

The Effect of the Two-Tier Systems and the Tight House Laws on the Growth of Craft Beer Industry in California

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Abstract: This review examines the impact of the two-tier distribution system and restrictive tied house laws on the growth and competitive landscape of the craft beer industry in California. While these regulatory frameworks were originally established to prevent monopolistic control and promote responsible alcohol distribution, they have inadvertently created structural barriers for small and independent craft breweries. The two-tier system, which separates producers from distributors, limits market access for emerging breweries and consolidates power among a few dominant distributors. Simultaneously, California's strict tied house laws—prohibiting breweries from having financial interests in retail outlets—constrain promotional flexibility and limit direct consumer engagement. This paper explores the historical origins of these regulations, analyzes their implications on market entry, branding, and economic scalability, and highlights how some legislative reforms and creative compliance strategies have attempted to foster industry growth. By synthesizing legal, economic, and entrepreneurial perspectives, this review provides critical insights into how regulatory constraints influence innovation, market diversity, and the sustainability of craft brewing in California.

Keywords: Craft Beer, Two-Tier System, Tied House Laws, Regulatory Barriers, California Brewing Industry.

1. INTRODUCTION

1.1 Review of the U.S. Craft Beer Industry

The U.S. craft beer industry has emerged as a dynamic sub-sector within the broader alcoholic beverage market, characterized by exponential growth in both production and consumer base over the past two decades. Unlike traditional macrobreweries, craft breweries emphasize innovation, small-scale production, and distinct regional identities, aligning with consumer preferences for authenticity and diversity in flavor profiles (Elzinga, Tremblay, & Tremblay, 2015). As of 2020, the Brewers Association reported over 8,000 craft breweries operating in the United States, contributing more than \$60 billion annually to the economy and accounting for nearly a quarter of the U.S. beer market by volume. This sector is also a significant employer, providing more than 400,000 direct and indirect jobs.

The sociocultural drivers of this growth are deeply rooted in the entrepreneurial spirit of the 1980s and 1990s, where a backlash against homogenous beer offerings spurred the microbrewery revolution. Carroll and Swaminathan (2000) argue that this growth was facilitated by resource partitioning, where niche players could thrive in market segments abandoned or underserved by large-scale producers. Importantly, the decentralized structure and innovation-driven ethos of craft breweries foster a highly competitive yet community-oriented ecosystem. These features set the stage for ongoing tensions with regulatory systems like the two-tier distribution model and tied house laws, which often prioritize large-scale distribution mechanisms incompatible with the craft beer model.

1.2 Significance of California in the Craft Brewing Landscape

California holds a pivotal role in the U.S. craft beer ecosystem, not only due to its substantial number of breweries but also because of its enduring influence on brewing culture, regulatory experimentation, and consumer behavior. By 2014, California had already distinguished itself as a national leader in craft brewing density and spatial clustering, fostering a unique environment for collaboration and innovation among small-scale producers (McLaughlin, Reid, & Moore, 2014). This momentum carried through the remainder of the decade, and by 2019, California remained at the forefront, hosting approximately 1,000 licensed craft breweries—more than any other U.S. state. The state's favorable climate, access to prime agricultural inputs such as barley and hops, and its proximity to large and diverse urban markets enabled vertically integrated operations and a proliferation of differentiated beer styles. Moreover, the California model has served as a template for emerging craft brewing regions, demonstrating the interplay between geographic advantages, policy conditions, and entrepreneurial ecosystems in advancing the craft beer industry.

The significance of California also lies in its contribution to redefining market penetration strategies for niche craft products. Murray and O'Neill (2012) emphasize that the California craft brewing model excels in brand storytelling, local sourcing, and experiential marketing—tools that small-scale brewers across the country have since emulated. Importantly, many regulatory debates and legislative reforms regarding tied house laws and distribution structures have originated from conflicts between California's innovative brewers and the restrictive framework of the three-tier system. As such, the state's experience offers a microcosm of the national struggle between regulatory tradition and entrepreneurial agility, highlighting the direct influence of legal context on the scalability and innovation potential of craft breweries.

1.3 Purpose of the Review and Research Questions

The purpose of this review is to critically examine how the regulatory frameworks governing alcohol distribution—specifically the two-tier distribution system and tied house laws—have shaped the developmental trajectory of the craft beer industry in California. By exploring the legal, economic, and operational dimensions of these regulations, this study seeks to understand the extent to which they have either constrained or enabled innovation, market expansion, and brand autonomy among craft breweries. This review also aims to highlight the adaptive strategies employed by small brewers in navigating these regulatory barriers, while assessing potential reforms that could foster a more equitable and competitive market structure.

