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https://doi.org/10.1080/00076791.2015.1041381

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Vertical monopoly power, profit and risk: The British beer industry, c.1970-2004

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Abstract

By investigating surplus and risk distribution in the British brewing industry, this paper shows that risk and risk transfer are important dimensions of vertical supply chain relationships. A comparative financial analysis shows the effects of models of vertical ownership before and after the break-up of producer controlled tenanted estates and the strategy and performance of pub-owning companies. Contrasting mechanisms for controlling the capture of surplus and division of risk are evaluated. The paper complements prior studies that have concentrated on the brewers by assessing winners and losers amongst pub owning companies and tenants in different models of vertical organisation and how they might be effectively regulated.

Key words: Beer industry; United Kingdom; Pub Companies; vertical control; risk; regulation
Vertical monopoly power, profit and risk: The British beer industry, c.1970-c.2004

1. Introduction

The defining characteristic of the British beer industry has long been the vertical tie, whereby brewers restricted the choice of beer, and often a wider range of alcoholic and soft drinks, that the tenant was permitted to retail. The historical evolution of this tie has been well documented with particular emphasis being placed on the need for brewers to secure outlets for their beer.¹ One feature of the tie, which has not received comparable attention, is the extent to which it affected the transfer of risk and the allocation of surplus between brewer and tenant. By comparing the financial consequences of alternative tied arrangements, this paper evaluates the extent to which major regulatory changes were beneficial for key players in the value chain.

The nature of surplus distribution and risk sharing in network governance, especially between first the brewer, and subsequently the pub-owning company (Pubco), and tenant, was a fundamental and long-established feature of the British brewing industry. Comparing these systems of ownership, two similar but distinct models of vertical network governance can be identified. The first, which prevailed until 1990, was the system of vertical control by large breweries over estates of tenanted or directly managed pubs. The managed house represents complete vertical integration and the manager is, in every respect, an employee of the brewer. A salaried manager runs the pub without incurring risks but also without sharing the profits. Hierarchical control and the power of fiat replace market based exchange and contracts and monitoring deal with residual moral hazard problems.²

The power that was exercised by the breweries in this respect led to regulatory reviews in 1969, and again in 1989, which resulted in the Beer Orders. As a consequence, brewers were forced to divest significant portions of their tied estates.³ In turn, this led to the
rapid emergence of the second model of vertical ownership, based on the Pubco and a renewed consolidation of tenanted estates. These developments led to further questions about the market dominance of Pubcos, the fair treatment of tenants and, indeed, the sustainability of Pubcos.5

In the second model, where tenants manage the pub, the licensee’s remuneration was based on a combination of property and beer margins (‘dry’ and ‘wet’ rents respectively). In terms of transaction cost economics (TCE), such arrangements were hybrids between the managed house and the free house, in which the landlord owned the property and assumed all the profits and risks of the enterprise. However, by its very nature, the advantages of this type cannot be described using a standard TCE approach.6 The hybrid form complicates issues of governance because it occupies the middle ground between market-based exchange and complete internalisation, in which, ‘business partners are neither friends nor strangers’.7 Nonetheless, it has the potential to deliver numerous advantages: it reduces transaction costs (trust implies there is less opportunism) and encourages cooperation. Additionally, hybrids facilitate long-term relationships (short-term, market-based contracts, encourage opportunism), because they foster mutual flexibility in the use of resources by relevant parties.8 Where long term interdependencies and relational contracting occurs in hybrid contexts that are neither hierarchical nor purely market based, personal relationships, reputation and trust can also be important and counteract the purely cost driven motives that might otherwise underpin network governance.9 Insofar as these forms lower transaction costs and deliver surplus, the division of such surplus and associated business risk remains problematic in terms of specifying governance arrangements.

As a consequence, the beer industry has the potential to illustrate the nature of such problems and attempts at solution. Moreover, vertically controlled organisation structures pose potential problems for regulators, particularly when monopoly power can be exercised
at key stages in the value chain. In the absence of integration, powerful operators can exercise dominance through direct contract specification motivated by cost minimisation.\textsuperscript{10} A specific aspect of the brewery tie and Pubco models that has not hitherto been investigated is the question of how much surplus or profit was generated under each regime and how the surplus and risk was distributed between the relevant parties, including the new financial stakeholders that entered the industry in the wake of the Beer Orders. In addressing these questions, the paper builds on previous histories of the British beer industry that have concentrated on the strategy and performance of the major brewers.\textsuperscript{11}

The paper complements previous research by considering for the first time the relative financial performance not just of Pubcos, but also of pubs themselves. Leaving the specifics of ownership temporarily aside, the British pub sector effectively consists of thousands of small businesses. To investigate the distribution of surplus and risk in vertical networks, the paper utilises pub level financial data to consider how these were shared in the pre and post Beer Orders models. For the purposes of assessing the relative profitability of brewers, Pubcos and pubs, the paper uses a variety of source material, including the financial accounting data of leading firms drawn from their annual accounts and statistical databases. It also draws on data from the major parliamentary enquiries of 1969, 1889 and 2004.\textsuperscript{12} The parameters of the study are set to include a sufficient window for the analysis of the pre-1989 system and the subsequent model, ending in 2004 to include evidence from the Department of Trade and Industry (DTI) enquiry of that year, but to exclude the effects of the financial crisis that developed in 2007 and which had further substantial implications for the British pub industry and which are beyond the scope of the present enquiry.

The paper is organised as follows. Section 2 provides further elaboration of theories to establish the value of an analysis of surplus, risk and governance relationships within vertical networks. Section 3 provides an analysis of the emergence of the vertically integrated
tied house model and the effects of its replacement with the Pubco model after 1991. Section 4 presents a case study of one Pubco, Enterprise Inns PLC (EIP), and the reasons for its emergence as the largest owner of pubs in the UK by the time of the 2004 DTI enquiry. Section 5 compares the financial performance of brewers in the periods before and after the Beer Orders. It also compares the performance of EIP with the rest of the industry. Section 6 analyses the financial performance of pub businesses under different contractual arrangements before and after the Beer Orders and examines the pattern of surplus and risk distribution within the value chain. Conclusions are presented in Section 7.

2. Vertical organisation: Surplus, risk and governance

Flexible structures have become more prevalent over recent decades, and have been the subject of significant research. Organisational theorists concerned with inter-firm relationships have tended to stress trust and commitment, whereas industrial economists and new institutional approaches highlight power and opportunism. As a consequence, there is a large literature on the potential advantages of inter-firm collaboration and how identity, path dependence and economies of specialisation might be combined with flexible and improvised organisational forms. Where there is increased uncertainty of customer demand, for example owing to obsolescence or seasonality, but also arising from social and regulatory changes, firms prefer vertical decoupling, thereby increasing the flexibility of the firm in conditions of uncertainty. At the same time, bilateral dependency leads to a lack of choice and increased risk of opportunism. Sharing human capital binds networks together and improves their performance, as does the product’s technical specification, thereby creating process improvements and product development opportunities. Managing network flows of resources and information involves developing co-ordination mechanisms that can be effectively governed, where governance involves inter alia mediating third parties that to
some degree are institutionalised. Such mediating institutions tend to be absent in UK and US models, leading to imbalances in the value chain that might result in market failure.

Such imbalances occur where activities in a supply chain are controlled from a ‘vantage point’, normally the organisation in the network closest to the final transformation of the product before it reaches the consumer. A dominant organisation occupying the vantage point can critique its customers/suppliers and potentially help them develop, but such evaluations do not usually operate in reverse. Although several authors have stressed the importance of fairly sharing risks and benefits derived from joint effort between buyers and suppliers, and acknowledge that close relationships between a powerful buyer and its supplier firms create the opportunity to ‘systematically shift risk’ to the weaker side, there is still a lack of rigorous cross-industry empirical research on risk and benefit sharing within supply networks. In addition, where financial aspects are referred to, the emphasis, given the predominance of theoretical perspectives from institutional economics, tends to be on transaction cost efficiencies. Risk, meanwhile, is specifically about supply risk and the counteracting effects of buffering. Financial risk and operating risk arising from the variability of a firm’s cash flows within the network, has not been incorporated into these conceptual models and taxonomies.

However, it is clear that such risk might be avoided or imposed according to the power structure of the network. In turn this risk distribution depends on the specification of contracts in vertical and relational contexts. For example, a powerful network member might specify a contract to receive relatively stable cash flows at the expense of increasing the variability of cash flows for another, weaker, network member. Differing attitudes to risk are also important in principal-agent relationships, or where such relationships are supplanted by some degree of trust. Consequently, a risk-averse network member might benefit from network membership by surrendering some share of the surplus in return for another member
absorbing more of the risk.

A further missing dimension of the analysis of vertical network governance, which has concentrated on the relationship between firms within the network, is the role of financial intermediaries and investors.27 Some research has considered the cooperative benefits of the venture capitalist relationship with entrepreneurs, and the issue of entrepreneurial opportunism,28 but there has been less attention given to the requirements of investors and their effects on parties at multiple layers of vertical organisations, or associated risk sharing arrangements.

