

GREENE KING PLC

STRATEGIC ANALYSIS OF

A REGIONAL INTEGRATED BREWER



1799

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Abstract

The long term repercussions arising from the Beer Orders introduced in November 1992 continue to influence the structure of today's brewing and licensed businesses. Set against a background of steadily declining beer sales and the break-up, ordered by the Director General of Fair Trading, of the Complex Monopoly (which was found to exist in favour of brewers who owned tied houses and who had tying agreements with free houses) some of the largest players withdrew. For example, in 2001 Bass and Whitbread divested their low margin, shrinking, brewing interests in the search of more profitable areas for investment. This dramatic restructuring of the industry led to the development of national chains of Pubcos and, in clearing the field, allowed for the expansion, through consolidation, of some of the existing (though highly fragmented) regional, integrated* brewing companies. (* These are vertically integrated businesses which are involved all stages in the value chain incorporating brewing, distribution, retailing to the Off trade and retailing for direct consumption on pub premises, many of which they own.)

This case study analyses, using concepts and models, the strategies employed, over the last five years, by East Anglia brewer, Greene King PLC as it seeks to maximise the growth opportunities to be found in this much improved business environment. Greene King have been acting like Pac-man, routinely acquiring small regional brewers then driving down costs, by closing the brewery and transferring production of the acquired brands to their Bury St Edmunds brewing centre. The inherited beer brands are added to the Greene King portfolio affording them the much wider distribution and exposure to both to the On and the rapidly developing Off trade. The pub outlets acquired are, if appropriate, absorbed into the Greene King network of managed and tenanted houses. That this business model works may be evidenced in the almost doubling of turnover and profitability as demonstrated in the Financial Highlights (2002-2006) found in Appendix 1.

Introduction

This exploratory case study employs an outside in approach to understand and explain, in a strategic context, the successful growth phenomena achieved by Greene King PLC over the last five years. It is to be used as an introductory case for use in class sessions for the final strategic management semester in which strategic formulation, choice and implementation are considered. Here the emphasis is on prescriptive or planned growth strategy through acquisition. It has immediate links to the policy directional matrix and raises questions as to the choice, feasibility, acceptability and suitability of this approach.

The aim of the case is for students to develop an appreciation of the need to analyse the strategic position and options and their implementation. In short, it helps them to develop an ability to combine analytical rigour with the reality of the process within a live case study context. The outcome can be expressed in student learning objectives

1. To appreciate the particular business environment or context
2. To understand why objectives concerning growth and expansion become important to a business.
3. To enable them to apply appropriate models, concepts and theories
4. To consider the issues associated with acquisition as a means to growth

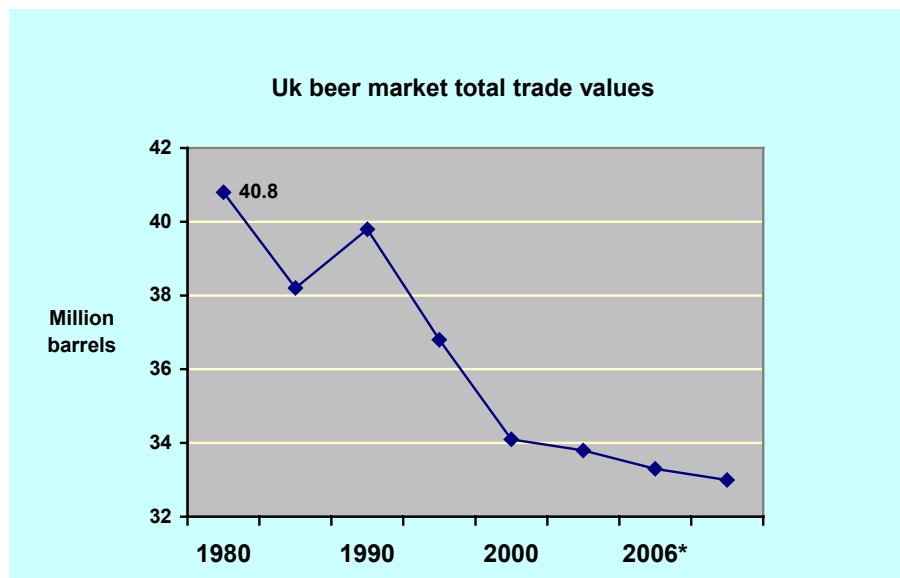
This paper analyses the strategies employed by East Anglia brewer Greene King PLC as it seeks to maximise the opportunities to be found in this much improved business environment.

