BREWING SUCCESS IN A DROUGHT: HOW NATIONAL BREWERIES USED PROHIBITION TO THEIR ADVANTAGE

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Ben Smith is a sophomore studying Economics and German at the United States Military Academy. He wrote this paper for an American History course in order to investigate how the modern-day domestic brewing giants came to power. Ben chose to write about this after watching a documentary on the struggle of craft breweries trying to capture market shares from major corporations.

The histories of America and that of the American brewing industries are closely tied. Studying the history of the brewing industries yields not only to the discovery of economic trends, but also sheds light upon contemporary attitudes towards brewing. Since European colonization, beer has been an important facet of everyday life, given the times of unpredictable quality of the water supply. This lifestyle, however, was dramatically altered during the era of Prohibition, which was ratified through the 18th Amendment in 1919. This amendment temporarily terminated the legitimate production of brewing industries in America. Following the repeal of Prohibition in 1933, the industry was markedly different in both structure and competitive environment. There existed two types of business models: local breweries which were small, family owned, limited to a local distribution, and national brands which shipped product outside of regional boundaries.[1] The relationship between these two types of breweries changed drastically during the years of Prohibition and would reflect a new brewery climate in the post Prohibition years. The amendment enabled the rise of dominance of national firms over regional and local breweries in the market through aggressive and entrepreneurial adaptations. These adjustments consisted of infrastructural investments involving new technologies and legislation that led to a restructuring of the industry in favor of larger breweries.

National corporations did not always exist in such a powerful position as they do in modern domestic beer markets. Prior to Prohibition,

[1] Anand Swaminathan, "Entry into New Market Segments in Mature Industries: Endogenous and Exogenous Segmentation in the U.S. Brewing Industry," *Strategic Management Journal* 19, no. 4 (1998): 391.

the industry had reached equilibrium between local and national firms.[2] Most breweries consisted of small, family-run ventures that catered to localized markets. The shelf-life of products and the difficulties to keep beer refrigerated for a large portion of the year kept these smaller industries localized. Larger operations, such as Pabst and Anheuser- Busch, utilized refrigeration and pasteurization to expand their potential distribution network outside of local boundaries. The expanded markets, however, did not lead to a dominant position in the industry in the pre- Prohibition period, as shipping costs were high and legal arrangements with local saloons prohibited market infiltration.[3] The state of the brewing industry was an uneasy balance of big business and family-owned operations, whose products were soon to be designated illegal.

Once Prohibition was in effect, breweries all across the country were faced with the decision to either liquidate their assets or attempt to adapt and survive to what they thought would be a temporary hindrance. Some of the larger breweries with factories, such as Anheuser Busch, produced products such as malt syrup and other non-alcoholic beverages.[4] Other survival techniques included the closure of saloons previously used to sell product to the masses.[5] Additionally, minor production of beer by select, politically connected breweries was allowed per special medicinal licenses.[6] This limited production, though, was nowhere near pre-Prohibition levels. Despite these creative efforts to keep their businesses going, most small breweries simply stopped operation during this era.

The popularization of bottles during this time period led the major breweries to gain valuable experience and relationships with the bottling industry.[7] This competitive advantage led to a greater success rate after Prohibition for larger breweries that had continued operations.[8] The experience and necessary adaptation during Prohibition gave the surviving

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[2] Martin Stack, "Local and Regional Breweries in America's Brewing Industry, 1865 to 1920," *The Buisness History Review* 74, no. 3 (Autumn 2000): 450.

[3] Ibid., 462.

[4] Amy Mittelman, "Chapter 4. Who Will Pay the Tax? Brewers and the Battle Over Prohibition, 1905-1933," in *Brewing Battles: A History of American Beer* (New York: Algora Pub., 2008), 89.

[5] Thomas Childs Cochran, *The Pabst Brewing Company; the History of an American Business* (New York: New York Univ. Press, 1948), 340.

[6] Ronald Jan. Plavchan, *A History of Anheuser-Busch, 1852-1933.*, PhD. diss., St. Louis University, 1969, 168.

[7] Ibid., 178.

[8] United States Federal Trade Commission, Bureau of Economics, *The Brewing Industry*, by Charles F. Keithahn (Washington, D.C.: Federal Trade Commission, Bureau of Economics, 1978), 13.

breweries a competitive edge to exploit following the repeal of the amendment.