Where hybrid organisations can use these relational resources effectively, to create flexible structures that transcend industry boundaries, they can be an important source of competitive advantage.29 Where competitive advantage can be achieved, the role of network governance and the determinants of surplus distribution within the network remain of substantial importance. Where interdependence is high, and power is therefore more equally distributed, surplus is also shared more equally. On the other hand, concentrated power within a network, particularly at strategic points in the value chain, may lead to the appropriation of value by specific participants at the expense of other, weaker members. Where the focus shifts from networks that achieve competitive advantage to networks operating in declining industries, the forces leading to the allocation of surplus, and the associated distribution of risk can potentially intensify. As the rate of profit and accumulation has slowed in recent decades in core industries,30 increasing corporate indebtedness and the dominance of financial markets and ideologies, such as shareholder value maximisation,31 suggest the importance of evaluating the role of financial intermediaries as part of the process of surplus and risk redistribution within vertical networks. The role of these intermediaries has been regarded as negative by some, for example leading to less investment in plant and equipment and increased short-termism,32 although further empirical evidence is needed,
particularly in relation to vertical networks. The British beer industry and the evolution of its vertical structure over several decades provide a unique opportunity to examine these relationships, and specifically to address the question: which method of vertical structure leads to improved performance of participants and how is the resulting surplus and risk allocated within the network to ensure long term stability and sustainability?

3. The beer industry before and after the Beer Orders, 1989

The rise of the tied and managed house systems

The principal long standing feature of the vertical organisation of the British beer industry was the tied house system which was well established by the nineteenth century and continued to occupy a central role in the long-run evolution of the industry. It developed rapidly before 1914 as the brewery firms utilised stock market and bank finance to secure control of extensive property portfolios. In the inter war period, prompted by declining beer consumption, the control of the larger brewers was consolidated through a series of mergers. Given the inherited pre-1914 structure of vertical integration, the only way brewers could maintain output with declining demand was to enlarge their market area by acquiring the licensed houses of other brewers via merger and acquisition. There were further merger waves in 1953–54, 1959–61, 1968, 1972, and 1978–79. Rapid concentration, particularly in the 1959-61 wave led to the emergence of the ‘Big 6’ national brewers, which following the abortive MC enquiry of 1969, controlled significant estates of pubs (Table 1). Subsequently, conglomerate mergers became a feature of the industry’s development. For example, the hotel chain Grand Metropolitan acquired the London brewers Truman, Hanbury & Buxton, in 1971, and Watney Mann, in 1972, while Allied Brewers acquired the food company J. Lyons & Co., in 1978. Nonetheless, as Table 1 shows, the concentration of
ownership of pubs by the ‘Big 6’, which emerged by 1970 was, for all practical purposes, that which confronted the Monopolies and Merger Commission (MMC) in 1989.

**Table 1 about here**

The tied arrangements, which evolved as a result of these transactions and institutional arrangements, had important impacts on the potential for unlocking scale and scope economies of the one hand, and for the evolved mechanisms of surplus and risk distribution between the network partners, on the other. They had several interacting components. The first of these was the ‘wet rent’, effectively the difference between the inflated ‘tied’ price of beer and the price that it could be purchased for in the market. The second was the ‘dry rent’, corresponding to the cost of renting the pub as a property, which included a benefit in kind element or nominal dry rent for associated domestic accommodation. The third was an element arising from managerial and other economies of scale that potentially provided the basis of co-operation in the vertical relationship. In today’s technical language of the industry, these are referred to as ‘special commercial or financial advantages’ (SCORFA), which include training, legal and professional support, business development managers, investment and centralised purchasing and technical services. The balance between dry and wet rent, which also included soft drinks and wines and spirits affected how the gross surplus generated from retail activities were shared between the tenant and the brewer.

The alternative to tenancy arrangements was the ‘managed house’, where managers were salaried employees of the brewers. Tenanted and managed houses differed significantly in terms of the risk and return they offered to brewer and tenant/manager. For example, the pay that a salaried manager received was independent of the earnings of the pub, and no dry rent was paid because this was part of the total remuneration package to the manager. If the pub was highly successful, which tended to be the case with larger pubs with steady revenue,
all the profits were returned to the brewer. The brewer meanwhile was responsible for the upkeep of the house and improving its amenities. Tenancy and managed house beer retailing had one major advantage compared to the free trade: greater control over quality at the point of sale. Both systems also required the tenant or manager to retail the beers produced by their brewer-landlord.40

For these reasons, between 1970 and 1990, a managerial hierarchical system prevailed in most of the industry. Investigations by the MMC reported that the ‘Big 6’, owned 52 per cent of the total pub stock in Britain and that the number of pubs owned by all brewers accounted for approximately 80 per cent of all British pubs meaning, therefore, that ‘free houses’ were very much in the minority.41 In addition, managed as opposed to tenanted houses became relatively more important. For example between 1971 and 1990, managed houses as a proportion of brewers’ ownership of all public houses increased from 25.4 to 31.2 per cent, respectively.42

The predominance of the managerial system also reflected the outcome of the 1969 MC investigation into the monopoly structure of the industry. The investigation revealed, but failed to act on, a series of conflicts between landlord and tenant. From the tenants point of view these included restrictive practices in terms of the range of beers stocked and recent increases in dry rent without a corresponding reduction in wet rent.43 Unsurprisingly, the brewers viewed the tied-house system more positively, claiming that tied houses were in the public interest because this was the only system that enabled them to achieve economies in production and distribution. They further argued that it was reasonable that a tied-house should primarily sell the beers of the owning brewery since otherwise there would be no reason for the brewer to own pubs or to spend money on improving their amenities.44 One issue on which the brewers presented their strongest arguments concerned the nature of risk bearing and how this was affected by managed versus tenanted pubs. Some brewers claimed
that managers were only installed in their most expensive houses, which would not be remunerative unless they obtained the wholesale and retail profits from these houses. Often, these pubs were very large, with multiple bars, and therefore the personality of the licensee was much less important. Allied Lyons, for example, claimed that they intended to increase efficiency in their larger houses by introducing managers and ‘managerial systems’, which would be inappropriate for tenants. In the case of tenanted houses, the brewers claimed that they took a greater share of the risk than was appreciated and reiterated that their relationship with their tenants was a co-partnership and that tenants appreciated that risks were shared with brewers.\textsuperscript{45} Overall, the Commission agreed that the evidence did not suggest that tenants’ income was unduly low or, ‘that the division of income between tenant and brewer is unreasonable’. The Commission acknowledged that even among tenants there were, ‘few strong expressions that the tie should be abolished’.\textsuperscript{46}

\textit{The Beer Orders}

Notwithstanding this evidence, by the 1980s, there were calls for a further MMC enquiry. Part of the explanation for renewed interest were investigations launched by various Price Commissions\textsuperscript{47} in the 1970s which indicated that the tied-house arrangement acted as a barrier to entry and, because it restricted tenants’ access to independent wholesalers, it hindered their ability to compete with managed houses.\textsuperscript{48} The landmark MMC Report of 1989 was unequivocal in its attack on the tied-estate of the major brewers and its harmful effects on tenants:

\begin{quote}
We have unanimously concluded that a monopoly exists in favour of those brewers who own tied houses or who have tying agreements with free houses in return for loans at favourable interest rates…We have confirmed our provisional finding that a complex monopoly
\end{quote}
situation exists in favour of the brewers with tied estates and loan
ties...tenants are unable to play a full part in meeting consumer
preferences, both because of the tie and because the tenant’s
bargaining position is so much weaker than his landlord’s...the
complex monopoly has enabled brewers to keep tenants in a poor
bargaining position.49

Despite the efforts of the major brewers to negate these claims, the MMC
recommended a number of provisions, including, inter alia: the requirement to divest half the
number of pubs above the 2000 ceiling on the total number of on-licensed premises that
could be owned by any brewing company, or group, which necessitated a total divestment of
22,000 houses; the complete abolition of loan ties; that to improve the competitiveness of
tenants in the tied-trade, they should be permitted to purchase a minimum of one draught beer
from independent suppliers, and that brewers should publish wholesale price lists for the on-
licensed trade which document the discounts available.50 These recommendations were
subsequently enshrined in the Beer Orders of 1989.51

There can be no doubt that following the Beer Orders there was a pronounced
structural change in the ownership of pubs and full on-licenses which are set out in Table 1.,
Because the MMC concentrated on eradicating vertical integration between brewing and pub
retailing, the tie itself was retained, so that the key transformation was the rise of the Pubco
and the demise of the brewery-owned estate. Thus, the ‘Big 6’ national brewers, such as
Bass, Allied, and Whitbread, who had previously dominated pub ownership, were replaced
by Pubcos that were primarily only engaged in the retailing of beer, largely eradicating the
strong vertical ties which had existed between brewers and their pubs.52 The exceptions to
this were the regional brewers Greene King, Mitchell & Butler, and Wolverhampton &
Dudley who continued with a tied-estate, albeit on a much smaller scale than the nationals.
Nonetheless, like the ‘Big 6’ before them, the Pubcos continued to use beer ties. Enterprise Inns Ltd, Innspired, and Punch Taverns, all retained variants of the ‘full-tie’ model, in which the tenant was required to purchase all alcoholic drinks (beers, lagers, wines, spirits) from the brewer. The last two companies admitted that their tenants were tied only to buying beer, lager, cider and soft drinks and were free to purchase spirits, wines, cigarettes and food from independent sources. Enterprise reported that it imposed a range of exclusive purchasing obligations ranging from a full-drinks tie ‘all alcoholic and soft drinks’ to a partial tie, which only applied to beer.$^53$