Examination of Bowman's (1995:242) strategic clock would indicate that they have adopted a Differentiation strategy. In a work by Michael Porter (1980:199-214), he devotes a whole chapter to unlocking the fragmented structure of historically highly fragmented industries which are, as here, location bound. He identifies a number of factors which would act as accelerants in this transition namely: economies of scale, technological innovation and the experience curve. He also projected that '*overcoming fragmentation can be a very significant opportunity, the payoffs can be high*'. That this business model works well will be evidenced here, as will Greene King's geographic ambitions, spreading their footprint into the Midlands and Scotland. An interesting irony is that the Department of Trade and Industry have called for the Beer Orders to be revoked as they have served their purpose of breaking that complex monopoly. Campaign for Real Ale (CAMRA) are shocked, their spokesman suggesting (Jan 2007), '*there will be nothing to stop larger brewers and pub chains tying up huge chunks of the market restricting access to smaller brewers and smashing consumer choice*', a real sense of déjà-vu.

A flavour of their successes may be found in their most recent results where half-year profits (December 2006) reveal a 23% rise in profits. The firm, which brews Old Speckled Hen, Abbott Ale, Ruddles and cask ale Greene King IPA, owns c.2,840 pubs, reported that purchase of the Laurel pub chain and the brewer Ridley's had helped boost profits to £55.8m.

1. The Industry environment

The continued decline or droop in UK Beer Market is illustrated in Fig 1



Source BBPA/Market Insight Blee M. (2007:879)

Fig 1

1.1 The Beer Orders 1992

At the end of the 1980s, the market for beer in the UK was dominated by six national brewers. (see Table 1) These accounted for over 75% of UK beer production, controlled over half of all public houses and a substantial proportion of off licence sales. Owned public houses fell into two categories – managed houses, where the publicans and their staff were employed by the brewery and tenancies where independent publicans rented the public house from the brewer. Under an exclusive supply deal, the 'beer tie' the tenants were required to retail their brewers' products, guaranteeing the brewer an outlet for their product. The remainder of public houses were owned by regional and small brewers or existed as free (from tie) houses. In many cases

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The Director General of Fair Trading, concerned about further brewer consolidation and the level of vertical integration (from production via distribution to retail and consumption) that existed in the beer market asked the Monopolies and Mergers Commission (MMC) to investigate the market. Its report 'The Supply of Beer' found that a complex monopoly existed in favour of the brewers who owned tied houses or had tying agreements with freehold outlets. To increase competition in the industry, in particular price led competition and, to enhance customer choice, the final agreement required that all brewers who owned more than 2,000 licensed premises either dispose of their breweries or release from their ties one half of on-licensed premises above the 2,000 threshold. In addition, landlords who remained tied were allowed to purchase one brand of draft cask-conditioned beer and one brand of bottle conditioned beer from any supplier, the 'guest beer' provision. This also prohibited ties for non-alcoholic drinks.

1.2 A ready parallel can be drawn with the current Office of Fair Trading's ongoing investigation by the Competition Commission (reporting later in 2007) into the dominance of certain UK grocery retailers. In particular, what has been called a 'Tesco polypoly' where Tesco which currently has a 32.5% market share but in some towns it is entirely dominant thus reducing choice. (Such towns as Bicester and Inverness and the ten Tesco outlets in the Fulham Road are regularly cited). According to market analyst CACI, Tesco has more than 40% of the market in 14 UK postal districts and more than 45% in another 5. There is talk of 'Tesco Towns', conurbations so dominated by a single retailer that a national market share statistic is irrelevant. However, as pointed out by Tesco CEO Sir Terry Leahey (Guardian 24 January 2007) '90% of consumers live within 20 minutes drive of at least three different supermarket formats'. The application of isochronous method (equal drive time) will be very pertinent to the final findings. Similar location tied densities or saturation were entirely prevalent prior to the introduction of the Beer Orders.

