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9B18M010

Steel String: To Bottle or Not to Bottle

Carri R. Tolmie and Thomas Tiemann wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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Inspired by the agricultural bounty of the North Carolina Piedmont and the funky, free-spirited vibes of Carrboro, Steel String adapts modern American brewing styles and techniques into a unique North Carolina vernacular. Steel String aims to brew beer that represents the culture and character of our local community.

“Welcome,” Steel String Brewery

Three-year-old Steel String Brewery was owned by three friends—Will Isley, the brewer; Andrew Scharfenberg, the business manager; and Eric Knight, planner for events and promotion. By July 2016, they had established a successful pub in downtown Carrboro, North Carolina, just a mile or two from the University of North Carolina at Chapel Hill campus. With an active craft-brewing scene, North Carolina had lots of people looking for good, local beer in bars, restaurants, and bottle shops. Therefore, it was not surprising that Steel String had faced fierce competition from other craft breweries in their first few years of operation. However, their determination led to continued growth, which allowed them to hire three other regular employees—Jesus Koesling, the assistant brewer; Steven Horton, the pub manager; and Alfred Kilzi, the odd-job man. They also had a group of bartenders who worked a shift or two each week. However, at the start of 2017, the co-owners had been grappling with several questions: Should they invest in the machinery and labour to start bottling their beer? Further, should they consider different pricing strategies? And finally, what additional ways could they look at for giving back to their community through their social responsibility efforts?

Craft Brewing at its Best

The brewery was in the same space as the pub, and while crowded, had a capacity of 600 barrels of beer a year. The beer was sold in three ways. First, and by far the most profitable, was through the pub. Second, some beer was sold in half-barrels to restaurants and other pubs in the area. Third, some specialty beers were sold in half-litre bottles to bottle shops—stores in the area that catered to the growing audience of people looking for an interesting beer or searching for a special taste. With this continued growth and success (see Exhibit 1), Isley, Scharfenberg, and Knight wondered what their next steps should be.

Pints in the Pub

In the pub, a 12- or 16-ounce glass of beer sold for US$5[[1]](#footnote-1) to $6, depending on the beer. Their biggest seller, Big Mon IPA, sold for $5.50 for 16 ounces; Rubber Room Session Ale was $5.25 for 16 ounces. High-alcohol beers and specialty beers were often sold at a higher price in the smaller glass, so the brewery’s strong Thick Freakness Stout was $6 for 12 ounces. The pub usually had eight or more of its own beers and one or two guest beers from other breweries on tap. Bottled hard cider, a limited selection of wine, and various soft drinks were also sold. The only foods sold were chips and nuts; however, North Carolina law allowed food from outside to be consumed in pubs, if the location did not have a kitchen. One of the regular specials was on one weeknight—if customers ordered a pizza from a certain food truck parked nearby, they got a dollar off their pizza if they bought a beer. The pub opened at 4 p.m. Monday through Wednesday, at 2 p.m. on Thursday and Friday, and at noon on Saturday and Sunday. There was seating for 55 inside and a shaded patio out front that sat about 35. Winter days were mild in Carrboro, and the patio was often crowded, even in January and February—its coldest months.

Half-barrels in Restaurants and Specialty Beers in Bottle Shops

Selling half-barrels to restaurants and other pubs was more difficult than most people thought. There were only so many taps in any area; if someone added a new beer, someone else’s beer had to be eliminated. Many places had a “rotating tap” that featured different beers at different times; if a brewery sold a half- barrel to be featured in that rotation, it could sell to that place only occasionally. On the other hand, filling and delivering half-barrels was easy, and breweries could rent empty barrels for almost nothing. Steel String charged $190 for a half-barrel of their beers. Big Mon IPA was the beer most often sold in half-barrels.