However, the extent to which tenants legitimately purchased drinks outside the tie has been questioned. Some tenants operated as if they were subject to a ‘full tie’ because they feared the imposition of sanctions such as higher rent or reduced monies for repairs.$^54$ Exacerbating matters, decisions reached in the European Court of Justice on the anti-competitive effects of vertical ties (sometimes referred to as ‘quantity forcing’) could be permitted. Thus, in Roberts v. Commission, involving Greene King, it was accepted that an exclusive purchase agreement with a brewer possessing a very small market share was unable to contribute significantly to market foreclosure. Whitbread faced similar challenges. In this case, the use of a ‘tie’ did prevent competition, but the benefits from having the tie exceeded any negative effects and Whitbread were granted an exemption. Finally, in the mid-1990s, following Foster’s decision to sell its UK brewing interests to Courage (Scottish & Newcastle), the Pubco Inntrepreneur Estates Ltd (IEL) had no alternative but to buy its beer from Courage because Fosters still retained 50 per cent ownership of IEL.$^55$

The longitudinal stages of Pubco development can be summarised as follows. Stage one, immediately following the Beer Orders, witnessed the emergence of the Pubco, typically organised through a management buy-out and backed by a venture capital fund.$^56$ During this stage the new Pubcos expanded primarily through acquisitions of ‘parcels’ of pub estates.$^57$
The second phase began around 1995 with a series of initial public offerings in the shares of Pubcos.\textsuperscript{58} These transactions provided a potential exit for the original investors,\textsuperscript{59} although the general effect through institutional placings was to consolidate control through specialist private equity firms or venture capital arms of major international banks.\textsuperscript{60} Ownership by financial institutions through stock market listings provided the opportunity for a wave of takeovers and mergers in the Pubco sector. Consequently, the surviving Pubcos were able to build up large estates of tied houses (Table 1).

The creation of these estates, with predictable cash flows arising from the terms of Pubco leasing arrangements, led to the third phase, which occurred in the mid to late 1990s, and was characterized by the securitisation of Pubco debt by the banks.\textsuperscript{61} In effect this meant that new bonds, typically with high coupon rates, could be issued against the cash generation potential of pub income streams.\textsuperscript{62} These profits were based on controlled margins, since the Pubco determined the transfer price of beer to the pub and therefore the debt could be issued safely if cash based earnings exceeded the required interest payments.\textsuperscript{63} Although different firms passed through different stages at different times, the general characteristics of the life cycle were strikingly similar: a management buyout supported by venture capital resulting in rapid growth, leading to estate consolidation, concentration of buyer power and financial re-engineering of ownership claims.

The combined effect of such structural and financing changes was to create continuous pressure on the Pubcos to expand their estates. Acquisitions of new estates created opportunities to boost earnings in line with market expectations, partly because there were economies of scale associated with the increased buyer power. The Beer Orders led to concentration in the supply chain, with some firms exiting brewing, closing breweries and consolidating the remainder.\textsuperscript{64} Pubcos negotiated discounts with suppliers resulting in declining wholesale margins, whilst competition for estate contracts increased.\textsuperscript{65} A further
opportunity set arose from portfolio management of outlets such that poorly performing pubs could be closed down in favour of investment in typically larger, better performing pubs. These trends were potentially good news for the profits of Pubcos and their financial backers.

Meanwhile in 2000 the Office of Fair Trading (OFT) completed a follow-up report on the industry, which recommended that most of the Articles of the Beer Orders could be rescinded, as none of the big six brewers had kept estates that were anywhere near the 2,000 ceiling. The Orders were revoked in 2003 on the grounds that the restructuring of the pub trade left no one to whom the Orders were relevant.\textsuperscript{66} The increased market power of Pubcos nonetheless led to a new wave of parliamentary scrutiny, and an investigation by the DTI in 2004.\textsuperscript{67} Despite the emergence and growth of the Pubcos, by 2004, the ten biggest of these companies shown in Table 1, owned nearly 6000 fewer pubs than those operated by the ‘Big 6’ at the time of the Beer orders. Even so, by 2003-04, Pubcos owned a large majority of UK pubs, with the two largest, EIP and Punch, owning 58.6 per cent of UK pubs.\textsuperscript{68} Ironically, these two pub companies had greater market share than under the ‘complex monopoly’ broken up by the Beer Orders, when the two largest firms controlled 40.7 per cent of pubs.\textsuperscript{69}

As a consequence of this new market dominance, the Federation of Small Businesses (FSB) asked the OFT to investigate the market for the resale of beer through tied public houses in 2002. The concerns expressed by the FSB expressed were: tied tenants paid too much for their beer; they paid too much rent and did not receive adequate support from their Pubcos, especially when levels of trade fell below expectations; and the beer tie itself restricted choice. Many of these concerns were raised in previous MMC investigations but, in the early years of the new millennium, they had added poignancy because significant monopoly power remained in the industry. For example, in production, whereas in 1989 the ‘big six’ controlled 75 per cent of beer production, by 2004, just four brewers accounted for 76 per cent. In addition, surveys of tenants under the new regime revealed considerable
dissatisfaction. A survey conducted in 2004, revealed that 45 per cent of tenants responding said that they would ‘probably not’ or ‘definitely not’ take out another lease with their landlord. The relevant figures for EIP and Punch were worse, being 60 and 61 per cent, respectively. In addition, tenants of EIP and Punch had a low opinion of the fairness of their landlord as business partner, with 55 per cent assessing their degree of fairness as ‘poor’ or ‘very poor’. Why, then, did the post beer order model generate these criticisms and lead to further regulatory investigation?

4. Enterprise Inns

As the largest Pubco, EIP’s history exemplifies the pattern of Pubco development sketched in the previous section and whose business model provides a useful opportunity to assess the processes of value capture and risk transfer within tenanted arrangements. The firm grew rapidly through acquisition of new estate, which is detailed in Table 2. The firm originated in 1991 when, following the Beer Orders, Bass Plc divested Enterprise Inns to a venture capital syndicate backed management buy-in led by Ted Tuppen. The company began with 370 pubs, increasing these to 500 by the time it was floated in 1995. Tuppen based EIPs strategy on the provision of buying power and expertise to assist pub managers. EIPs financial strategy was based on rapid growth through acquisition financed mainly by debt, but underpinned by strong asset backing from a property estate that was rising in value and that could generate cash through selective disposals.

Table 2 about here

Following flotation, EIP’s acquisitive activities intensified. It acquired 12 pubs from the Greenalls Group PLC, 39 pubs from Whitbread PLC and disposed of 14 underperforming pubs. In July 1996 it acquired John Labatt (UK) Limited and its estate of 413
pubs from Interbrew SA for a total consideration, including the assumption of associated
debt, of £62 million. The deal was financed by a £9m share issue with the balance from bank
loans. In May 1997 it acquired Discovery Inns plc and its estate of 277 pubs for a total
consideration, including the assumption of associated debt (£26.7m), of £46.2 million taking
its total estate to 1200 pubs. The Discovery acquisition was partly funded by a rights issue of
£33.2m.

By these methods, Tuppen’s strategy in the late 1990s was to acquire a sustainable
estate of 1600 pubs. He achieved the target with a £48m cash bid for Gibbs Mew (GM) plc
and its estate of 310 pubs in February 1998. The GM acquisition exemplified EIP’s wider
strategy of taking over struggling firms, which as a consequence of poor estates and/or
excessive debt had a poor financial track record, and meant that EIP could purchase the
company for under book value and sell off its brewery, drinks wholesaling business and 30 of
its worst performing pubs. In March 1999 after soliciting support from institutional
shareholders, including Norwich Union, EIP secured control of Century Inns plc and its
estate of 498 pubs with a £79.1m bid and a total consideration, including the assumption of
associated debt, of £139.0 million. Century had floated at the same time as EIP, but Century’s
managed house business model achieved less financial success than EIP’s tenancy based
approach. These and other successful acquisitions took the EIP estate to around 9000 pubs
by December 2004.

EIP progressively withdrew its dependence on the distribution and administrative
systems of brewers and ended its relationship with Bass. Meanwhile it used subcontracting to
achieve control over its supply chain through an agreement with S&N, which subcontracted
its entire supply chain to Scottish Courage. In June 1999 EIP signed supply contracts with
Scottish and Newcastle, centralising its warehousing and distribution activities.
In common with the wider sector, these deals were orchestrated by the private equity industry, which generated large returns on from deals involving pub estates. In June 2001 EIP’s acquisition of an estate of 439 pubs from Morgan Grenfell Private Equity for a total cash consideration of £266.7 million was financed using a facility provided by its parent, Deutsche Bank. A further acquisition in the following month of an estate of 431 pubs from S&N for a total cash consideration of £269.5 million was financed by a £66m rights issue and backed by HSBC and Deutsche Bank.\(^8\) Deals were increasingly characterised by sophisticated financial engineering. In March 2002 EIP took a 16.8% stake in Newco, a special purpose vehicle set up by the private equity boutique, Cinven, led by Morgan Stanley's Princes Gate Investors and Legal & General Ventures. Its purpose was to acquire the Unique Pub Company (UPC) and Voyager Pub Group from Nomura International, valuing the total enterprise at £2.013bn. EIP's investment cost £75m and included a call option to purchase the remainder of the equity two years later at a fixed price of £608m. Securitised loans were sold in the newly merged UPC entity, which raised £855m. Cinven returned over twice the originally invested capital.\(^9\) In May 2002 EIP raised a £1.28bn syndicated acquisition loan and announced a bid for the estate of 1,860 pubs of Laurel Pub Group Limited from MGPE for a total cash consideration of £881 million. As part of the deal it promised to sell 60 of its pubs to avoid a review by the Competition Commission.\(^2\) By 2004, then, EIP had achieved rapid growth funded mainly through expensive debt. As a consequence, it now had the largest estate of pubs in the UK.