Caterers might like to reflect on the similarity of behaviour as displayed by Starbucks. Reported in the Guardian (16 January 2007) as '*a serious case of caffeine overdose where their reporter, Oliver Burkeman found that if he stood on the corner of Regent Street and Wigmore Street in central London, he was within five miles of 164 branches of Starbucks. Even at home in the London suburbs, there were 158 branches within five miles*'. Check your personal proximity/density on the company's web site www.starbucks.com, enter your postcode into the store locator. Starbucks method of area saturation which includes the cannibalisation of their own outlets driving out all local competition is well documented in the US in Naomi Klein's (2000:135-139) '*No Logo*'. They still have declared plans for aggressive expansion in the UK as well as globally. On the next day 17 January, the Guardian under the heading '*Skinny delocator*' pointed out that there existed another web site which gives you full details of all the independent coffee shops within the vicinity of your postcode. www.delocator.org.uk '

1.3 That the Beer Orders were effective in breaking the Complex Monopoly found in 1989 is shown in the second report to the Select Committee on Trade and Industry – The Development of the UK Market for Beer 1989 – 2004. Published by the United Kingdom Parliament. This fully illustrated the radical nature of the change in particular the emergence and consolidation of players in both the Pubco and brewer markets, see table 2.

Estimate of public house ownership, 1989 and 2004 Table 1

1989			2004		
Bass	Brewer	7,190	Enterprise Inns	Leased	8,739
Allied	Brewer	6,678	Punch Taverns	Leased	8,419
Whitbread	Brewer	6,483	Spirit Group	Managed	2,468
Grand Met	Brewer	6,419	Wolves&Dudley	Mixed/Brewer	2,112
Courage	Brewer	5,002	Greene King	Mixed/Brewer	2,100
S & N	Brewer	2,287	Mitchell & B	Managed	2,007
			S & N	Leased	1,094
			Wellington Pubco	Leased	835
			Avebury Taverns	Leased	750
			London& Edin Inns	Lease/Mngd	696
Total		34,059			29,218

Table 1

The top six brewers in Great Britain in 2003 were Table 2

Company	Market	
	On trade	Off trade
Scottish Courage	26%	23%
Coors	20%	17%
Interbrew UK	16%	26%
Carlsberg - Tetley	14%	11%
Diageo	6%	3%
Anheuser - Busch	2%	4%
Total	84%	83%

Table 2

The top six brewery players now own more market share, at 83%, than the top six players in 1989 who held 75%

2. The Drive for Growth and Expansion

2.1 Businesses must grow to maintain their market position and to keep up with or ahead of their competitors. They also need to satisfy the needs of their various stakeholders in particular stockholders and staff. There is a vibrancy and confidence to be found in growth. Some of these growth motivations or advantages are to be found in Campbell, Smith and Houston (1999 p186) those that apply to Green King are

- To increase market share thus increasing buying power and economies of scale
- To increase their geographic spread or footprint
- To broad the range of their products, in particular acquiring valuable brands
- To reduce competition by buying them out
- To achieve preferential access to distribution channels
- To make productive use of spare capacity both in brewing and bottling
- To grow and develop their corporate reputation

- To be able to reinvest in their outlets maintaining them at the highest possible standards and to comply with changes in legislation where, for example, they have invested up to £100,000 in the provision of 'out side smoking rooms' at individual locations.
- To produce funds for the next acquisition

3. Issues associated with growth by acquisition

Lynch (2006 pp 466-469) endorses this list and observes that '*Financial reasons associated with purchase of undervalued assets could be another advantage*'. In all cases, Green King's acquisitions have been of underperforming or marginal businesses on the treadmill of increasing production costs and declining volumes and yields. Through their core competences in turning round such acquired assets they are able to return them to profitability. In an earlier work Peters and Waterman (1982 pp 292- 305) strongly advocate, as demonstrated here, the creation of an overpowering niche strategy where they found that truly excellent companies should '*stick to their knitting*'. Lynch identifies a disadvantage of growth by acquisition when the premium paid is too expensive. A thorough approach to due diligence ensures that this potential trap is avoided.

3.1 Greene King's mission states –

Our aim is to emphasise the achievement of organic growth, supplemented by a prudent acquisitions strategy through three horizontally integrated trading divisions. The integrated model provides financial and operational synergies, as well as the opportunities to share intellectual capital across the group. It allows flexibility to transfer pubs between divisions, helping to maximise returns on assets, as well as giving balance and an element of natural hedging of risk.