To guide this inquiry, the review is driven by the following research questions:

- How have the two-tier distribution system and tied house laws affected the market access and scalability of craft breweries in California?
- In what ways do these regulatory mechanisms influence marketing practices, consumer engagement, and inter-tier relationships within the state?
- What legal adaptations or policy innovations have emerged to mitigate the constraints imposed on the craft beer sector by these laws?

1.4 Outline of the Regulatory Focus (Two-Tier System and Tied House Laws)

This review centers on two primary regulatory mechanisms that structure the craft beer industry in California: the two-tier distribution system and tied house laws. The two-tier system requires breweries to sell their products to independent distributors, who then supply retailers. While originally designed to prevent monopolistic control and encourage temperance, this structure can create substantial barriers for small breweries by limiting direct market access and increasing dependence on intermediary networks. Tied house laws, on the other hand, prohibit brewers from owning or having financial interests in retail establishments that sell alcohol, thereby restricting vertical integration and direct-to-consumer

engagement. Together, these regulations form a complex legal environment that governs how craft breweries operate, market, and expand within California. The review evaluates the implications of these laws across operational, promotional, and economic dimensions, with a focus on how they impact competition, innovation, and long-term growth in the sector.

1.5 Structure of the Paper

This paper is structured into six key sections to systematically explore the impact of regulatory frameworks on the craft beer industry in California. Following the introduction, Section 2 provides a historical and legal background on alcohol regulation in the United States, with a focus on the origins and evolution of the two-tier distribution system and tied house laws. Section 3 analyzes how these regulatory structures influence market access and distribution strategies for craft breweries, particularly small and independent operators. Section 4 examines the effects of these laws on marketing, branding, and the ability of breweries to cultivate retail relationships and consumer loyalty. Section 5 highlights recent legislative reforms, advocacy efforts, and adaptive strategies employed by California brewers to overcome regulatory constraints. Finally, Section 6 synthesizes the key findings and offers policy recommendations aimed at balancing regulatory objectives with industry innovation and equitable market growth.

2. HISTORICAL AND LEGAL BACKGROUND

2.1 Origins of Alcohol Regulation Post-Prohibition

The modern structure of alcohol regulation in the United States is deeply rooted in the post-Prohibition era, a period that redefined the relationship between government authority, public health, and market access. Following the repeal of the 18th Amendment through the ratification of the 21st Amendment in 1933, the federal government delegated authority over alcohol regulation to individual states. This devolution of control was intended to curb the excessive concentration of power seen during the pre-Prohibition era, where vertical integration between producers and retailers led to aggressive sales practices and widespread alcohol abuse as shown in Figure 1 (Carp, 2012). The resulting legal architecture introduced the three-tier system—separating producers, distributors, and retailers—which formed the regulatory baseline for states like California.

Miller (2016) emphasizes that the creation of this system was not only a response to temperance movements but also a deliberate attempt to insulate public health from commercial incentives. By imposing structural barriers between market participants, lawmakers aimed to diminish overconsumption and promote tax accountability. However, while the system succeeded in restoring legal alcohol commerce under strict governance, it also introduced rigidity into the marketplace that continues to shape the operational scope of emerging craft breweries. The foundational logic of this framework—designed for large-scale producers and a different era—now intersects problematically with the innovation-driven, small-batch model of the craft beer industry.

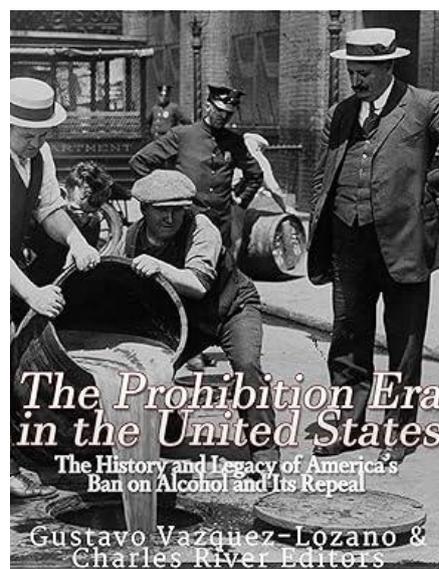


Figure 1: Prohibition Enforcement and the Foundations of Modern Alcohol Regulation in the United States (Editors, & Lozano, 2017).