5. Comparative financial performance

From the above discussion, several issues are worthy of further investigation. The first is whether or not the Beer Orders impacted on industry profits. If the regulation succeeded in breaking up a complex monopoly, then the average rate of profit in the industry should have
declined. Second, the above evidence on the emergence of the Pubco suggests that the incorporation of new methods of financial control and flexibility into vertical network arrangements could be a business model that provided the basis of competitive advantage, at least before the financial crisis of 2007-2008. To assess this proposition, the performance of EIP and other features of its financial model are compared to industry benchmarks.\textsuperscript{83}

**Figure 1 about here**

To illustrate the first issue, Figure 1 shows comparative returns on capital employed (ROCE) for samples of firms before and after the Beer Orders. The evidence in Figure 1 suggests that there was indeed a significant decline in average profit after the Beer Orders, which appear to represent an important structural break. Average profits before the Beer Orders were 12.9\% and followed no particular trend, although the onset of long-term decline is perceptible from the early 1980s. Other factors influencing the trend included the recession of 1990-1991 and the rapid growth of imported beers for home consumption, spurred by the exit from the ERM in 1992.\textsuperscript{84} Price increases accentuated this trend, with on sale prices reaching an index level of 173.4 by 1996 (Jan 1988 = 100), compared to an equivalent of 140.6 for off sales. However, there was an even more dramatic divergence in the early 2000s, when the price index of off sales fell from 157.8 in 2001 to 149.9 in 2004, compared to an increase for on sales from 212.1 to 231.1 in the same period.\textsuperscript{85} Changes to accounting rules may also have impacted on specific business valuations, although without having substantial impact on the general trends across our whole sample.\textsuperscript{86} These wider trends only partly explain the decline of pub profitability, and the Beer Orders accentuated this decline, such that in the subsequent period profits have averaged only 6.7\%. Even in the 10 years prior to the Beer Orders, when profits were below their long run level, they nonetheless averaged
11.5%. The evidence strongly suggests that the effect of breaking the vertical tie was to reduce the profitability of the industry.

To examine the relative performance of Britain’s most rapidly growing Pubco, Figure 2 compares the performance of EIP to the industry average. As Figure 2 shows, EIP indeed outperformed its competitors. The average return on capital for EIP for the period 1996-2004 was 8.8% compared to 6.8% for the rest of the industry. However, it is also notable that, despite its industry dominance, EIP’s performance did not achieve the same level of success achieved by the vertical brewers prior to the Beer Orders. Moreover, as the above discussion has suggested, much of EIP’s success was attributable to buying and selling estate, as opposed to running the core business of vending beer. In the period 1996 to 2004, asset disposals generated 50.0 per cent of the cash from operating activities.\(^{87}\)

**Figure 2 about here**

**Figure 3 about here**

**Figure 4 about here**

A further interesting feature of EIP’s underlying financial returns was their stability in comparison to the rest of the industry. Returns to equity investors outstripped underlying returns during this period, averaging 12.4%\(^{88}\). The additional return of around 3.5% was generated by EIPs financial structure and specifically its extensive use of debt finance. Figure 3 shows the ratio of debt to equity for EIP compared to the rest of the sector. As the figure illustrates, the industry as a whole generally financed just over 50% of its investment using
debt finance. Throughout the period EIP used a consistently higher ratio and for most of the time this was very high. As a consequence a high proportion of the cash flow generated from the estate was used to service interest payments. Even so, the financial model delivered spectacular returns to investors. Rapid growth of the estate, combined with refinancing deals, for example the Civen case, and the contribution from property price inflation and estate disposals to profits have been noted above and their combined effect was to generate spectacular returns for shareholders. These are shown in Figure 4. During the period November 1995 to December 2004 EIP shareholder return outperformed the return on the London all share index by a very significant margin. Declining interest rates combined with high leverage boosted these returns. During this period the annual equivalent return on EIP shares was 39.5% compared to 7.1% return on the index. In the same period sales turnover grew by an equivalent 44.2% and earning per share by 31.9% per annum.

In summary, although underlying accounting returns were ahead of the industry average, they were nonetheless low in relative terms and were boosted from the shareholder point of view by increased leverage. The EIP evidence suggests that the Pubco model involved transferring risk to equity holders through borrowing. If the model worked, the Pubco could arbitrage the returns from its estate using cheaper debt finance, which could be boosted by capital profits from deals in the pub estate. The strategy was also dangerous one, particularly if underlying returns from the estate fell below the interest rate on securitised and other loans. A second and important element of the strategy was therefore to ensure that pub income streams were at a sufficient level and, where possible to offload risk to the tenant. The next section investigates how surplus and risk was shared between stakeholder groups in the vertical network in each of the main contractual circumstances discussed above.

6. Tenancy arrangements: pub level profits and risk
There is relatively little prior literature on business performance at pub level. These businesses are either small, private, independently controlled units, or part of larger centrally administered estates. Consequently, there is a paucity of publicly available data. The MMC report of 1989 and the 2004 Trade and Industry Select Committee on Pubcos are therefore important sources of evidence, which offer the opportunity to conduct pub-level analyses of vertical relationships.

Debates about rents and the contradictory evidence furnished to regulatory and legislative authorities suggest the value of further empirical investigation. The Pubco model is investigated first because in managing its relations with tenants it developed new combinations of dry/wet rent, which the tenant could choose according to their degree of risk aversion. These have important implications for measuring the division of surplus and risk transfer in the value chain and allow a suitable test of the equity of risk transfer. Once this comparison is established, further comparisons can be undertaken with typical pre 1989 arrangements.

To assess the claims and counter claims of excessive rent and the allocation of risk and reward between brewer/Pubco and tenant, Table 3 compares pub level financial results according to varying contracts and trading conditions. The table is based on the four different contractual scenarios set out by EIP to illustrate how tenants could be offered the same net profit but with variations in dry and wet rent and machine income. For simplicity, contracts based on machine income sharing (scenarios (1) and (3)) are ignored. Model (1) sets out the financial position of a free house, which is used as a base case. Models (2) and (3) are elaborations of two of the four scenarios given in evidence by EIP to the 2004 TIC enquiry. In (2) the tenant pays a higher wet rent and compensating lower dry rent, with the effect that cost of sales (ie the direct cost) is proportionately higher in (2) compared to (3), which is a low wet rent, high dry rent, scenario. Dry rent is correspondingly higher in (3). In (2) and (3)
the expected average profit to the licensee is the same and the differences reflect only the contractual arrangements. The important difference is the risk and, implicitly, how the Pubco determined its price.

Table 3 about here

Table 3 compares the rates of profit under the three models. As the data show, free houses are more profitable than the tenancy options. The net return (profit after interest and rent respectively) is over three percentage points higher for the free house than the tenancy, regardless of the specific arrangement in (2) and (3). Morgan Stanley’s investigation revealed similar yields from the point of view of the pub landlord and concluded that such returns offered the prospect of a reasonable standard of living.97 Even so, witnesses to the DTI enquiry suggested that most of the surplus was being taken by the Pubco at the expense of the tenant.98

Table 3 also computes the risk to the owner/tenant arising from leverage effects. The leverage is financial, arising from fixed interest charges, in the case of the free house and arising from fixed rent in the case of tenancies in (2) and (3). In both cases the leverage coefficient can be interpreted as a measure of risk associated with the type of ownership. In the free house scenario, the interest rate on the pub value is used as a proxy for the opportunity cost of the investment. The consequence of leverage is that the required rate of return, or cost of capital rises to accommodate the associated risk.

Computing risk in this fashion is useful because an important difference between (2) and (3) is the risk taken on by the tenant. In (3) the tenant has more risk because the high dry rent represents a fixed cost, which must be covered regardless of trading conditions, leading to greater variability in residual returns. The effect of transferring to a lower dry rent contract,
as in (2) is to transform some of the fixed cost into variable cost, such that in effect the Pubco provides some insurance to the more risk-averse pub landlord. Table 3 quantifies the insurance value of the wet rent contract. First it determines whether the risk transfer from the Pubco to the tenant is fairly priced. If a pub landlord is considering changing from (2) to (3), the beer will become cheaper, and the extent of the reduction, in a fair contract will be proportionate to the increase in risk. In other words the cost of sales should fall to the amount required to secure the rate of return that corresponds to that level of risk. Reflecting this, the cost of capital is 17% higher in (3) compared to (2) (10.887% and 9.263% respectively), but the expected residual profit rate for the tenant remains unaltered. In view of the increased risk, other things being equal, the residual rate of profit would also need to rise by 17% such that the profit to the licensee would be £45,600 instead of £38,800, an increase of £6,800. Instead of offering the landlord a wet rent reduction of £18,000 through beer discounts (the difference between (2) and (3) cost of sales in Table 3, the Pubco would have to offer £24,800 (ie £18,000 plus the increase in required profit of £6,800) to induce a risk neutral landlord to shift to a type (3) contract. On EIP’s own evidence and figures, the tenants were not being fairly compensated for extra risk implied by high dry rent contracts. In similar vein, although some risk could be avoided by moving from (3) to (2) the loss of discount would disproportionately reduce the gross return on capital.