The specialty beers that Steel String bottled were aimed at beer aficionados. The brewery bottled sour beers, beers with fruit flavours, and beers aged for many months in used wooden wine or bourbon barrels. These were bottled using a home-made rig of lumber and tubing. Steel String sold these to bottle shops at a high price, often over $75 for a case of 12 half-litre (roughly 17 ounce) bottles. On the shelf, these bottles retailed for $8 or more. While profitable, putting these beers in bottles using this homemade bottling rig was slow and labour-intensive, and the market for beer at such high prices was limited.

In North Carolina, small brewers could deliver packaged beer to stores directly; however, larger brewers, like all brewers in many states, had to use a distributor—a middle-man. This law allowed Steel String to sell its half-barrels and specialty beers directly to restaurants and retailers in the area and get to know the customers directly—a competitive advantage in a market where knowing the target audience was key. Given the active craft brew scene in Carrboro and the surrounding area, the Steel String partners wanted to determine the best way to capitalize on locals’ willingness to pay a premium for good craft beer. Altogether, Steel String sold about 350 barrels of beer through these three channels. The brewery was profitable, but that excess capacity was tempting to the three partners. They really liked making beer, so if they could sell the extra they would happily brew the extra. They also saw it as a business opportunity. More and more, small breweries were putting their beers into 12-ounce bottles and cans—the size most Americans were used to. These smaller containers were then sold in four- or six-packs, just like mass produced beer, though at higher prices.

Beer in Bottles

The partners were confident that they could sell the beer from their excess capacity by packaging their best-selling beers in four- and six-packs of 12-ounce bottles. But would it be profitable? Big Mon was incredibly popular and was expected to bring a higher than usual premium in bottle shops, retailing for $13.99 per six-pack, while Rubber Room was expected to sell for $11.99 at the bottle shop. Wholesale price was just under 75 per cent of the retail price for craft beer sold to bottle shops. For example, the wholesale price for a case of 24 bottles would be $41 for Big Mon and $35 for Rubber Room. The partners also planned to sell some seasonal beers in four-packs of bottles or cans. They figured on a wholesale average price of $38 per case.

There was a lot involved in bottling. Buying a canning or bottling machine, getting labels and six-pack carriers, choosing between cans and short or tall bottles, and getting a loan were a few of the things that came to mind. They had decided to look into it, and Scharfenberg, the business manager, had started making calls and talking to other small brewers in the area.

First, they needed to figure out how many cases (each with 24, 12-ounce bottles or cans) they could make if they put all of their excess capacity into making packaged beer. A beer barrel was 31 U.S. gallons, or 3,968 ounces. But no manufacturing process was perfect, so they needed to account for some spilled beer and poorly filled bottles—maybe 5 per cent wastage—while getting the beer into bottles. Steel String’s equipment was set up to brew seven-barrel batches. Isley figured that it would cost about $1,100 for each batch of the beers they expected to sell in four- and six-packs of 12-ounce bottles. However, the specialty beers they sold in the half-litre bottles and in the smaller glasses in the pub often cost more to brew.

After a lot of searching, Scharfenberg found a bottling machine he thought was right for Steel String. This machine had two filling heads, and once it was set up and running, filled about eight bottles per minute. Starting it up and getting everything adjusted took about a half hour, as did cleaning everything when bottling was over for the day. To operate it, two people were needed to keep things adjusted, take empty bottles from cases, feed them into the machine, and then take full ones off the machine and put them back in the cases. The sales material from the machine manufacturer implied that two workers would need about five hours to set up the machine, fill 50 or 60 cases, and clean everything afterwards. The machine worked best if the operators labelled the bottles first and put empty, labelled bottles in six-pack carriers in the cases. The machine would cost Steel String $40,452 delivered to their brewery; training, including travel and accommodation for a night or two in a motel, would cost another $1,500. However, the travel could be considered a relevant excursion because they would pass through the craft-beer hot spot of Asheville, North Carolina on the way.

