

Presentation of the Hypothetical Case Studies

ICN Unilateral Conduct Workshop

December 2-3, 2010 Brussels

Hypothetical Case Studies

- **Loyalty Discount Arrangement by a Beer Manufacturer**
- **Margin Squeeze in the Telecom Sector**

Three Breakout Sessions

- **BOS 1: Opening the Investigation**
- **BOS 2: Analyzing Competitive Effects**
- **BOS 3: Crafting a Remedy**

Loyalty Discounts & Rebates Case Study

Background

- **Cerveja** is the largest brewer in ICNland with 1 billion in sales
- Cerveja's national market share is 73% of all branded beer sales
- **ICNland** has three states: Urbania, Mineralia and Agrilandia

Beer Sales Market(s) & Distribution

Two Main Types of Sellers

- **Large Supermarkets** sell 70% of ICNlandian beer in unrefrigerated bottles and cans
- **Small Retailers Outlets** (many with bars) sell 30% of ICNlandian beer in chilled bottles
- 70% to 80% of stock is Cerveja brand beer
- Small retailers stock a higher share than large supermarkets
- Cerveja and other beer manufacturers sell directly to these downstream outlets
- No imports - all beer sold is brewed in ICNland due to health regulations

National Market Shares

Downstream Distribution of Beer to All Retailers

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

Hollandia

- The leading international brewer and distributor of beer
 - operations in 20 countries
 - annual global turnover is 10 billion
- Entered ICNland in 2008 through acquisition of **Pappabeer**
 - second largest brewer and distributor of beer in ICNland
 - market share grew from 13% to 18% within one year, after Pappabeer acquisition
- Rebranded Pappabeer's one and only brand as "**Hollandia Brew**" in 2008
- Invested 50 million to modernize its facilities
- Built 2 modern brewing facilities in ICNland
- Announced its intention to expand its portfolio in ICNland

Other Brewers

- 30 small local breweries located in ICNland
 - number of brewers declining over past 20 years
 - individual turnover does not exceed 50 million
 - few new brands introduced during last 5 years
- Shorter shelf life
- Different type of distribution network
 - cannot provide same guarantee as to frequent deliveries on short notice
- Larger impact in small retail outlets
 - no small brewer has penetrated the large supermarket sector in the last 5 years
 - Shares of small brands carried by large supermarkets have not increased in last 5 years

Local Retail Beer Sales Market

Consumer prices vary in different retail markets, depending upon

- income levels
 - number of competitors
 - local taste
 - other factors
-
- Within a local market, prices per unit of beer sold are lower in supermarkets and somewhat higher in small outlet
 - 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

Large Supermarkets & Small Retailers

- Hollandia focused mostly on growing its sales through large supermarkets
 - national marketing campaigns
 - promotions
 - more limited sales in other sectors, so far
- 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 national media campaigns, large-scale distribution networks, favorable shelf space placements to induce large supermarkets to carry them
 - Small retailer channel is important to build consumer recognition and loyalty
- No new brand has entered the large supermarket channel in over 5 years
- Cerveja is carried by all large supermarkets and negotiates individual contracts with supermarket chains.

Cost Breakdown for Cerveja

% of revenue net of all rebates and discounts:

- Brewing & Bottling: 50%
- Advertising & Marketing: 15%
- Distribution: 15%
 - By Cerveja through networks of depots and contracted freight and delivery companies

Source: 2008 Presentation to Investors

So Hoppy Together Program

- Established in 2009
- Open to all small retailers in ICNland
- A “two facet” program
 - under the first facet, a small retailer can achieve a cash rebate of up to 4%
 - under the second facet, a small retailer can achieve a 3% cash rebate
- Small retailers are eligible for rebates under both facets if they meet the specified qualifications

So Hoppy Together Program

First Facet

- Cash rebate on a quarterly basis, as a percentage of all the retailer's Cerveja sales over the quarter, if the retailer hits the following targets:
 - **2%** if the outlet has the **same dollar sales** volume as in the same quarter the previous year
 - an extra **1%** if it achieves at least a **5% growth** in sales volume over the same quarter the previous year
 - an extra **1%** if it achieves at least a **10% growth** in sales volume over the same quarter the previous year

So Hoppy Together Program

Second Facet

- At the end of every one year period under the program, Cerveja will grant each small retailer a **3% cash** rebate for each case of Cerveja beer sold
- 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 for that year

So Hoppy Together Program

- Cerveja typically recommends a maximum retail price -- 2.50 per case above the wholesale delivered price -- for smaller outlets
- Outlets pricing above the recommended price
 - might not receive signage, marketing and promotional materials from Cervaja
 - not likely to be included in specials, where a discount might be run around an event, such as a soccer final or public holiday
 - would be expected to pass on the discounts and not increase their margins
- Once the Hoppy Program was introduced, 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.
- Cerveja indicated it would reward performance
 - outlets doing better in terms of growth get the benefit in their margin
 - outlets performing on par with before should not be worse off

The Complaints

- 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.

Documents

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 from Small Retailers

- Cerveja is viewed as a “must carry” product by all retail categories with a strong public recognition supported by heavy advertising to consumers.
- Small retailers 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, 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!
- Demand is declining because of depressed local conditions and/or the increased penetration of supermarkets
 - small outlets are even more at risk
- Cerveja does not provide enough support and promotions for our members to meet these challenges.

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 from Small Breweries

- Unreasonable demands of supermarkets regarding delivery schedules and shelf life are used as an excuse not to stock our members' products.
- 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.
- 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 cannot match Cerveja's 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.



MEMORANDUM FOR RICARDO SALAZAR PRESIDENT OF CERVEJA

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.



Small Retailers Association

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 INcland 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.



MEMORANDUM FOR THE PRESIDENT OF HOLLANDIA

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

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”

2009 Independent Marketing Study

- *Preference trends for Beer in ICNland*
- *Evolution of Different routes to market*
- *Likely Hollandia Strategy*

“Grab a Cerveja and have fun today”