Those seeking regulatory intervention against Pubco rent policies did not address this issue in the evidence given before the Trade and Industry Committee investigating Pubcos in 2004-2005. Instead they relied on the testimony of individual licensees. Linda Newport, an EIP licensee of the Brasenose Arms in North Oxfordshire, provided a detailed and critical account of the effects of her Pubco contract. She stated that she worked 90 hours per week, earning £200, and that rents were increased by 40% on renegotiation to a 21-year lease, which was subject to further RPI increases each year. Landlords spent substantial amounts on
improving their property, only to face rent increases.\textsuperscript{100} Newport claimed that rents were high, although her evidence was ambiguous.\textsuperscript{101} These charges led landlords to sell their leaseholds.\textsuperscript{102} Considering the accounting evidence that Newport provided to the Committee and comparing it with the ‘average’ pub detailed in the EIP annual report and accounts and the information provided by EIP to the committee, there were some wide discrepancies. Rent charges for the Brasenose were comparable to pubs of similar size in the EIP estate, but the sales turnover was around 9\% below average and the gross (pre-rent) profit nearly 50\% below average.\textsuperscript{103} The evidence available to the committee suggests that the problems were with this atypical business rather than the EIP rent collection model per se.

Tuppen meanwhile defended the EIP model when subsequently giving evidence to the same committee. He suggested that EIP licensees were partners and the partnership was built on mutual advantages arising from the tie and the rent models available to tenants.\textsuperscript{104} Tuppen questioned Newport’s evidence, pointing out her refusal to allow EIP staff to access her accounts for the purposes of assessing her request for a rent review. At the same time he conceded that EIP would not disclose the prices it paid for the beer supplied to tenants and prospective tenants.\textsuperscript{105}

Subsequently at a committee hearing in 2009 on the same subject, he suggested that an important advantage of the tied system was that it balanced 'the fixed costs and the variable risks and rewards between the pub company and the licensee'.\textsuperscript{106} As far as EIP was concerned it offered the opportunity for rent reviews with the possibility of rent reductions and offered a programme of direct financial assistance to struggling licensees.\textsuperscript{107} Notwithstanding such supportive aspects of EIP policies, lack of disclosure, the use of fiat in rent adjustments and the formalisation of the review process were indicative of a lack of trust between the two parties which, when relationships were difficult -- as in the Brasenose case -- tended to escalate transaction costs.
As the above discussion has demonstrated, many features of the pre 1989 beer tie were reproduced in the Pubco business model. To assess the similarities and differences in the application of vertical relationships, and the effects on pub level profitability, Table 4 compares the three scenarios in Table 3 with three further scenarios using 1986 data. These are a free house 1986 (4), a 1986 managed house (5) and an adjusted scenario in (6). Model (6) shows the profit that would have accrued to the pub without the effects of inflated transfer prices from the brewer. The figures in Table 4 suggest that tied houses were performing marginally worse in 2004 compared to 1986 and that free houses were performing much better in 2004. The improvement of free house performance reflects lower interest rates but was mainly the result of improved gross margins. Models (3) and (5) show comparable gross margins suggesting some gain for the Pubco at the expense of the tenant in (3) due to the specification of the contract. The model in (6) is similar to the results for the 2004 free house, which factoring changes in property values suggest that the 2004 free house corresponds to the effect of removing the tie in 1989 in terms of transferring profit from the brewer to the tenant.

Table 4 about here

The evidence above suggests that Pubcos were able to exert some financial pressure on their tenants, but that the 2004 Pubco model was not radically different from the division of profit in the 1986 pre Beer Orders model. Thus far the 2004 data has relied on EIP and it is useful to assess how representative EIP was. Table 5 compares the EIP high wet rent scenario (Table 3, model [2]) shown here as model (1) with Wolverhampton and Dudley (2) and a shadow profit and loss account for an average pub calculated from data supplied by Morgan Stanley (3).

Table 5 about here
The outstanding feature of Table 5 is the similarity of the three scenarios. All have very similar gross and net returns on capital. It is perhaps not surprising as the Morgan Stanley data was taken from EIP and Punch Taverns. The Wolverhampton and Dudley memorandum noted that the ‘pub estates are managed in a similar way to the Pubcos’.\textsuperscript{108} In line with the comparison earlier, the profit of Linda Newport’s pub was very low when compared to the alternative cases in Table 3. Using the figures given in her evidence suggests the equivalent profit before appropriations figure was around £37,000, which was substantially below all comparable scenarios in Table 4.\textsuperscript{109} Newport’s evidence suggested that her profits were below average, and that many tenants were experiencing financial difficulties. Tenants, many of whom believed they were entering into a cooperative and mutually beneficial relationship with the Pubcos felt badly let down, and in some cases were traumatised by the treatment they subsequently received.\textsuperscript{110} Although this evidence could be questioned for a number of reasons, the case demonstrated a lack of trust between the parties, and from the tenant’s point of view, escalating transaction cost associated with compliance with Pubco procedures.

7. Conclusions
The purpose of the above analysis was to demonstrate that the distribution of power within vertical networks has an important impact on the division of surplus between network participants and, by way of addition to prior literature, the corresponding division of risk. The evidence suggests that after the Beer Orders, the Pubcos maintained the profit margins available to tenants under the previous system, but transferred onto them a disproportionate level of risk. As the above analysis shows, tenants had typically taken on more risk without compensatory higher margins, or risk-averse tenants had obtained only low margins. At the same time, trust, which is a defining characteristic of ‘hybrid’ forms of organisation, did not
feature in the Pubco-tenant relationship, which was characterised by opacity and fiat in the
determination of wet and dry rents. Typical margins for tenants in 2004 were comparable to
those earned in similar arrangements in 1986. Indeed low margins seemed to persist at similar
levels in all models of pub ownership. The exception was the free house, which performed
better in 2004 conditions by comparison to those prevailing in the period of the beer tie and
the dominance of the big 6. Tenants’ risk aversion was natural in an increasingly volatile and
competitive trading environment, providing the Pubcos with the opportunity to use the
wet/dry rent system to specify asymmetric contracts for their tenants.

Regulation then has assisted some pub owners by freeing the supply of beer but has
not succeeded in preventing large and powerful companies controlling key stages of the value
chain. Notwithstanding their rapid growth and apparent market power, Pubcos were less
profitable in the post beer orders period than the large monopoly brewers before 1989.
Moreover much of their growth has come from debt-financed acquisition creating significant
cash flows from subsequent disposals and the securitisation of the remainder. Financial
intermediaries were significant beneficiaries of this process, which generated some
spectacular returns to shareholders, entering the industry in the 1990s and building up
substantial ownership positions prior to the financial crisis of 2007. Notwithstanding these
transformations, they have failed to halt the long run decline of the industry, and regulation
has failed to protect either tenants or consumers.

The above analysis of the beer industry, and in particular the Pubco model of vertical
ownership, has provided some useful insights into the processes of distributing surplus and
risk within the network. In particular, powerful operators within vertical networks not only
control the financial returns of weaker members explicitly through contractual relationships,
but can also implicitly control risk arising from variation in underlying cash flows such that it
is borne disproportionately to the level of expected return. Whilst Pubcos and indeed their
shareholders benefited from such arrangements, tenants in particular have suffered declining fortunes, or at least can only earn returns similar to historic norms by taking on disproportionate risk from the Pubco.

Research that has explored the power dynamics in other vertical networks, for example food retailing, might usefully be complemented by new approaches considering the extent to which such disproportionate risk transfer occurs. Incorporating this new element, the unequal distribution of power within vertical networks becomes all the more problematic for regulators. As the experience of the British beer industry post the Beer Orders demonstrates, regulation is indeed difficult, and in the face of declining margins and pub closures, all the more urgent.
Notes


2 Williamson, “Markets and hierarchies”, “The modern corporation”.

3 Monopolies Commission (MC), *Beer*; Monopolies and Mergers Commission (MMC), *Supply of Beer*. After substantial lobbying by the Brewer’s Society, the 1989 Beer Orders Brewers were amended to require divestment through sale, or lease free from any tie, half the pubs they owned over the DTI-imposed limit of 2000 before November 1992 (Bower, “Competition policy and the legitimacy of finance”, p.9; DTI Press Release, 89/745, 1989).

4 Preece, “Change and continuity”.

5 Day and Kelton, “The valuation”

6 Bachmann, “Trust, power and control”, 339; Nootbooom et al, “Effects of Trust”: 310; 313.

7 Bachmann, “Trust, power and control”, 337.

8 Bachmann, “Trust, power and control”, 338.

9 Larson, “Network dyads”.

10 Williamson, “Comparative economic organization”.


14 Vangen, and Huxham, “Nurturing collaborative relations”, 5-6.

15 Piore and Sabel. *The Second Industrial Divide*; Schreyögg, G., & Sydow, “Crossroads-
organizing for fluidity?”


18 For example, expertise sharing at M&S, Tse, Marks & Spencer, although cases of beneficial collaborations are rarer than their ostensible benefits suggest (Lamming, “Squaring Lean Supply”; Clark and Fujimoto, Product development performance).

