Pestle analysis of the beer industry economics essay

[Food & Diet]

This report examines two organizations operating in the same industry, and their responses to the environment during the period 2007 to 2009. Heineken N. V (Heineken or “ the company”) operates internationally through a global network of distributors and breweries. The company is one of the leading brewers that owns and manages a portfolio of more than 200 varieties of international premiums, regional, local and specialty beers.

It owns or joint ventures 125 breweries and distributors in over 70 countries in five geographic segments: Europe, the Americas, Africa, the Middle East and Asia Pacific. It is headquartered in Amsterdam, the Netherlands and employs about 55, 301 people.

SABMiller is similarly engaged in the production and distribution of beer, malts and carbonated soft drinks. Its brands include international premium beers and the company primarily operates in the Americas, South Africa and Europe. It is headquartered in London, the United Kingdom (UK) and employs about 68, 635 people.

The company’s markets its products in both the developed economies in Europe and North America to emerging markets such as China and India. SABMiller is also one of the largest bottlers of Coca-Cola products in the world.

SABMiller’s operations segmented across beer manufacturing and soft drinks business and also has brewing interests or distribution agreements across six continents.

This report critically analyzes Heineken’s financial performance compared with one of its many competitors, SABMiller and examines the market conditions and economic statistics during the period 2007 to 2009.

2. ECONOMIC OVERVIEW

In the report entitled “ Emerging or Developed Markets – which will lead global economic recovery?” by SABMiller Globalization Debates, it was concluded that Western developed economies will be the hardest hit by the current economic slump.

The report confirmed that major nations and regions would emerge from this slump by the first or second half of 2010. The Middle East was expected to be the first to recover, followed by China and India. Canada is the highest place of the developed nations, in fourth. The United Kingdom (UK) and Italy were expected to be last to emerge into recovery.

Heineken N. V.

Heineken N. V. in its first trading update in 2009 made the following statement, “ The global economic downturn, bad weather and smoking bans caused global beer sales volumes to drop 6. 3 percent in the first three months of 2009. However, better selling prices largely compensated for lost volumes, yielding a revenue decline of only one percent. In the first quarter of 2009, revenue increased 24 percent compared with the first quarter of 2008 owing to first-time consolidations and better pricing. This was partly offset by the financial impact of lower volume and unfavourable exchange rate fluctuations. Organically, revenue decreased one percent.”

Beer sales volumes declined across West European markets, while in Africa and the Middle East volumes grew.

Organic volume was adversely impacted by a combination of factors, including the global economic downturn, unfavourable weather, the continued effect of smoking bans, distributor destocking, excise duty increases and selling price increases," Heineken said.

Given this scenario, the company focused in 2009 on initiatives to reduce debt and costs, and improve the performance of newly acquired companies.

In February 2009, Heineken announced a 74 percent drop in 2008 net profit but said it remained optimistic, as beer consumption was " relatively resilient" in hard economic times.

The exceptional economic circumstances required Heineken to reduce the value of goodwill in Russia, their investment in India and the pub portfolios in the United Kingdom (UK).

In Malaysia, consumer confidence reached an all-time low and with that Malaysians became the world's third greatest savers, with more than half choosing to cope with rising costs by cutting down on their spending.

Heineken in recognizing its challenges recommitted to utilizing its global marketing excellence to build its key brands across all markets and to maintaining, or where possible improving, its price positioning.

SABMiller

SABMiller, its competitor also reported, in a trading update, a dip in global beer volumes for its fourth quarter of 2009, reflecting the impact of the economic downturn in its markets across Eastern Europe, Latin America and Asia.

Compared to a similar basis, beer sales by volume were flat for the 12 months to the end of March 2009 and fell by 1% in the final quarter of the year. Beer volumes on a non-comparable basis rose by 2% for the year of 2009.

Beer sales suffered in the fourth quarter of 2009 due to the effects of the global economic downturn on consumer spending, the UK-listed brewer said.

