2

From: Pascal, Louise [L.Pascal@cerveja.com]
To: Smith, Jesus [J.Smith@shoptoday.co.icn]
Date: 24 May 2010
Subject: So Hoppy Together Program

Dear Mr Smith:

I regret to inform you that due to the 3% drop in total Cerveja sales during the fourth quarter of 2009, Cerveja has decided to no longer offer the So Hoppy Together program to your store, Shop Today. We hope you get back on track quickly and, of course, will give you the due recognition on a quarterly basis, as set out in the reward schedule. Keeping this up over the year will also mean you qualify once more for the annual performance recognition.

I look forward to welcoming you back,

Louise Pascal
Regional Sales Manager 7
Cerveja S.r.l.

“Grab a Cerveja and have fun today”

E-MAIL 3

From: Irunde, Sammy [S.Irunde@cerveja.com]
To: Irunde, Pablo [P.Irunde@coldmail.com]
Date: 2 June 2010
Subject: WAKE UP!!!!!!!

Pablo, what's the deal man???? I was in your store the other day and Hollandia is positioned right up front, with that huge, obnoxious big Hollandia advertisement when you just enter the store with those horrible green and white colors! Yuck! Brother, I already told you what I overheard Louise and Armand from sales talking about the other day – that Cerveja isn't going to tolerate small stores being too friendly with Hollandia!!! I know you're depending on that big rebate from Cerveja, so **please** wake up and smell the coffee before its dumped over your head!

Anyway, look forward to seeing you, Adriana and the kids on Saturday. We'll be having lamb and beans, your favorite. See you around 3!

Take Care,

Sammy

Samuel IRUNDE
Assistant to the Region 2 Stock Manager
Cerveja S.r.l.

“Grab a Cerveja and have fun today”

Summary of Complaint to ICNland Competition Agency from Small Breweries

We represent a large number of small breweries that are a dying breed due to the blatant bullying by Cerveja of the smaller outlets and the callous disregard for local sensibilities by the national supermarket chains.

As we would think is common sense, consumers should have the option to buy their local beers, reflecting local tastes. The breweries established by our members over decades make quality products that meet all the necessary regulatory standards. However, the unreasonable demands of the supermarkets regarding delivery schedules and shelf life are used as an excuse not to stock our members' products. And, of course, being locally based, our members cannot do the national promotions with big branding and gimmicks that the supermarkets seem to like. The scale and reach to sustain the distribution, marketing and advertising campaigns simply mean our members are not given the chance by the supermarkets.

This has not been so important until now as we could sell to the man and woman in the street through the outlets closest to them in the most convenient way. But, Cerveja's new loyalty program, misleadingly called 'So Hoppy Together', will kill us - lots of our weaker brewery members will be driven out of business with a huge loss to the fabric of local life.

We recognize the strong pull of the Cerveja brand and applaud their success and support for our national symbols such as the soccer team. We are merely pointing out that consumers deserve a real choice.

It is already easier for outlets to just push Cerveja as we cannot match its delivery network and its promotional materials. Our members distribute through smaller, local trucking companies and support the local economies, and people know our brands as they have been passed on from one generation to the next.

As we understand it, the Hoppy programme does not on the face of it look as if it would necessarily squeeze our members out, as the outlets only have to meet the existing Cerveja volumes for a rebate. But, it seems as if the outlets have pushed Cerveja hard in response to it because they are either scared of missing the target, or because there are some other incentives at work.

We don't know the details, but we trust the ICNLandia competition authority will protect local choice and local businesses.

September 1, 2008

MEMORANDUM FOR RICARDO SALAZAR, PRESIDENT OF CERVEJA

FROM: Jose Perez, Vice President for Marketing, Cerveja

SUBJECT: The Hollandia Threat

Our marketing team reports disturbing news about Hollandia's threat in the ICNland beer market. Ever since Hollandia acquired Pappabeer and rebranded it as Hollandia Brew, Hollandia's market share in the large supermarket niche has risen sharply. Some supermarkets even are giving Hollandia Brew superior shelf placement! Although longstanding customer loyalty provides us some defense, I fear that long-term Hollandia will be able to use its deep pockets to match us in mass media markets and for supermarket placement.

To put it bluntly, we do not have Hollandia's financial resources. We can maintain, and ramp up, our adspend based on our large volumes, but Hollandia can match this if they choose to. What we can do, however, is fortify our traditionally strong customer loyalty through the small retailer channel. As you know, the small retail sector is essential for the ubiquity of Cerveja. Hollandia also needs to have national reach if it is going to seriously challenge the number one position of Cerveja. Hollandia now seems to recognize the importance of the sector, as our sales teams report seeing Hollandia Brew more frequently in small retailers, and there are rumors that Hollandia may also be looking to expand by acquiring or developing new indigenous ICNland brands. The small retail sector is also the birthplace of new brands and customer loyalty. If we can kill brand development in the small retailer channel, it may make it harder for Hollandia to acquire an "attractive" brand and/or to take Hollandia Brew itself to the mass market. Hollandia may then decide just to remain a high end niche player with Hollandia Brew, and not take us on seriously. That would be a relief.