19 Ebers & Grandori, “The Forms, Costs, and Development Dynamics of Inter-Organisational Networking”.

20 Nootenboom, “Innovation and inter-firm linkages”.

21 Lamming, “Squaring Lean Supply”.

22 For example, Grandori and Soda, “Inter-firm Networks”.

23 Bachmann, “Trust, power and control”.

24 Harland et al, “A conceptual model”.


26 Eisenhardt, “Agency theory”; De Clercq and Sapienza, “The creation”.

27 An exception is provided by Toms and Filatotchev, “Corporate governance”.

28 De Clercq and Sapienza, “The creation”.


31 Lazonick, “Innovative business”; Lazonick and O’Sullivan, “Maximising shareholder value”.

32 Stockhammer, “Financialisation”; Crotty, “The neoliberal paradox”.
Before 1880, the majority of brewers relied almost entirely on sales to independent publicans. Hawkins and Pass, *The Brewing Industry*: 25.

Between 1895 and 1902 the London brewers as a whole were buying up some 500 leases a year, and by 1902 between 80 and 85% of the trade of the leading London concerns was tied. The major Burton brewers were not immune from these trends: Bass floated in 1888 to raise funds to extend their tied-housing estate and by 1900 they owned 550 licensed premises. Allsopp, another renowned Burton brewer, owned 1200 houses by 1902. Hawkins and Pass, *The Brewing Industry*: 32.

For example the Ind Coope merged with Allsopps in 1934, and Bass a series of acquisitions by Bass (Worthington, Thomas Salt and James Eadie). Estimates of the proportion of beer sold through tied houses range from 90 per cent in 1927, to 75 per cent in 1948, when there was substantial variation by brewery (for example Boddingtons’ sold 99.9 per cent, and the Malton-based brewer, Russells & Wrangham 37 per cent, respectively of their beer through their tied estates. Gourvish and Wilson, *The British Brewing Industry*, 436.


Gourvish and Wilson, *The British Brewing Industry*, 450.

TISC, *Pub Companies Q.133*;

For the scope of the product tie, including items other than beer, see MMC, *Supply of Beer*, p.5

Hawkins and Radcliffe, “Competition”.


Mutch, *Strategic and Organisational*, Table 8.1, 137

Ibid: 77.

Ibid: 86.

Ibid: 60; 88.

High levels of industrial concentration were exacerbated by the dominance of some brewers in particular regions (geographical concentration), which restricted the ability of the brewers to extend their estates geographically. In 1978 the ‘big 6’ as well as regional brewers such as Greenall Whitley, Daniel Thwaites and Tollemarch & Cobbold, agreed to ‘swap’ pubs to ensure that their ownership fell below the 50% threshold in certain areas. By 1988 the Director General of Fair Trading advised the government that the ‘swap’ was effectively completed. Spicer, et al., Intervention, 22-24.

Spicer et al., Intervention: 9-26. In addition, secret lobbying by Guinness to the Office of Fair Trade highlighted further difficulties which existed in the structure of the industry. For example, Guinness’s non-alcoholic lager, Kaliber, was effectively debarred by the ‘Big 6’, who wished to promote their own substitutes in their tied houses. Ibid, 43.

MMC, The Supply of Beer: paras.1.1; 1.18; 1.22; 1.23.

Ibid: para 1.1: 1; paras 1.18, 1.22, 1.23: 4.

For our purposes, the most important of these Orders was Statutory Instrument 2390, The Supply of Beer (Tied Estate) Order 1989, which specified limits on the ownership of tied premises.

During the period covered by Table 1, there was a decline in the total number of pubs in the UK. It has been estimated that, between 1991 and 1999, the total fell from 62,255 to 61473. By 2004, the figure was slightly under 60,000, and by 2009, it was approximately 52,495. Spicer, et al., Intervention: 189.

TISC, Pub Companies, QQ.144; 175, 237.

Spicer et al, Intervention, 77.
Many of these decisions were based on *Delimitis v. Henninger Bräu Ag* (1991) and raised
the question of whether beer ties violated Article 81 of the EC Treaty, which outlawed
Timothy John Falla 5 Eur L. Rep 150 (2001); Annex to the Decision of the Commission to
reject the complaint in Case No IV/34.907/F3.

For example Enterprise Inns was a spin out from Bass backed by a venture capital

By 1995 the six largest Pubcos (owning between 215 and 500 pubs) were: Ascot Holdings;
Enterprise Inns; Century Inns; Innkeeper Group; Sycamore Inns; Ushers. TISC, *UK policy on
monopolies*, Q.72.

For example in February 1996 the Famous Pub Company was floated with market value of
£2.3m, placed to city firms; *Investors Chronicle*, 12th January, 1996.

For example, Discovery Inns, backed by Kleinwort Benson (KB), although a financially
successful Pubco with strong earnings growth pulled a flotation in favour of a sale to
Enterprise Inns. The motive was to provide an exit for KB; *Independent*, 2nd March, 1997.

New investors included Nomura (Grand Pub Co.) Daiwa (Avebury Taverns) and BT
Capital Partners (Grovebase, which acquired a large chunk of the former Bass estate).
£1.62bn for the Whitbread pubs business including the tenanted estate and the Hogshead
chain, renamed the Laurel Pub Company. Deutsche Bank subsequently divested MGPE to
MidOcean Partners, which put Laurel up for sale in early 2004 following poor financial

For example Nomura issued the Phoenix Inns Ltd bond, yielding 9 per cent and listed in
Luxembourg, initially for two years, subsequently extended to 12. Meanwhile, it disposed of

Nomura issued the Unique Pub Finance Plc securitization in March 1999 for £810 million, with a tap issuance of £335 million in February 2001. With the tap, 677 pubs were added to the original 2,614 pubs. Some of these are piecemeal acquisitions, but many are houses that could not be securitized earlier. A second tap was made in September 2002, incorporating 888 new pubs into the transaction. Further issues are subject to ratings agency approval to prevent dilution. Vink and Thibeault, “An Empirical Analysis Of Asset-Backed Securitization”.

Where cash based earnings are measured using Earnings before Interest, Depreciation and Amortisation (EBITDA).

By 1994 the large brewing firms had closed 14 breweries. TISC, UK policy on monopolies. Q.72.

Competition Commission, Interbrew SA and Bass Plc, 92.


TISC Pub Companies.

TISC, Pub Companies, Q.123 and Q.2 and table 1.

Calculated from Table 1. See also TISC, Pub Companies, Q.11.

Spicer et al., Intervention, 211; TISC, Pub Companies, 128-II, Oral and Written Evidence, Appendix 12, paras. 8.4-8.12.
Graham Edward Tuppen, 1952- Chief Executive Enterprise Inns, 1991-2014. The venture capital consortium was led by National Westminster. Sunday Times 17th September, 1995; Daily Telegraph, 7th February, 2014. EIP was originally set up as a management consortium led by Michael Cottrell, chairman of Taunton Cider and a former managing director of Courage. The purchase of 372 pubs from Bass was funded by by ANZ Banking Group and County NatWest Ventures; Independent, 10th September, 1991.

Times, April 24, 1997

Consideration was 51.3m plus 10.2m of debt. Financial Post (Toronto, Canada) 22nd May, 1996,

Times, April 24, 1997; Discovery was formed as a result of a management buy-out from Whitbread in 1992 led by the chairman, Paul Smith. The Scotsman April 24, 1997,

Independent, 4th February; Investors Chronicle, 6th February, 1998. In October 1998 EI acquired Mayfair Tavens Limited and its estate of 276 pubs for £8.3m together with debt totalling £29.1m, a total consideration of £37.4 million. Earlier that year Mayfair’s estate had been valued at £39.2m. Nottingham Evening Post, 27th October, 1997. June 2000 the acquisition of an estate of 183 pubs from Whitbread Plc’s Swallow pub estate for a total cash consideration of £118 million, 35 of the pubs acquired were subsequently sold for £50 million (Times, 20th June, 2000).


These included June 1999 the acquisition of an estate of 217 pubs from Bass Holdings Limited and Bass Taverns Limited for a consideration of £69.2 million in June 1999 (Independent, 11th June, 1999), in May 2000, a £115m deal to buy 183 pubs, mostly in the North-East, Yorkshire and Lancashire, from Whitbread, and in July 2000, the Famous Pub Co and its chain of 20 outlets in the South East (Guardian, 25th November 2000).
Confirmation of EIP as Britain’s largest landlord, see *The Herald*, 1st December 2004. See also table 1.

78 Competition Commission. *Interbrew SA and Bass Plc.*, pp.92-93. Scottish Courage was the brewing division of S&N.


81 *European Venture Capital Journal*, 1st April, 2002.


83 Industry financial variables were constructed using all available data from firms in the brewing and malting industry group (Group 231) in the DTI/Cambridge Companies Database, 1949-1984 and Datastream 1984-2004 using corresponding INDC codes. Companies with insufficient data, and not explicitly engaged in brewing or pub estate management, or with data for only short periods (<10 years) were excluded, resulting in a sample of 23 firms with 828 firm/years observations.

84 Mason and McNally, ‘Market change’, p.414

85 Calculated from Office of National Statistics data, Retail Price Index, CZCI beer – off sales and CZCH – beer on sales.

86 With regard to property asset valuations and depreciation, the major change in the period was the introduction of Financial Reporting Standard 15, *Tangible Fixed Assets* in 1999, which recognised the increasing practice of not depreciating pub estate assets on the grounds that they were regularly maintained, thereby raising the economic life and residual value.


88 Calculated from *Datapage*. 
The proportion of operating cash flow used to service interest payments was always over 50% throughout the period 1996-2004 and rose steadily such that by 2004 interest payments were £181m compared to operating cash flow of 208.6m (86.7%). Calculated from Datastream.