Packaging materials were more expensive than people generally believed, based on the fact that consumers usually recycled them or threw out empty ones without considering their cost. The shorter bottles, which worked with the bottling machine that Scharfenberg liked, cost 24 cents each. Each label cost four cents, including running it through the labeller, and the crown (the official name for a bottle cap) was a penny. All the cardboard—the four- or six-pack carriers and the heavy corrugated case itself—came to almost $2 per case. The company would then also have to buy a labelling machine for $1,750, and those full cases would have to be delivered to the bottle shop shelves or the restaurant coolers. If the company packaged 50 to 60 cases each week, distribution would take the driver an average of about 10 hours per week. A van was needed that would hold much more than the cars the company had been using for distribution of the half-barrels and specialty beers. The purchase of a van would cost about $450 per month. Gas and the driver’s wages would come to about $150 per week.

Social Responsibility

Finally, even though Steel String was a small start-up business, social responsibility was important to the partners, who had spent time and money engaging in some of these initiatives. The company paid all its workers at least the local living wage of $12 an hour for those who received tips and $13 for others. The spent grain, left over after brewing, was picked up by a local firm for composting. Fundraisers were hosted for many local organizations. The company had allowed voter registration officials to set up a table at the pub and to hold campaign events that kicked off voter registration in the area. The partners also joined the Bike-Friendly Business Program in Carrboro, which was created by a bicycle advocacy group called the Carrboro Bicycle Coalition. This organization recognized businesses that supported and encouraged employees to bike or walk to work when possible. Steel String joined this program in 2014, and renewed its membership each year. As the company continued to grow, it looked forward to engaging in other socially responsible projects, in addition to expanding the way it sold its beer.

As can be seen from the balance sheet (see Exhibit 1), the three partners did not have much extra capital for themselves after getting the brewery started. However, Steel String had a good credit record. It had paid its bills on time, including a bank loan to cover some of the costs of getting started, and the bottling machine could be used as collateral. Also, interest rates were low after a few years of low inflation and a soft economy. Scharfenberg thought he could get a bank loan at 5.9 per cent for four years, which was the extent of their future forecast. Taking out another loan and starting a new (though related) line of business was a big undertaking. Scharfenberg, Knight, and Isley now needed to decide: should they start bottling Big Mon IPA, Rubber Room Session Ale, and some of their other beers?

Exhibit 1: Steel String Financial statements as of October 2016

Profit and Loss Statement Year Ending October 1, 2016

|  |  |
| --- | --- |
| **ORDINARY INCOME** |  |
|  |  |
| **Sales** |  |
| Bar | $472,198.64 |
| Kegs | $54,432.74 |
| Keg deposits and refunds | $1,740.39 |
| 500 ml bottles | $50,333.30 |
| Other | $20,608.59 |
| Festival income | $24,349.70 |
| Other income | $550.54 |
|  |  |
| **Total Income** | **$624,213.90** |
|  |  |
| **COST OF GOODS SOLD** |  |
|  |  |
| **Purchases** |  |
| Beer | $23,714.00 |
| Food | $10,022.26 |
| Glassware | $6,173.64 |
| Shirts, etc. | $4,111.93 |
| Wine | $5,783.94 |
| Costs of other goods sold | $40,860.86 |
| Bottles | $15,803.03 |
| Malt and hops | $33,761.76 |
| Yeast | $5,720.03 |
|  |  |
| **Total** | **$145,951.45** |
|  |  |
| **Gross Profit** | **$478,262.45** |
|  |  |
| **EXPENSES** |  |
|  |  |
| Barrels | $3,681.45 |
| Keg rentals | $8,580.59 |
| Other brewery supplies | $4,375.20 |
| Draft line cleaning | $214.50 |
| Advertising and promotion | $5,159.58 |
| Bar equipment | $87.00 |
| Automobile expense | $5,569.97 |
| Amortization expense | $823.91 |
| Bank fees | $389.00 |
| Computer and internet | $583.50 |
| Software | $654.90 |
| Continuing education | $234.00 |
| Depreciation | $39,925.68 |
| Donations | $10,313.02 |
| Permits | $260.00 |
| Dues and subscriptions | $2,189.53 |
| Meals and entertainment | $2,533.26 |
| Hotel | $502.16 |
| Insurance | $13,197.77 |
| Bar supplies | $13,787.19 |
| Office supplies | $1,132.45 |
| Miscellaneous | $990.00 |
| Uncategorized | $10.00 |
| Payroll taxes | $13,487.69 |
| Postage and delivery | $2,883.15 |
| Professional fees | $24,283.05 |
| Performer fees | $7,938.30 |
| Festival expense | $10,587.07 |
| Festival advertising | $500.00 |
| Rent | $74,503.68 |
| Construction costs | $17,662.53 |
| Repairs and maintenance | $3,939.71 |
| Guaranteed payments to partners | $12,300.00 |
| Payroll—employees | $130,912.66 |
| Payroll fees | $1,702.76 |
| Taxes, licenses, permits | $33,274.15 |
| Cable, Internet and Phone | $2,612.04 |
| Travel expense | $4,923.25 |
| Utilities | $17,046.04 |
| Interest expense | $2,378.13 |
|  |  |
| **Total Expense** | **$476,084.05** |
| **Net Ordinary Income** | **$2,718.40** |
| **Other Income and Expenses** |  |
| **Other Income** |  |
| **Other Income** | **$734.65** |
| **Gain on Sale of Asset** | **$16,000.00** |
| **Other Expense** | **$8,000.00** |
| **Net Other Income** | **$8,734.65** |
| **Net Income** | **$10,913.05** |