With these facts in mind, I have developed a draft program called "So Hoppy Together," aimed solely at our small retail channel. This program will involve targeted discounts to small retailers that show loyalty to Cerveja (details to follow next week). It may kill any attempts by Hollandia to increase customer acceptance of Hollandia Brew and develop small brands in the small retailer channel, and thus help us as we combat Hollandia. Importantly, the maximum payment for reaching the target is on all units sold taking advantage of the fact that studies have shown that customers are very unlikely to switch in significant numbers in the short to medium term to other similarly priced beers. Outlets have no choice but to promote our leading beer. Indeed, with our jacked up marketing we think customer loyalty is at least around 75-80%, even if rivals match our adspend.

If you and the Cerveja board approve the program, marketing would be able to introduce it as early as the beginning of 2009. Let me know what you think.

March 1, 2010

From: Paolo Gomez, President, Small Retailers Association (SRA) of ICNland

To: Member Small Retail Owners

Re: So Hoppy Together: Threat or Opportunity

I have heard conflicting reports about the Hoppy program. Some SRA members – those that qualify for large Hoppy rebates – report that their overall sales and net profit margins have risen and that consumers are pleased. Others – mainly those that have not qualified for rebates – report that they do not want to disappoint local customers who want alternatives to Cerveja but at the same time feel they may suffer long term if they do not give in to Cerveja’s “Hoppy” demands. In the latter category, many small retailers report that “Hoppy” is more a threat than a benefit – one that precludes the opportunity to try out new brands and perhaps get noticed by Hollandia.

As you know, so far Hollandia seems to have focused its marketing efforts on large supermarkets. As a result, the penetration of Hollandia Brew among small retailers has been relatively modest to date. However, we’ve heard increasingly that Hollandia is turning its focus more to small retailers. In addition to trying to promote Hollandia Brew, we heard that Hollandia sales reps have been asking small retailers to help them identify “hot” new brands. Hollandia has very deep pockets and may offer great long term potential, but great risk as well – who knows how long they will stay in the INClan market? And, of course, becoming close to Hollandia may have a blow-back effect on a retailer’s existing relationship with Cerveja.

I leave it up to you, member owners, to follow the policy that works best for you, either aggressively working to promote Cerveja fully; partially going along with Hoppy inducements; or dropping Hoppy altogether. From my perspective, however, it seems to me it would be highly risky not to do your best to keep on the best of terms with Cerveja.

May 5, 2010

MEMORANDUM FOR THE PRESIDENT OF HOLLANDIA, INC.

FROM: Hans Huizinga, Hollandia Regional Vice President for ICNland

SUBJECT: Update on the ICNland Market

As you know, Hollandia has rapidly increased its market share in ICNland since the 2008 Pappabeer acquisition.

While this is good news, longer term prospects are uncertain. Our sales are mostly through large supermarkets, and we have had to grant major promotional concessions to grow the Hollandia Brew brand in these outlets. We simply cannot afford to continue to “buy” market share through large advertising campaigns. Furthermore, our recent market research indicates that we need to both increase customer acceptance of Hollandia Brew (despite our marketing efforts, our surveys show that it’s still way behind Cerveja in terms of customer preference) and diversify into new brands. Our marketing surveys also indicate that only brands that have gained a critical acceptance level through small local retail sales are likely to do well in the long-term.

To further grow in ICNland and challenge Cerveja for supremacy, we simply can’t just keep throwing money at supermarket promotions. We need to redouble our efforts to promote the Hollandia Brew label within the small retailer channel, and also should expand our portfolio by developing or acquiring one or two new “hot” brands. Regrettably, Cerveja must recognize this and it has been granting small local retailers incentives to protect its turf. Clearly, further growth in ICNland will require more investment on our part, to which Cerveja may retaliate further in kind. Moreover, there may be other, more immediately profitable opportunities in other countries. I leave this question up to you and the board, of course.

Long term, we will have to decide whether (1) to withdraw entirely from the Cerveja market, (2) to maintain Hollandia Brew as a niche number two brand with limited growth potential, of (3) aggressively promote Hollandia Brew at small retailers and also seek to proliferate brands and try to dominate the ICNland market. Over the next few months, I will be meeting with major supermarket chains, the small local retailers’ association, and marketing survey firms as I contemplate next steps. I will report back to you by the end of the year on developments and further steps, if any, we should consider taking.