It added, however, that full-year sales revenue rose by high single digits, due to beer price rises, and that trading for the year of 2009 was in-line with the company's expectations.

In 2009, Eastern Europe proved particularly difficult for SABMiller. Like-for-like beer volume sales in Russia fell by 7%, due to wholesalers running down their stocks amid weakening consumer confidence, although volumes were flat in the fourth quarter.

SAB's volumes also fell by 4% in Czech Republic for the year. Volumes rose by 18% in Romania, but " slowed significantly" in the second half, the brewer said.

In other markets, China reported a 4% rise in beer volume sales for the year, despite a weakening economy and the earthquake in 2008 in Sichuan province, one of SAB's strongholds in the country. China saw double-digit growth in the fourth quarter.

SABMiller's ability to contribute its business profitability was largely due to the impact of its business in Latin America and in the United States where it performed reasonably well.

3. THE BEER INDUSTRY

1The saturation of traditionally thriving beer markets such as North America and Europe has driven the consolidation of the industry. Major brewers have sought growth through strategic mergers and acquisitions, which has reorganized the industry and strengthened the market positions of the industry's largest brewers. Expansion into key emerging markets has become a strategic priority for leading firms, who are now competing for market share in several important regions of the world (Hutter, pg. 1).

China

In 2003 China eclipsed the US as the world's largest beer market. Although China has low unemployment levels and growing urban centres, it is seen as the world's next big consumer market. The local beer industry is firmly established and contains approximately 300 brewers (Slocum, et al. p. 35), primarily supplying the urban coastal areas. Many multinational firms have invested heavily in the Chinese beer market and although there is a threat of overâ€ saturation, relatively low perâ€ capita consumption levels indicate that this market has room to grow.

India

1India is one of the world's fastest growing consumer markets. A rapidly growing population, an emerging middle class with rising perâ€ capita incomes and blossoming urban centers make India a powerful emerging market.

India has an established local beer industry and although perâ€ capita consumption is low, as the country becomes more westernized younger generations have the potential to be highâ€ volume consumers. However, regionalism, political unrest and the potential for growing pains temper this market's attraction.

South Africa

South Africa is one of the fastest growing beer markets in the world. This region has an active domestic brewing industry and a population of high perâ€ capita beer consumers. Favorable agricultural conditions exist for harvesting beer ingredients and consumer tastes are shifting from sorghumâ€ based beer toward Westernâ€ style products creating growth opportunities for light beer and specialty brewers. However, SABMiller, one of the largest brewers in the world has roots in South Africa and has a strong market position there. Opportunity still exists in this market for brewers keen on pursuing a market thirsty for western imports. South Africa's beer market provides an attractive investment opportunity for a multinational firm looking to capitalize on this region's high perâ€ capita consumption and changing, westernized, tastes.

Russia & Latin America

1The early 2000's saw booming beer consumption rates in Russia, which spurred a flurry of foreign investment, but a subsequent slowdown and strict government regulations have driven this market's costs up.

Russia's longâ€ standing preferences for spirits have waned and beer is now more ingrained in the culture, but brewers must now find opportunity in the higherâ€ margin specialty markets. Latin America is an active beer market with high growth potential, largely driven by growth in key demographics, a favorable farming climate, Brazil's developing economy and Mexico's high levels of beer consumption.

Supporting Data

Figure 1. 1 shows that China surpassed the US as the world's larges beer market in 2003. However, as Figure 1. 2 demonstrates, the country has relatively low perâ€ capita consumption rates suggesting that China's growth has been driven by its massive population. Whether this unique dynamic limits growth or represents significant room for growth will be a key factor in China's future strength as a beer market. Figure 1. 3 demonstrates recent general population growth trends for the key growth demographic of 15â€ 34 yearâ€ olds. Asia and Latin America have shown significant growth while the US and Western Europe have demonstrated flat or negative growth rates. This is further evidence that the key growth opportunities in the brewing industry are primarily in emerging markets, rather than traditional established markets.