That Greene King is in the business of acquisition is evidenced here. During the late 90's they embarked on a series of takeovers. In 1996 they bought the Magic Pub Company; Beards of Sussex in 1998; the Marston's southern estate in 1999. In the same year they purchased Morland which had a considerable tenanted and managed pub estate and whose brews included Ruddles Bitter and Ruddles County. They then closed Moreland's Abingdon brewery transferring production to Bury St Edmunds. In total, these acquisitions provided Greene King with 903 pubs.

Growth continues through acquisitions in the 2000s. In September 2001 they acquired 136 managed pubs with the purchase of Old English Inns (of these, they retained 81 under management, transferred 25 to tenancy and disposed of the remaining 20. In April 2002, they bought the 8 properties of Dalgety Taverns and followed in June with the purchase of Morrells of Oxford acquiring some 107 outlets.

In July 2004 they purchased 432 pubs from the Laurel Pub Co for £654m. This acquisition boosted their premises to more than 2,100. In June 2005, they acquired the 73 pubs of Essex-based T.J. Ridley & Sons. Two months later they agreed to acquire the Scottish group Belhaven for £187m. Said purchase added 300 pubs to their estate. Brewing is to continue at Dunbar near Edinburgh. Apart from sheer logistics, it would be politically imprudent to move brewing south of the border.

Following an intensive review and due diligence, in September 2006, they bought Midlands-based (Kimberly) Hardys & Hansons, with 268 pubs for £270m. It was reported that H&H had a high quality estate that would be integrated into Greene King's managed and tenanted pub estate division and that they would benefit from the shared experience, expertise of and enhanced support from a larger group whilst maintaining their individual characters and ability to service their local communities.

In A Media Release (3 October 2006) CEO Rooney Anand stated that *'with regret, it does not make economic sense to continue brewing at Kimberly and sadly this means that the brewery will close at the end of the year. Greene King invests more in cask beer than any other brewer but, to remain viable, returns has to be delivered on this investment. The best way to ensure that Hardys and Hansons' brands continue to flourish in a challenging ale market is to transfer brewing to Bury St Edmunds. The head office functions will also be moved there. Beer matching will begin shortly and we'll soon be beginning the painstaking process of brewing trials and taste-profiling. We'll ensure that customers can continue to drink the same great beer in the future. We have a track record in making a success of the brands we acquire and look forward to offering H&H's Dark Mild, Cool and Olde Trip to a much wider audience in both the on and off trade. At the time of this deal, our companies make an ideal match historically, culturally and structurally. Like Greene King, Hardys and Hanson built its trade on running great pubs and selling top quality beer. By joining together H&H can extend beyond their current communities.'* This demonstrates the flexibility and sensitivity exercised in both integrating and bringing acquisitions on side.

Whilst this much expanded portfolio of pubs gives them both critical mass and improved location representation, it also presents the opportunity to review the total estate and churn or sell off those deemed surplus or not to today's quality standard.

An example of this comes from the industry's trade press 'The Morning Advertiser' (18 October.2006) where it is reported that *'Greene King has appointed Pricewaterhouse Coopers to advise on the sale of 150 tenanted pubs. The pubs, most of which are freeholds, are said to be a mix of smaller drink or wet-led operations and sites with property development potential'* A key criteria is emerging with the rapidly approaching smoking ban, only pubs capable of strong food business will be retained On 21 November 2006, Greene King announced the sale of 155 (5 extra) pubs to Admiral Taverns for £56.53m. Anand stated *'Greene King's drive to improve the quality of our estate has meant that we have long been sellers as well as buyers of pub assets. Today's deal marks another step in this strategy'*

A similar strategy is being employed by Punch Taverns, Britain's biggest pubco. On 21 March in The Times (p44) it was announced that *'Punch calls time on 1,000 pubs ahead of the smoke ban'* Here it was indicated that Punch had earmarked for disposal many of their small drink or wet-led tenancies that would suffer most when smoking was banned in Wales from April 2 2007 and in England from 1st July. It was also recorded that *'most of Punch's rivals had already sold or put on the block large tranches of smaller pubs that are less able to mitigate the impact of the ban by serving more food'*.