Note: ml = millilitre

Source: Company files.

Exhibit 1 (continued)

Balance Sheet Year Ending October 1, 2016

|  |  |
| --- | --- |
| **ASSETS** |  |
| **Current Assets** |  |
| Checking | $35,786.10 |
| Money market | –$18,527.58 |
| Petty cash | $1,200.00 |
| Total | $18,458.52 |
|  |  |
| **Accounts Receivable** | **$4,601.37** |
|  |  |
| **Other Current Assets** |  |
| Undeposited funds | $8,098.49 |
| Inventory | $6,574.25 |
| Total | $14,672.74 |
|  |  |
| **Total Current Assets** | **$37,732.63** |
|  |  |
|  |  |
| **Fixed Assets** |  |
| Brewing equipment | $88,019.74 |
| Bar furniture and equipment | $212,628.76 |
| Computer equipment | $1,824.22 |
| Leasehold improvements | $184,561.64 |
| Accumulated depreciation | –$292,928.00 |
| Start-up costs | $12,358.70 |
| Accumulated amortization | –$2,746.37 |
|  |  |
| **Total Fixed Assets** | **$203,718.69** |
|  |  |
| **TOTAL ASSETS** | **$241,451.32** |
|  |  |
|  |  |
|  | |
| **LIABILITIES & EQUITY** |  |
| **Liabilities** |  |
| **Current Liabilities** |  |
| Accounts payable | $1,347.00 |
| Credit cards | $9,016.90 |
| Sales tax payable | $3,232.00 |
| FICA tax payable | $2,211.92 |
| Fed withholding tax payable | $2,012.01 |
| State withholding payable | $820.00 |
| Fed use tax payable | $381.83 |
| State use tax payable | $684.45 |
| Loans payable | $26,275.11 |
| **Total Current Liabilities** | **$45,981.22** |
|  |  |
| **Long-Term Liabilities** |  |
| Member loans | $350,000.00 |
| Bank loans | $160,967.21 |
| Total | $510,967.21 |
|  |  |
| **Total Liabilities** | **$556,948.43** |
|  |  |
| **Equity** |  |
| Member equity | –$318,218.65 |
| Retained earnings | $46,595.22 |
| Member distributions | –$123,296.61 |
| Net Income | $79,422.93 |
|  |  |
| **Total Equity** | **–$315,497.11** |
|  |  |
| **Total Liabilities & Equity** | **$241,451.32** |
|  |  |

Note: FICA = Federal Insurance Contributions Act; Fed = Federal

Source: Company files.

1. All currency amounts are in US$ unless otherwise specified. [↑](#footnote-ref-1)