3. 1 PESTLE ANALYSIS ON THE INDUSTRY

PESTLE is the Political, Economic, Sociological, Technological, Legal, and Environmental factors that describes the macro-environmental factors used in the environmental scanning component of strategic management. The following factors demonstrates:

Political (includes Legal)

The beer brewing industry is one that faces a large amount of government regulation. A cause for the large amount of regulation is due to the fact that in some area’s brewers can be regulated by the federal government, state governments, and localities. The federal government has seven different areas of regulation relating to the beer industry. The area relating to breweries and beer production is the one that affects the beer brewing industry.

The government agency that is responsible for regulating this industry is the Bureau of Alcohol, Tobacco, and Firearms. The bureau has issued regulations regarding brewing of beer that “ include restrictions on the location, use, construction, and equipment of breweries, as well as laws pertaining to the qualification of breweries and their issuance of bonds and consents of surety.”

Beer breweries also face “ brewing process regulations include mandatory approval of the formula and process for domestic flavored beers, such as lambics, and requirements for the measurement of beer. In addition, federal law imposes a special occupational tax (SOT) on all brewers.” Breweries also face state regulations that vary according to each individual state in which they are located. The government regulations that breweries face help to prevent barriers to entry for potential firms considering entry into this industry. This is a benefit to the firms currently in the industry as it promotes an environment that is conducive to sustainable profits.

Economic

The Scope of competitive rivalry is one the best ways to identify the economic characteristics of any industry; with the beer industry the scope entails the global geographic area over which most of the leading brewing leaders compete. Penetration in the foreign market arena is becoming a key success indicator for most of the competitors in the beer industry.

The market size of the beer industry is incredible. As you can see, this is a very large industry, which provides many jobs, and the market consists of many competitors, some being very large and some operating on a very small scale. The competitive rivalry is broken up into three segments, National, Regional, and Microbrewers. National competitors have wide market coverage and generally a large company. Regional competitors are smaller than National in the fact that they only distribute in certain regions. Microbrewers are the smallest of the three because their size and capacity limit them to only distribute to small geographic areas. The market growth rate of the beer industry is perplexing.

Economies of scale are defined by Porter as the " declines in unit costs of a product as the absolute volume per period increase" (Porter 7). Therefore the greater quantity of a product that is produced the lower the cost of each will be to the producer. This creates an advantage for a high volume producer like those seen in the brewing industry. Economies of scale in the brewing industry also exist in areas other than in production and these include purchasing, distribution, and advertising. For example, national brewers achieve economies of scale in advertising through bulk media purchases and umbrella brand marketing. Local-craft brewers spend more than twice that spent by large brewers on marketing and advertising per barrel.

Social & Cultural Issues

Throughout history there has consistently been opposition to the sale and use of alcohol. This opposition to the use of alcohol traditionally stemmed from a moral or religious opposition to the consumption of alcohol. Today however, increasingly it isn't a moral or religious reason that prompts this opposition; it's the negative medical effects that abuse of alcohol has been shown to have on the human body. Society is also feeling the effects of alcohol abuse; it is because of this that Sin Taxes have been levied on alcohol, as an attempt for government to find a ways and means to profit from the sale and consumption of alcohol.

Technological

New harvesting and production technologies must be identified to increase process efficiency and ensure continued growth.

Environmental

The beverage industry is extremely competitive, with private labels greatly influencing the environment.

In developing markets, the consumption of beer has fluctuated due to changing beverage preferences and relatively slow population growth among key demographics. Brewers must seek growth in developing countries such as India, China, South Africa and others, where global middle class is rapidly emerging. Therefore, players in the beer industry should look for ways to reinvent themselves in attracting the younger generations by responding to varying tastes and a wide range of products.

4. FINANCIAL ANALYSIS

The years selected for review were 2007, 2008 and 2009. The outlook of these three years provides a perspective on general developments in the international beer industry, their effects on Heineken and SABMiller's position, its profit forecast and its capital investment. It examines some key financial ratios, analyzing its profitability and liquidity making a comparison between Heineken and its competitor, SABMiller.