In his half-year profits statement December 2006, Anand stated that *'these recent acquisitions had served to increase operating profits by 17% to £101m on revenues of £419m.*

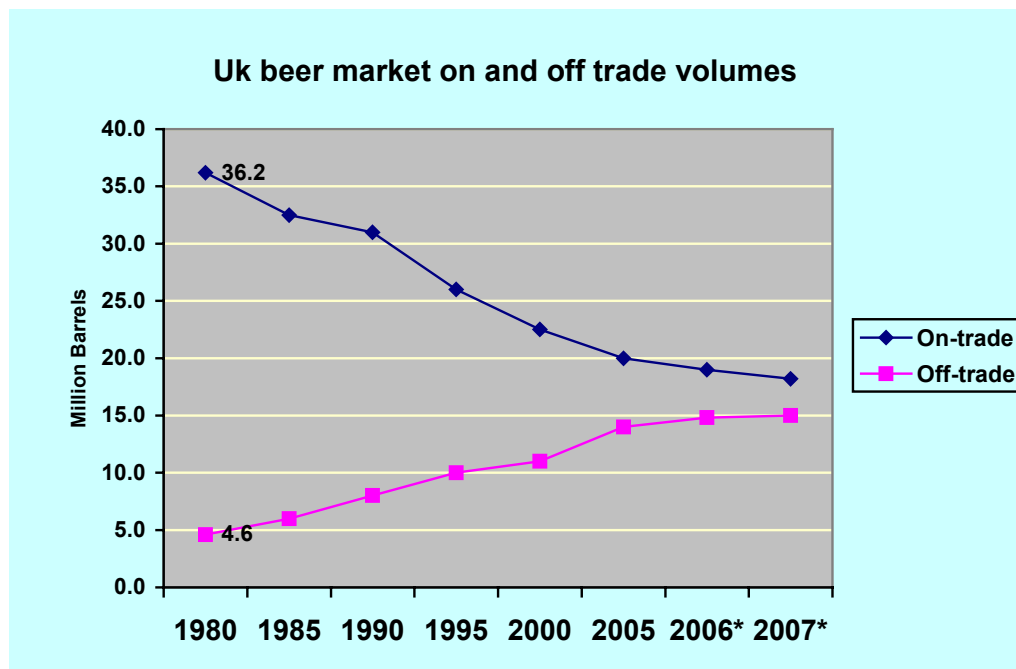
That Greene King is involved in the consolidation of regional brewing in the East of England is evidenced here, its bid to increase its geographic footprint with excursions into the Midlands and Scotland most certainly is a portent for its future growth.

In his seminal work *Competitive Strategy* Michael Porter (1980:199-214) devoted a whole chapter to the unlocking of the fragmented structure of traditionally highly fragmented industries where owner-managers abounded often in disparate locations. He predicted that as these industries became more consolidated, there would emerge *'market leaders with the power to shape events'* Porter projected that *'overcoming fragmentation can be a very significant strategic opportunity and that the payoffs can be high'* all of the accelerants he identified in this process present here.

1. Greene King achieves significant economies of scale through cost dilution, central cost savings and increased buying power.
2. Their expanded portfolio of pub outlets gives them better representation and/or critical mass often filling gaps and allowing better opportunity to churn their estate determining the most appropriate mix in terms of managed to tenanted pubs. They can also sell off units which perform below par, quality standards etc.
3. For their much expanded portfolio of beer brands they can achieve more effective and efficient distribution in 'on' sales and have much more clout with the major UK retailers for their 'off' sales. All this leads to increased yields and profitability.
4. There is an increase in their core competence in brewing as they travel down this experience curve. Bottling and other distribution costs are reduced pro rata.

4. The Greene King Experience

Greene King's competitive strategy is that of Broad Differentiation as illustrated in Bowman (1995) Strategic Clock. *They seek to provide products and services that offer benefits different from those offered by others and that are widely valued by buyers.* They are particularly proud the range of their cask and bottled beer brands which they are currently repositioning through up-market advertising in the broadsheets. Certainly their brands are well represented on the supermarket shelves where promotion is essential to securing shelf space. The increasing significance of the 'off-trade' sale through supermarkets (in particular Tesco, Asda, Sainsbury and Morrisons) and off-licenses and the steady decline in 'on-trade' is illustrated in Fig 2



Source BBPA/Market Insight Blee M. (2007:879) Fig 2

Mintel (2006) reported that according to the latest statistical handbook by the British Beer and Pub Association, pubs and bars have continued to lose ground to the supermarkets with 41% of the country's beer purchased off-trade.