E-MAIL

From: da Silva, Joao [J.dasilva@cerveja.com]

To: Perez, Jose [J.Perez@cerveja.com]

Date: 2 July 2010

Subject: So Hoppy Together Program

Jose:

You are a marketing genius, my friend! 2009 was indeed a tough year but based on the most recent data for this year (2010) collected by my analysts, Cerveja sales at SHTP stores are up, on average, 15% this year compared to last! Take that, Hollandia! And we've been able to prevent prices falling further in the small outlet channel. These increased volumes more than make up for the rebates we're giving out here – our overall profitability is actually up over the same period for this business! Also, the increased volumes we're producing, combined with the new production software package we installed last year, means overall costs are down 2%, on average, at our breweries. A true win, win, win situation – for everyone except our competitors!!!!

You have my vote for employee of the year! I think you get a nice plaque in your office if you win! ;-)

Joao da Silva
Director of Accounting
Cerveja S.r.l.

“Grab a Cerveja and have fun today”

Summary of Independent Marketing/Industry Study, 2009

This is a fascinating time for analysts of the beer industry with serious rivalry from an established player threatening to shake up the market in a more significant way than we have seen for decades.

Hollandia have put up breweries using latest production technologies which means, despite substantial capital costs, they should be very cost competitive. On the other side, massive advertising is necessary to position its main brands for growth, and the returns to these advertising costs require being able to ramp up volumes.

Preference trends for beer in ICNLandia

The overall market is growing, as would be expected with economic growth averaging around 4%. But the growth in beer consumption is much slower as the extra disposable income tends to go on things such as mobile phones and electronic devices. Drinking choices, especially in the middle income market segment where the economic growth is concentrated, are also looking to products such as wine reflecting habits shifting to drinking with meals and less at bars. However, beer is still overwhelmingly the alcoholic beverage of choice.

Our assessment is that the many local beers are in long-term decline for several reasons. Their main market is older people, mainly men, who have grown up with the beer. Younger drinkers have wider frame of reference – in national and international terms and want to engage in a drinking experience which they feel links them into wider communities. While Cerveja's national identity undoubtedly keeps it right up there, coupled with their new moves to bring in fashion brand derivatives such as their new 'ice' beer, Hollandia's international reach places them in a good position.

Smaller beers need to make themselves appealing as a 'craft' product, but have failed to do so, with unimaginative branding tending to emphasise their 'localness', something which people relate to less and less when it comes to beer. We also doubt whether the smaller breweries have the finance base to lay-out the adspend necessary to make such a re-positioning strategy work.

Evolution of different routes to market

Along with long-term shifts in preferences we see similar changes in the routes to market for beer producers. The inexorable roll-out of large supermarkets, most who are part of national chains, is the product of improved logistics and stock control technologies coupled with greater car ownership. While the trend is in one direction, it is important not to get carried away, however. Although it may seem from the wealthier large cities that this is the big story, and it accounts for a lot of consumption spend, in the poorer states, relying on mining or agriculture levels, of car ownership are much lower and these shifts are much slower.

The smaller outlets in the states of Mineralia and Agrilandia, as well as in rural areas of Urbania, are crucial to get product to the population conveniently, when they want it. The importance of habit means that not having a brand available on a close to universal basis means its growth will be limited.

Likely Hollandia strategy?

All this suggests very interesting choices face Hollandia, especially in light of Cerveja's apparent response.

On the one hand, Cerveja is not likely to be a particularly efficient overall operator given that it has been in such a comfortable position for so long. Its strengths, however, include its very effective distribution network through its own and contracted drivers meaning that it is able to meet orders at very short notice and guarantee its beer is on hand to customers anywhere in the country. It also has the cash pile to respond to any threat, whether with advertising and promotion blitzes which it can carry on its massive national sales base, or in hiring the best external marketing experts to look at launching new brands where necessary.

On the other hand, Hollandia has world class logistics capabilities especially in meeting the needs of the large supermarket chains. It just needs to get the scale to bring its unit costs down. It has the brands and the appeal.

We see the big choice facing Hollandia is whether to locate its beers in a somewhat premium 'international' niche, with strong marketing aimed at middle income urban drinkers, as against the importance for growth of having its beer available in all outlets. We must remember that middle class urban drinkers also frequent street corner outlets and beachfront stands.

It has come in at very price competitive levels, really shaking up the market, but it has, wisely in our opinion, not followed Cerveja down in its pricing.

We will be watching closely as events unfold, and also looking to see the effect of the latest tactic, Cerveja's loyalty programme 'So Hoppy Together'.