The factors, which were used by the company, are contained in the report to shareholders by the Chairman and the Chief executive Officer and it is this report that provides the basis for our review.

The analysis of operating ratios is seen in Appendix I and II.

4. 1 The Chairman & Chief Executive Officer Overview for 2007 – 2009

4. 1. 1 Heineken N. V.

2007

According to the review, 2007 was an outstanding year because of the following:

The company achieved cost reductions

New profit grew by 22. 6%

Beer volumes increased by 6. 5%

Premium segment increased by 10%

Strategic acquisition – Building leadership and;

There was focus on selective opportunities

For 2007, Heineken continued to benefit from their ability to extract value from their mature markets.

In May of 2007, Heineken renewed the sales and marketing agreement in the USA for a further ten years which would significantly impact the growth segment in the US markets and secondly, they regained control of the Amstel brand in South Africa and decided to construct a brewery there.

Performance for their Central and Eastern European (CEE), African and Asian markets were considered outstanding given the state of the market and showed signs of growth in profit and volumes. Consolidated volumes grew by

9 percent and earnings before interest and tax (EBIT) (beia) rose by 22 percent. With an 18 percent volume growth and 41 percent EBIT increase, Africa and Middle East region was again consistent in rowing both its consolidated volumes and EBIT (beia) and their Asia Pacific region continued its positive growth in volumes, revenue and profitability.

Heineken's strategy continued to focus on ensuring that environmental and social sustainability remained high on their agenda. They strengthened their existing commitment to responsible consumption activities in partnership with their employees, the industry and third parties in order to play an active role in addressing alcohol misuse. They continued to maintain their focus on meeting the environmental and safety targets that they have set for themselves an invested in their people and business resources.

2008

2008 was considered a unique year, there was large-scale industry consolidation, a global slowdown in category growth, significant increase in input cost and cost pressures and above all, an unprecedented economic crisis.

Heineken managed to maintain in this environment a strong organic growth in net profit of 11 percent, revenue growth of more than 27 percent and 16 percent increase in group volume. However, goodwill in Russia had to be reduced due to the economic circumstances as well as their investments in India and the pub portfolios in the United Kingdom.

Heineken entered 11 new markets and completed the largest acquisition in their history in 2008. They attained leading positions in 59 of their 66 markets, none of which accounts EBIT (beia) for more than 10 percent.

The economic downturn impacted significantly on the performance in UK and a combination of other factors such as smoking bans, excise duty increased and adverse exchange rates. In this regard, Heineken reduced costs significantly, restructured parts of their business and improved pricing in order to increased the efficiency and profitability of the UK business.

Heineken continued to focus on increasing their value share in all markets by increasing the efficiency and effectiveness of their marketing investments. They also focused on reducing their debt levels and introduced a company wide program aimed at restoring their cash conversion rates to more than 100 percent by 2011.

2009

In 2009, the company focused on a creating a more globally competitive business as a number of beers showed a reduction in sales in 2008 because of the economic slowdown. Transformation occurred and focus moved to growing their brands and value share in critical markets, leveraging their leadership position and developing specific action plans to grow and strengthen their business and the category. Heineken also looked at ways to accelerate their investment in consumer focused innovation.

4. 1. 2 Results of 2007 – 2009 – ACTIONS

In summary, an overview of the period 2007 to 2009, will indicate that Heineken was one in which the company found its market place affected by a number of very challenging events and it responded through various interventions. At the end of the period the company was transformed and able to survive.

The operating profit margin declined over the years, 2007 to 2009. Although there was a decline in operating profit, Heineken is still effective in controlling its cost and expenses associated with its business operations.

After reviewing its financial statements net profit continues to grow well ahead of their forecast as beer volumes continue to grow.

From 2007 to 2009, cash flow from operating activities continue to improve mainly due to:

Cash flow from operations before changes in working capital and provisions increased

Decrease in working capital; resulting in a positive contribution to cash flow

Decrease in cash flow used in operational investing activities as a result of reduced CAPEX.