Their pubs very much reflect today's needs for Families, for Females and for Food (the 3 Fs) Customers demand a lot more from their pub experience than a simple pint of beer. Mintel (May 2006) detect a period of transition as pubs adopt specific consumer profiles better

reflecting the demands of the locality. Investing in a meal service is their high priority where they now achieve over 50% of turnover. Greene King's own research, corroborated by evidence from their Scottish operations show that *'one in three young couples with families who have avoided pubs would be prepared to buy family meals there once the ban came in. It said that the survey showed more women aged 45 to 54 were likely to visit pubs when the ban came into force'*. Wetherspoons PLC pre-empted the smoking ban in England. Since 2004 they have ensured that all new branches that opened (over 100 per year) were no smoking and that those that were refurbished were returned as non smoking outlets, in some cases, this conversion took longer than expected as kitchens needed to be extended due to the anticipated increase in food orders.

There is a significant investment in training and Greene King have recently launched their Get Ahead flexible learning initiative, including a career progression ladder, a structured BIIAB industry recognised qualification and a four-stage house manager training programme. The scheme has won the IDG Food Industry Award for Learning and Development.

They experience relatively low staff turnover for this industry, their investment in training paying off when they were recognised as the third best Restaurant, Drink, Pub and Brewery employer in the Management Today survey published December 2006.

The London Evening Standard (5 December 2006) recorded that *'across the country, hundreds of Greene King landlords and staff are poised to swing into Operation Clean and Fresh (OCF) the moment the smoking ban comes into force in the UK hospitality industry on 1 July 2007'*. The earlier purchase of Belhaven has given Greene King much insight as the ban on smoking in Scotland was introduced in March 2006. As Anand stated *'we want to win back people who stopped going to pubs, particularly women and families. We are making for pristine surroundings in part to achieve this we are installing industrial scale air-fresheners'*. The Belhaven experience has proved reassuring, the negative impact on beer sales being more than offset by better food sales.

4. Conclusion

In his CEO review of the business in the 2005/06 Annual Report Anand wrote -

We firmly believe in our business model which combines the scale required for efficient processes and purchasing with the advantages of integration. These advantages include

- *The ability to transfer pubs between management and tenancy thus optimising their contribution over the life cycle*
- *The ability easily to integrate other integrated brewer/pub companies*
- *The customer insights that come from being both buyer and seller*
- *Leveraging our trusted heritage brand with both consumers and the trade*

In his closing statement he strongly asserted the basis for the company's success -

The leisure industry remains a changing, intensely competitive space and it is only the dynamic players that will survive. Within it, the British community pub has proved remarkably resilient and adaptable over many centuries. Green King, founded in 1799, has remained at the heart of this through its commitment to the enduring strengths of the business and continuous innovation to improve customer appeal

These results demonstrate our proven strategy that delivers value for shareholders. The intrinsic quality of our assets, combined with the passion and talent of our team, along with recent acquisitions, give us confidence that there are exciting opportunities to deliver further growth in future

Examination of the five years Financial Highlights shown in Appendix 1 shows an enviable and incremental growth in all prime indicators, turnover, profitability and dividends paid. This analysis on the management practices and policy employed entirely endorses their dynamic nature and their ability not only to survive but to thrive in today's highly competitive business environment.

This case study was developed with the aim of providing students with an opportunity to appreciate the nature of strategic analysis with specific learning objectives set concerning context: growth: acquisition and associated concepts models and theories. It has now (March 2007) been trialled by over thirty final year BA(Hons) business students, the consensus was that the aim and objectives were met in full

5. Post Script

For many years, Green King had been regarded as a sort of White Knight buying out uneconomic brewers, revitalising their pubs and maintaining the favourite 'local' tippie, albeit brewed at Bury St Edmunds. In its dash for growth (now worth more than £1bn and listed in the FTSE 250 index) they appear to attract the sort of opprobrium reserved for other big corporations being accused of insensitivity to local needs and decimating local businesses.

The first sign of this revised status came as this paper was going for publication, a four page exposé by Tim Minogue in The Guardian (23 March 2007 G2 pp6-9) below are a few extracts to demonstrate the flavour of this critique.

Hundreds of regulars already have withdrawn from this, their most popular pub, The Lewes Arms. They have been boycotting the 220-year-old pub since December 11, when Greene King, despite a petition signed by 1,200 locals, including Lib Dem MP Norman Baker, withdrew Lewesians' favourite tippie, Harveys Bitter, from sale.