In the same period UK base rates fell from 13.38% in 1991 to 4.75% in 2004 (Bank of England, Interactive database; http://www.bankofengland.co.uk/boeapps/jadb/repo.asp).

Calculated from Datastream.

To the extent that such contingencies might crystallise, there were further contingent liabilities. These were not accrued in the EIP accounts, but should be borne in mind when interpreting return to capital measures.

Disputes about the equity of rents were the subject of protracted legal proceedings. For example the leading case: Intrepreneur v Crehan [2006] UKHL 38.

EIP stated, ‘The flexibility of Enterprise agreements enables licensees to determine the balance between “fixed” costs such as rent and variable costs (beer prices) in their lease or tenancy. TISC, Pub Companies, Q. 134, s.3.3; Q. 143, s.3.3.

TISC, Pub companies Q. 148, Annex 4. Scenarios 2 and 4 exclude the effects of games machine income and show only the trade off between dry and wet rents.

The base case is abstracted for the purposes of comparing key variables and ignores additional factors such as additional upfront costs and quantity discounts available to groups of free houses.

TISC, Pub companies Q.201; Q.206, exhibit 7 showed EIP tenants yielding between 7.0% and 7.5%.

‘The Pubcos keep marching on and on and on and pushing the margins higher and higher. They keep getting bigger and bigger discounts from the brewers, from the manufacturers, and never pass those on to the tenants. If they pass them on in any way, shape
or form, even in the smallest form...they go and whack a huge chunk onto the rent’, TISC

Pub companies Q. A.B Jacobs, HC 128, Q. 136.

99 Risk is fairly priced if, consistent with capital market theory, there is a linear relationship
between return and its volatility.

100 The new lease was unusual compared to industry norms, which more typically offered 20-
year leases assignable after 5 or 10 years with similar duration rent reviews. We are grateful
to a reviewer for assistance on this point.

101 The witness stated that ‘my rent showed against turnover 17.62% of my turnover’ (sic)
and in written evidence that rent averages 12% of turnover (TISC Pub companies, Newport,
Q.44; Appendix 21).

102 TISC, Pub companies, Newport, QQ, 22, 32, 41, 43.

103 TISC, Pub companies, C 128, Newport, QQ, 44, HC 128 Trade and Industry Select
Committee: Pub companies (Pubcos) Q.148, Annex 4; EIP Annual Report and Accounts,

104 TISC, Pub companies, HC 128, Tuppen, Q.339.

105 TISC, Pub companies, HC 128, Tuppen, Q.339-341; 345

106 TISC, Business and Enterprise Committee (hereafter BEC), Pub companies, B&E 7th
Report, Q. Tuppen, Q.213.

107 BEC, Pub companies, Tuppen, QQ.215, 216.

108 TISC, Pub companies, Q. 304, appendix 28; Memorandum by Wolverhampton & Dudley

109 TISC, Pub companies, Q. 231, appendix 21; Memorandum by Linda Newport

110 ‘We just had to leave our pub, in debt, after almost five years of hard slog getting
nowhere, due in significant part, to the crippling nature of the pub-co tenant relationship…’
TISC Pub companies, HC 128, Q. s.8.4.
References


Table 1: Changes in the ownership of pubs by leading companies, 1989 and 2004 (1)

<table>
<thead>
<tr>
<th>Firm</th>
<th>1970</th>
<th>1989</th>
<th>2004</th>
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<tr>
<td>Bass Charr.</td>
<td>9450</td>
<td>Bass</td>
<td>7190</td>
</tr>
<tr>
<td>Allied</td>
<td>8250</td>
<td>Allied</td>
<td>6678</td>
</tr>
<tr>
<td>Whitbread</td>
<td>8280</td>
<td>Whitbread</td>
<td>6483</td>
</tr>
<tr>
<td>Grand Met.</td>
<td>6135</td>
<td>Grand Met.</td>
<td>6419</td>
</tr>
<tr>
<td>Courage</td>
<td>6000</td>
<td>Courage</td>
<td>5002</td>
</tr>
<tr>
<td>S &amp; N</td>
<td>1700</td>
<td>S &amp; N</td>
<td>2287</td>
</tr>
<tr>
<td>Enterprise</td>
<td></td>
<td></td>
<td>9093</td>
</tr>
<tr>
<td>Punch</td>
<td></td>
<td></td>
<td>7400</td>
</tr>
<tr>
<td>Spirit</td>
<td></td>
<td></td>
<td>2470</td>
</tr>
<tr>
<td>Mitchells</td>
<td></td>
<td></td>
<td>2077</td>
</tr>
<tr>
<td>&amp; Butler</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Greene King</td>
<td></td>
<td></td>
<td>1684</td>
</tr>
<tr>
<td>Wolverhampton</td>
<td></td>
<td></td>
<td>1605</td>
</tr>
<tr>
<td>&amp; Dudley</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Innspired</td>
<td></td>
<td></td>
<td>1066</td>
</tr>
<tr>
<td>Wellington</td>
<td></td>
<td></td>
<td>835</td>
</tr>
<tr>
<td>Avebury</td>
<td></td>
<td></td>
<td>750</td>
</tr>
</tbody>
</table>

Total: 39,815


Notes:
1. The figures reported above refer to the total number of pubs owned by the leading companies.
2. Grand Metropolitan (Grand Met) acquired Watney Mann in 1972.
(P) indicates Pubco
Table 2: Enterprise Inns: Major Purchases and Acquisitions, 1991 – 2004

<table>
<thead>
<tr>
<th>Year</th>
<th>Cumulative Total No. of Outlets</th>
<th>Pub purchases and Major Acquisitions</th>
<th>Deal Value £m</th>
<th>Financing Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>372</td>
<td>09/09/1991 Enterprise Inns, backed by County NatWest Ventures, acquired 372 pubs from Bass Plc.</td>
<td>60.0</td>
<td>Venture capital</td>
</tr>
<tr>
<td>1994</td>
<td>462</td>
<td>05/04/1994 100 pubs, mostly from Allied-Lyons disposals</td>
<td>15.0</td>
<td>Bank syndicate led by Samuel Montagu.</td>
</tr>
<tr>
<td>1996</td>
<td>905</td>
<td>30/04/1996 39 pubs acquired from Whitbread PLC</td>
<td>3.0</td>
<td>Cash</td>
</tr>
<tr>
<td></td>
<td></td>
<td>07/06/1996 Acquisition of John Labatt (UK) (JL) from John Labatt, a unit of Interbrew Belgium,</td>
<td>61.5</td>
<td>£43m debt and a one-for-six rights issue at 163p a share.</td>
</tr>
<tr>
<td>1997</td>
<td>1224</td>
<td>12/05/1997 Acquisition of Discovery Inns</td>
<td>46.2</td>
<td>3 for 8 rights issue.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>04/09/1997. Acquired eight pubs from Pubmaster</td>
<td>1.6</td>
<td>Cash</td>
</tr>
<tr>
<td></td>
<td></td>
<td>04/09/1997 Acquired 94 pubs from Whitbread</td>
<td>9.4</td>
<td>Cash</td>
</tr>
<tr>
<td>1998</td>
<td>1780</td>
<td>03/02/1998 Tender offer to acquire 25% ordinary share capital of Gibbs Mew (GM)</td>
<td>12.4</td>
<td>Cash</td>
</tr>
<tr>
<td></td>
<td></td>
<td>20/05/1998 Tender offer to acquire 75% ordinary share capital of Gibbs Mew</td>
<td>48.1</td>
<td>Share for share exchange.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>26/10/1998 Acquisition of Mayfair Taverns</td>
<td>37.4</td>
<td>£8.3m cash, assumption of £20.3m Mayfair debt and redemption of preference shares.</td>
</tr>
<tr>
<td>1999</td>
<td>2430</td>
<td>04/05/1999 Tender offer to acquire 93.4% of Century Inns PLC</td>
<td>73.8</td>
<td>Share for share exchange</td>
</tr>
<tr>
<td></td>
<td></td>
<td>01/09/1999, Acquired 217 public houses from Bass PLC</td>
<td>85</td>
<td>Cash offer and pub swap.</td>
</tr>
<tr>
<td>2000</td>
<td>2580</td>
<td>08/06/2000 Acquired 187 pubs from Whitbread PLC</td>
<td>115.0</td>
<td>Debt</td>
</tr>
<tr>
<td></td>
<td></td>
<td>14/08/2000, Acquisition of the Famous Pub Co.</td>
<td>3.8</td>
<td>Cash</td>
</tr>
<tr>
<td>2001</td>
<td>3499</td>
<td>09/06/2001 Acquired 439 pubs from Morgan Grenfell Private Equity Ltd</td>
<td>262.5</td>
<td>Cash and debt</td>
</tr>
<tr>
<td></td>
<td></td>
<td>05/07/2001 Agreement to acquire 431 managed public houses from Scottish &amp; Newcastle PLC</td>
<td>269.5</td>
<td>£66 million right issue and debt</td>
</tr>
<tr>
<td>2002</td>
<td>4189</td>
<td>24/05/2002 Acquisition of Laurel Pub Co Ltd from Morgan Grenfell Private Equity, a unit of Deutsche Bank AG,</td>
<td>875.0</td>
<td>£1.28 billion syndicated loan. Five tranches debt facility: tranche 'A' £200m five-year revolving loan, tranche 'B' £400m five year term loan. Tranche 'C1' £200m facility maturing March 31 2003, tranche 'C2' £200m maturing on March 31 2004. £280m short term bridge loan to a rights issue underwritten by Deutsche Bank</td>
</tr>
<tr>
<td>2004</td>
<td>8727</td>
<td>31/03/2004 Exercised call option to acquire the remaining 83.2% interest in Unique Pub Holding Co Ltd (UP)</td>
<td>609.0</td>
<td>New share issue plus debt.</td>
</tr>
</tbody>
</table>