Heineken's net profit has grown over the years with an increase of 11 percent between 2007 and 2008 and a further increase of 18 percent from 2008 to 2009. Despite the economic downturn, Heineken experienced the highest number and value of new acquisitions ever, however, the economic situation impacted the value of certain assets and investments, it affected foreign translation reserve, hedging reserve in equity and also impacted other net financing expenses significantly.

Revenues increased over the years showing a 27. 3 percent between 2007 and 2008 and a 2. 7 percent between 2008 and 2009. However there was a fall in beer volumes in 2009 due to the economic environment and excise duty increases. This is reflected in the decrease in the operating profit margin.

The return on equity ratio had a significant decline between 2007 and 2008. This impact came about as a result of the investments made in that year when Heineken entered 11 new markets and completed their largest acquisition in history when they acquired the Scottish and Newcastle businesses in the UK, Portugal, Finland, Belgium, Ireland, India and the USA. In addition, they acquired breweries across Europe and Africa and they began construction of a brewery in South Africa. These investments would also have impacted on the returns received in that year.

Heineken continued to outperform the sector with EBIT growth over the years. In 2007, the performance from the Central and Eastern European, African and Asian markets was outstanding and began to deliver on their potential for both profit and volume growth. As in 2007, the Africa and Middle East continued to grow in volume and profits hence increasing EBIT figures while Asia Pacific region continued its solid growth record. In 2009, Heineken continues to benefit from developing markets with a further increase in EBIT.

In analyzing the current ratios, the company's shows that it is unable to pay off its obligations when they become due. However it does not necessarily mean that the company will go bankrupt as there maybe ways to access financing but it shows that the company may not be in good financial health.

In concluding, Heineken has a high gearing ratio and based on the beer industry this can be considered risky. This is so as shareholders are concerned at the very high level of debt relative to equity and borrowers might doubt the company's potential to service the interest in new borrowings.

High gearing ratios simply indicate that a company has placed a greater reliance upon borrowing than equity to finance its operations. The higher the ratio the more highly geared or levered the company is said to be. Although it should provide a higher return to its shareholders when the economy is experiencing boom conditions, during period of increased interest rates, economic recession or simply loss of customers the opposite will apply. A company which has high gearing is particularly vulnerable and might find that it cannot continue to finance its borrowings.

4. 1. 3 SABMiller Analysis

2007

2007 was a successful year for the group when developing and developed market operations generated 10 percent organic growth in larger volumes and 12 percent growth in earnings before interest and tax and amortization (EBITA).

SABMiller's total volumes in lager, soft drinks and other beverages increased and their net cash was 22 percent above the prior year reflecting the overall strength of the trading performance and strong cash characteristics.

That year, SABMiller shaped and expanded its international portfolio business. Acquisitions and joint ventures in China, Vietnam, Australia and Angola have been further steps in creating an attractive, international spread of businesses with good exposure to fast growing, developing markets.

2007 was a year of good growth with strong performance in the fourth quarter. However there were challenges in increased commodities, cost pressures and the need to rebuild share of premium segment in South Africa. Despite those challenges, progress was expected.

2008

In 2008, economies in general and the brewing sector were faced with challenges such as the economic melt down and the food price inflation. However, SABMiller beverage volumes continue to grow and the net cash generated an increase from 2007.

2008 was a year of strong growth with results continuing the trend of several strong years.

2009

SABMiller's growth over the previous two years had been almost double their normal expectations, despite with the growing economic pressures on consumers.

In 2009, commodity prices and the cost of brewing materials increased. However, SABMiller delivered yet another year of creditable results as beverage volumes continues to grow.

The market capitalization also grew and SABMIller continued to invest in the business, with capital expenditure during the year totaling some US$2, 100 million and acquisitions a further US$300 million. Despite this very significant investment, net debt at the year-end was lower than the prior year and the group remains financially strong.

SABMiller continued to develop their international portfolios with joint ventures in the United States.