The ratification of the 21st Amendment created the rebirth of an industry overnight—an industry, however, that bore little resemblance to the old system of brewery-owned saloons. One of the major changes was the government regulated distribution chain from producer to consumer. Before Prohibition, large breweries that attempted to ship into new markets found no place to sell their product because of the saloon system. In this system, local breweries owned and operated saloons to distribute their beer exclusively to their regional market. This policy put Anheuser-Busch and other large shipping brewers at a competitive disadvantage before Prohibition.[9] At the urging of these brewers, President Franklin Delano Roosevelt created the Federal Alcohol Control Administration, made possible by the National Industrial Reconstruction Act, one day before the enforcement of the 21st Amendment.[10] The new system forbid the old style of saloon distribution, and opened up many more markets for the national shipping breweries. This introduced competition from outsiders into areas where for decades local breweries had held near-monopolies. National brewers reached these newly opened markets by utilizing technological advancements in canning and shipping perfected during Prohibition-era operations to level with, or gain advantage over local operations. Practices such as remote bottling, where beer was canned or bottled at the factory, enabled the distribution of shipments in bulk, which led to lower manufacturing and shipping costs.[11]

The New Deal Legislation that mandated a new system of distribution ultimately sought to generate as much tax revenue from the brewing industry as feasible to fund various projects. All breweries, both national and local, were subject to tax rates 400 to 500 times greater than before Prohibition in addition to the induction of an annual permit fee. [12] Smaller breweries that decided to reopen in 1933 faced higher fixed costs, due to higher taxes, that posed significant threats to their existence. Additionally, expansion to compete with larger breweries required sizable capital, which was difficult to support during the economic climate of the Great Depression. Despite these high costs, the dark years of Prohibition were still fresh in the brewers' memories, thus, they were content with

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[9] Amy Mittelman, "Chapter 5. Beer Flows: Repeal of Prohibition, 1933-1941," in *Brewing Battles: A History of American Beer*. (New York: Algora Pub., 2008), 103.

[10] Executive Order no. 6474, *Creation of the Federal Alcohol Control Administration*, 1933.

[11] Mittelman, "Beer Flows," 118.

[12] Ibid., 98.

paying these dues as they struggled to create a positive public perception of the industry while attempting to carve out a market for their new product.

Lower bottom lines for national breweries and a plethora of open markets set the conditions for the rise of giant firms to dominate the industry. From 1934 to 1940, the number of breweries in the United States dropped from 756 to 684, while the average barrelage per brewery increased from 49,867 to 80,263.[13] This indicates a trend which points to the increase in larger companies. While there were a few larger breweries that failed during this period, the vast majority were local, family-run operations that could not survive in the new competitive climate. These small-scale brewers could not compete with the lower prices offered by the national brewers. High foreclosure rates of the small breweries led to even more aggressive expansion by national brewers into new markets. Anheuser-Busch and Pabst both doubled their annual output between 1935 and 1940, and the growth of these national brands had just begun.[14]

August A. Busch Jr., presidents of Anheuser-Busch, declared on December 5, 1933, the day Prohibition was repealed, via a national radio broadcast, that "happy days are here again."[15] Indeed, "happy days" were in the future for large breweries such as Busch's which went on to garner massive profits in the coming decades. Other breweries, however, were less optimistic about the future of the industry. In 1938, head of the American Brewers Association, John Bruckmann, predicted that the competitive advantages held by the larger brewers would one day result in a "few large brewers . . . manufacturing all of the beer in the United States."[16] Factors favorable to the rise of a few, powerful breweries, were brought about by the changes in the industry's environment as a result of Prohibition. Ultimately, higher bottom lines for smaller operations caused by increased taxes, a wider distribution range in which to sell products gained by the Prohibition experience, and an abundance of potential growth available within this larger sphere due to high mortality rates for breweries, set the conditions for an overhaul of the industry. These conditions enabled the rise of mega-breweries that dominate the brewing market to this day.

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[13] Martin Stack, "A Concise History of America's Brewing Industry," *EH.Net Encyclopedia,* edited by Robert Whaples, 2003.

[14] Ibid.

[15] August A. Busch Jr., "National Radio Address Celebrating the repeal of Prohibition," speech made on national radio, St. Louis, Missouri, December 7, 1933.

[16] Mittelman, "Beer Flows," 119.