Sources: Thomson One Banker Deal Database and Nexis

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Table 3: Licensee profits, risk and return by agreement type

<table>
<thead>
<tr>
<th>License agreement type</th>
<th>(1) Free House</th>
<th>(2) High wet rent</th>
<th>(3) High dry rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Summary profit and loss account</td>
<td>£'000</td>
<td>£'000</td>
<td>£'000</td>
</tr>
<tr>
<td>Turnover</td>
<td>212.1</td>
<td>212.1</td>
<td>212.1</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>83.1</td>
<td>99.9</td>
<td>81.9</td>
</tr>
<tr>
<td>Gross margin</td>
<td>129</td>
<td>112.2</td>
<td>130.2</td>
</tr>
<tr>
<td>Wages and overhead</td>
<td>59.4</td>
<td>59.4</td>
<td>59.4</td>
</tr>
<tr>
<td>Profit before appropriations</td>
<td>69.6</td>
<td>52.8</td>
<td>70.8</td>
</tr>
<tr>
<td>Rent</td>
<td>14</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td>Interest payable</td>
<td>14.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Licensee profit</td>
<td>55.1</td>
<td>38.8</td>
<td>38.8</td>
</tr>
</tbody>
</table>

b) Profitability ratios

<table>
<thead>
<tr>
<th></th>
<th>(1) Free House</th>
<th>(2) High wet rent</th>
<th>(3) High dry rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pub value</td>
<td>500</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Leverage</td>
<td>1.263</td>
<td>1.361</td>
<td>1.825</td>
</tr>
<tr>
<td>Cost of capital%</td>
<td>8.921</td>
<td>9.263</td>
<td>10.887</td>
</tr>
<tr>
<td>Return on capital (gross) %</td>
<td>13.918</td>
<td>10.558</td>
<td>14.158</td>
</tr>
<tr>
<td>Return on capital (net) %</td>
<td>11.020</td>
<td>7.760</td>
<td>7.760</td>
</tr>
</tbody>
</table>

Notes:
Agreement type (1) is an artificial ‘base case’ created for the purposes of strict comparison using limited parameters. Agreement types (2) and (3) correspond to the cases given in evidence by Enterprise Inns, excluding further complicating factors such as machine income sharing agreements.

1. Turnover and overhead costs calculated by adjusting values from EIP accounts pro rata to pub value assumed in TIC ev 148, Annex 4. Pub value and turnover standardised at £500,000 and £212,100 in all three scenarios.
2. Cost of sales adjusted according to variations in wet rents, per TIC ev 148, Annex 4, scenarios 2 and 4. Free house equivalent calculated by subtracting £16.8k discounts foregone (standard wet rent in tenanted houses).
3. Rent charges after crediting £8k domestic accommodation allowance.
4. Interest charges computed by applying interest rate (4.5%, \( R_f \)) to pub value and subtracting £8k domestic accommodation allowance. Average base interest rate 2004 = 4.5% (Bank of England http://www.bankofengland.co.uk/boeapps/idadb/repo.asp).
5. Leverage (\( L \)) defined as: \( \Delta \) licensee profit/\( \Delta \) turnover, assuming all revenues and costs are variable, except rent/interest which are fixed.
6. Cost of capital defined as: \( R_f + (L \times Rp) \), where \( Rp \) is the long run equity premium on the UK stock market.
7. Return on capital defined as: (Gross) Profit before appropriations divided by pub value; (Net) Licensee profit divided by pub value.

Sources: Enterprise Inns interim results, 2004; 004/05 HC 128 Trade and Industry Select Committee: Pub companies (Pubcos) ev 148, Annex 4.
### Table 4: Comparative profitability 1986 and 2004

<table>
<thead>
<tr>
<th></th>
<th>2004 (1)</th>
<th>2004 (2)</th>
<th>2004 (3)</th>
<th>1986 (4)</th>
<th>1986 (5)</th>
<th>1986 (6)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£’000</td>
<td>£’000</td>
<td>£’000</td>
<td>£’000</td>
<td>£’000</td>
<td>£’000</td>
</tr>
<tr>
<td>Turnover</td>
<td>212.1</td>
<td>212.1</td>
<td>212.1</td>
<td>205.4</td>
<td>205.4</td>
<td>205.4</td>
</tr>
<tr>
<td>Profit before</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>appropriations/contribution</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machine income</td>
<td>69.6</td>
<td>52.8</td>
<td>70.8</td>
<td>20.9</td>
<td>39.4</td>
<td>60.0</td>
</tr>
<tr>
<td>Rent</td>
<td>14.0</td>
<td>32.0</td>
<td>24.1</td>
<td>24.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest payable</td>
<td>14.5</td>
<td></td>
<td>22.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Licensee/pub profit</td>
<td>55.1</td>
<td>38.8</td>
<td>38.8</td>
<td>7.2</td>
<td>24.1</td>
<td>44.7</td>
</tr>
<tr>
<td>Pub value</td>
<td>500.0</td>
<td>500.0</td>
<td>500.0</td>
<td>268.3</td>
<td>268.3</td>
<td>268.3</td>
</tr>
<tr>
<td>Return on capital net</td>
<td>11.018</td>
<td>7.760</td>
<td>7.758</td>
<td>2.681</td>
<td>8.979</td>
<td>16.658</td>
</tr>
</tbody>
</table>

**Notes:** Columns 1-3 derived from scenarios listed in annex 4, TISC, ev.148; columns 4-6 derived from data for national brewers using MMC 651, 1988/89, appendix 3.7, table 1, p.416; table 3, p.428; appendix 3.5, table 1, p.408. Free house cases (columns 1 and 4) constructed using comparable data, adjusted pro-rata to capital values cited for tenanted houses. Column 6 adjusts column 5 using the mark up calculation in MMC 651, 1988/89, table 3, p.428 to show the profit the pub would have earned without the inflation of transfer price by the brewery.

1. Machine income was netted off rent in (2) and (3) in the 2004 calculations and for consistency is included calculation of net income for 1986.
2. 4.5% (2004) and 10.0% (1986) (Bank of England [http://www.bankofengland.co.uk/boeapps/iadb/repo.asp](http://www.bankofengland.co.uk/boeapps/iadb/repo.asp)) in both cases after subtracting the assumed value of the benefit of domestic accommodation.
3. Profit before appropriations/contribution divided by pub value.
4. Licensee/pub profit divided by pub value

**Sources:** Enterprise Inns interim results, 2004; 004/05 HC 128 Trade and Industry Select Committee: Pub companies (Pubcos) ev 148, Annex 4. MMC 651, 1988/89, appendix 3.7, table 1, p.416; table 3, p.428; appendix 3.5, table 1, p.408.

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Table 5: Licensee profits and ownership

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Enterprise Inns</td>
<td>Wolverhampton and Dudley</td>
<td>Average tenanted pub</td>
</tr>
<tr>
<td>a) Summary profit and loss account</td>
<td>£’000</td>
<td>£’000</td>
<td>£’000</td>
</tr>
<tr>
<td>Turnover</td>
<td>212.1</td>
<td>212.1</td>
<td>212.1</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>99.9</td>
<td>*</td>
<td>114.4</td>
</tr>
<tr>
<td>Gross margin</td>
<td>112.2</td>
<td>*</td>
<td>97.7</td>
</tr>
<tr>
<td>Wages and overhead</td>
<td>59.4</td>
<td>*</td>
<td>39.8</td>
</tr>
<tr>
<td>Profit before appropriations</td>
<td>52.8</td>
<td>59.0</td>
<td>57.9</td>
</tr>
<tr>
<td>Rent</td>
<td>14.0</td>
<td>24.0</td>
<td>20.4</td>
</tr>
<tr>
<td>Licensee profit</td>
<td>38.8</td>
<td>35.0</td>
<td>37.5</td>
</tr>
<tr>
<td>b) Profitability ratios</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pub value(^1)</td>
<td>500</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Gross return on capital</td>
<td>10.560</td>
<td>11.800</td>
<td>11.584</td>
</tr>
<tr>
<td>Net return on capital</td>
<td>7.760</td>
<td>7.000</td>
<td>7.505</td>
</tr>
</tbody>
</table>

Notes:
* no data. Assumptions as Table 2.

Sources: (1) as Table 2; (2) HC 128 Trade and Industry Select Committee: Pub companies (Pubcos) ev 304, appendix 28; Memorandum by the Wolverhampton & Dudley Breweries PLC (3) HC 128 Trade and Industry Select Committee: Pub companies (Pubcos) ev 204, Exhibit 8; Profit & Loss account of an Average Tenanted Pub, Morgan Stanley report.
Sources: Calculated from Cambridge University Companies Database and Datastream. 
Note: Return of capital employed is defined as profit before interest and tax divided by long term debt and equity capital.

Source: Datastream

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Figure 3: Debt/Equity ratio, Beer Industry and Enterprise Inns

Source: Calculated from Datastream

Figure 4: Total shareholder return, EIP and London Stock exchange

Source: Calculated from Datastream.
Note: Total return is calculated as the difference in share price plus dividend indexed to 100 for the first day of EIP trading, 3rd November 1995.