4. 1. 4 Results of 2007 – 2009 – ACTIONS

In summary and overview of the period 2007 – 2009 for SABMiller also found its external environment changed by circumstances and responded by a number of changes to its business model. At the end of the period, it has grown through market growth.

SABMiller reported EBITA profit measures give shareholders additional information on trends and make it easier to compare different segments. Segmental performance is reported after the specific apportionment of attributable head office service costs.

There has been a continued growth in EBITA margins as it grew 12% in 2007, 9% in 2008 on an organic, constant currency basis. In 2007, reported EBITA, which includes the impact of currency movements and acquisitions, grew by 22% and in 2008, SABMiller managed to maintain an EBITA of 17. 4% and growth in EBITA reflects the benefits of volume and revenue increases as well as productivity.

Between 2007 and 2008, net cash inflow from operating activities before working capital movements, Earnings before interest, tax, depreciation and amortization (EBITDA) rose 12% and continues to grow in the following years. The group's cash flow generation was again strong as demonstrated by the ratio of EBITDA to revenue (both metrics excluding results of associates) at 21% (2007: 22%).

Total assets continue to increase over the years. Goodwill increased in 2007 and 2008 as a result of foreign exchange on goodwill denominated in currencies other than the US dollar and on the acquisition of the Foster's India business and the various minority interest acquired. However, Goodwill decreased in 2009, primarily as a result of the contribution of goodwill relating to the Miller business into the MillerCoors joint venture and the impact of foreign exchange rate changes on goodwill denominated in currencies other than the US dollar. In addition, goodwill was reduced by impairments in Europe, partially offset by goodwill arising on acquisitions in Europe and Africa and Asia.

During the period there was also a marginal increase in equity earnings attributable to minorities less balances acquired as part of minority interest acquisitions.

The group has a good record of generating cash, and increases in cash generation reflect growth in profitability before interest and tax payments and investment activities.

5. ANALYSIS

Heineken N. V. vs. SABMiller – Some Observations

A SWOT analysis was conducted to compare the positioning of both companies as it relates to the industry. The following was taken from Data Monitor report (published on August 12th 2010) and these were the findings of the analysis:

Heineken N. V.

Strengths

Strong and diverse brand portfolio.

Large scale of brewery and distribution network for efficient global supply chain management

Brand innovation to adjust with the changes in consumer tastes and preferences

Strategic planning and cost containment measure to improve cash flow and profit margins

Opportunities

Rising disposal income and cultural shift towards alcoholic beverages in Asia

Association with sports events enhances the company's visibility and popularity

Partnerships and strategic acquisitions

Weaknesses

Higher debt poses liquidity problems

Weak presence in the top beer consuming countries

Threats

Declining beer market in Europe

Stringent advertising regulations for alcoholic drinks

SABMiller

Strengths

Globally spread operations

Wide portfolio of international and local brands

Opportunities

Partnering with big retailers

Booming beer industry in China

Strategic alliance

Weaknesses

Sluggish financial performance

Weak employee productivity

Weak liquidity position

Threats

Rising raw material prices

Sluggish growth in the US and Europe

Increasing labour costs

The global economic environment will continue to lead to lower beer consumption and down-trading in a number of regions in the foreseeable future.

Heineken N. V.

However Heineken plans to continue utilizing its global marketing excellence to build its key brands across all markets and to maintaining, or where possible improving, its price positioning. Price increases will be at levels well below of those of 2009. Heineken aims to continue passing on excise duty increases through its higher sales prices.

Heineken has significant market leadership in Europe and there are plans to capitalize on this opportunity despite the intense competition. However, that task would not be easy given the economic, market, consumer and regulatory dynamics across many markets. The company will leverage their leadership positions and develop specific action plans to grown and strengthen the business and the category. Heineken will accelerate their investment in consumer-focused innovation especially on the Heineken brand.

SABMiller

SABMiller has a record of improving its productivity over time, notwithstanding increases in capital investment and in sales and marketing expenses.

In summary, the group delivered resilient underlying results over the period 2007 to 2009 despite the strong h