Harveys has been brewed a few hundred metres away, beside the River Ouse, by an independent family firm since 1790. It was voted best bitter in 2005 and 2006 at the Great British Beer Festival. In the Lewes Arms, as a "guest beer", it outsold Greene King's own IPA, brewed in faraway Bury St Edmunds, Suffolk, by at least four-times. But GK, as supplier as well as retailer, made more from every pint of IPA sold than Harveys. Get rid of Harveys, the thinking went, and the locals, after a bit of grumbling, would switch to IPA and GK would make more money. But it hasn't worked out that way. According to the trade paper the Morning Advertiser, the pub has lost 90% of its business since the boycott, which was 100 days old on Wednesday, and now sells very few pints of anything. At lunchtimes and weekday evenings, hours go by when no one at all crosses the threshold.

But this dispute is not just about beer. Across Britain the traditional "community" local is under threat as never before. According to the Campaign for Real Ale (Camra), 56 pubs close in Britain every month, most of them urban locals. Camra's head of research, Iain Loe, says: "The bricks and mortar are often worth more, in the short term, for conversion to flats than the place is as a going concern."

Ownership of pubs is becoming concentrated in fewer and fewer hands. The giant "pubcos", Punch Taverns and Enterprise Inns, own some 9,000 outlets each, while Greene King itself has more than 2,600. "If a smaller pub doesn't fit into their business model they will sell it to a developer to be converted into flats or a restaurant without a second thought," says Loe.

Storm in a pint pot? ...Discuss!

In an earlier study by McCaskey (2000) concerning the consolidation or polarisation of the various sectors of the hospitality industry Conrad Lashley's (1999) states that this cleansing and renewal process was apparent in the licensed retail sector. Lashley cites Mintel – '*Mintel estimates that there has been a six percent reduction in pub outlets between 1993 and 1998...with some 5,000 fewer properties ... and industry analysts suggest that there is scope for further shrinkage in pub capacity. Another 5,000 could easily go, through releasing property for private use however, this shrinkage, is being matched by new licensed applications in new buildings.*' And thus, the churn continues.

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Appendix 1

FINANCIAL HIGHLIGHTS FOR THE TWENTY-FOUR WEEKS ENDED 15 OCTOBER 2006

- Revenue + 16% to £419.2m

- EBITDA* +17% to £119.9m

- Operating profit* +17% to £100.9m

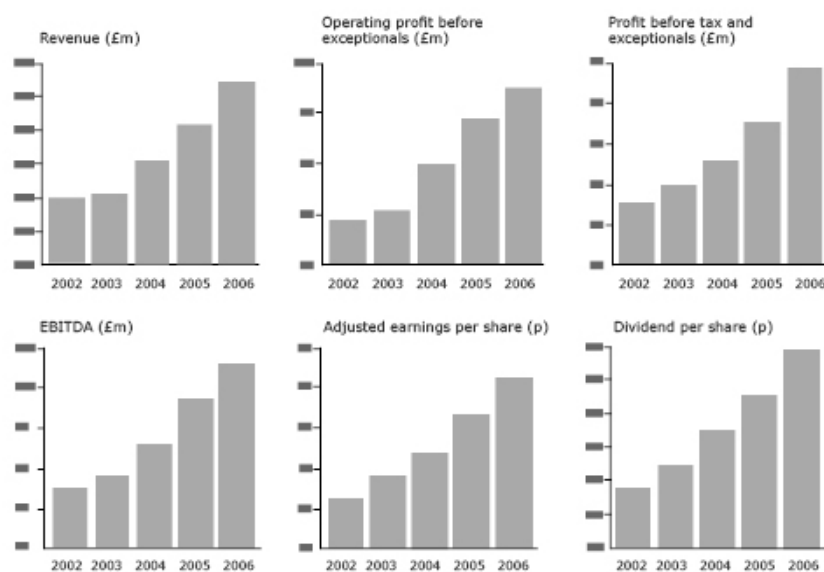
- Operating profit margin* +0.1% to 24.1%

- Profit before tax* +20% to £67.1m

- Adjusted earnings per share* +17% to 31.1p

- Interim dividend per share + 11% to 6.45p

*before exceptional items



Financial information for 2004, 2005 and 2006 is presented under IFRS. 2003 and earlier figures are presented under UK GAAP.