Figure 1 visually captures the enforcement of Prohibition laws in the early 20th century—specifically, the public disposal of alcohol by law enforcement. This scene embodies the federal government’s intense efforts to control alcohol consumption following the ratification of the 18th Amendment and the Volstead Act. This Figure symbolizes the moral, political, and social forces that led to a sweeping national ban on alcohol and subsequently shaped the regulatory framework that followed its repeal in 1933. The spectacle of public barrel dumping not only reflected the ideological zeal of temperance advocates but also exposed the impracticalities and unintended consequences of blanket prohibition, such as the rise of illegal bootlegging and organized crime. These challenges ultimately informed the creation of post-Prohibition laws, including the decentralized, state-based alcohol regulation system and the establishment of mechanisms like the three-tier distribution model and tied house laws—designed to prevent vertical integration and promote responsible commerce. The image is thus a historical anchor for understanding how the failures of Prohibition gave rise to modern alcohol policy in the United States.

2.2 Structure and Rationale Behind the Two-Tier Distribution System

The two-tier distribution system in the United States is a regulatory mechanism designed to enforce separation between alcohol producers and retailers by requiring products to pass through an independent distribution tier. Though often conflated with the three-tier system, the two-tier variant removes the retailer from direct legal entanglement with the producer while still maintaining the distributor as a legally mandated intermediary. As Pennock, and Kerr, (2005) explains, this model was a compromise between commercial liberalization and moral governance, ensuring producers could not dominate retail spaces through coercive agreements, exclusive contracts, or financial inducements. It reflects a deep-seated tension within American federalism—balancing decentralized control with uniform regulatory goals across the states.

The rationale behind this structure extends beyond anti-monopoly concerns; it was meant to support fair market competition, facilitate tax collection, and prevent vertical consolidation. Diamond, (2007) argue that the system also served a democratic function, allowing states to control local alcohol availability through licensing, zoning, and distribution regulation. However, in practice, this model has created structural inefficiencies for emerging craft brewers who often lack leverage in negotiating with dominant distributors as presented in Table 1. These producers face limited shelf space, reduced market reach, and fewer branding opportunities—constraints that disproportionately hinder innovation-driven entrants like craft breweries in California, whose market access is critically shaped by the power dynamics embedded in this two-tier architecture.

Table 1: Summary of Structure and Rationale Behind the Two-Tier Distribution System

Aspect	Description	Purpose/Rationale	Impact on Craft Brewers
Two-Tier System Structure	Separation between producers and retailers via an independent distributor tier; retailer not legally tied to producer.	Compromise balancing commercial liberalization and moral governance; prevent producer dominance.	Creates barriers due to required intermediaries; limits direct retailer access for producers.
Regulatory Goals	Support fair market competition, ensure tax collection, prevent vertical consolidation.	Maintain decentralized state control while ensuring uniform regulatory objectives.	Disadvantages small, emerging craft breweries that lack negotiating power with large distributors.
Commercial Control	Prohibits coercive agreements, exclusive contracts, or financial inducements between producers and retailers.	Prevents monopolistic or unfair practices in alcohol retail markets.	Limits shelf space, market reach, and branding opportunities for small and innovative craft breweries.
Federalism & Local Control	States regulate alcohol availability through licensing, zoning, and distribution oversight.	Allows local regulation reflecting community standards and public interest.	Market access for craft brewers heavily influenced by distributor power dynamics within the two-tier system.

2.3 Evolution of Tied House Laws in California

The tied house laws in California, like those in other U.S. states, originated in the wake of Prohibition with the intent of dismantling vertical monopolies that allowed producers to control retail operations. These laws prohibit alcohol manufacturers from holding ownership or financial interests in retail establishments, aiming to prevent undue influence and ensure a separation of economic power across the supply chain. Hawkins, and Holden, (2013) note that these regulations were heavily influenced by early 20th-century concerns about public morality, worker productivity, and corporate manipulation of alcohol consumption patterns. As a result, the legal architecture was constructed to eliminate any scenario in which suppliers could coerce retailers into exclusive sales relationships.

Over time, California's application of tied house laws has become increasingly complex, especially as the craft beer industry has expanded. Lachenmeier, Taylor, and Rehm, (2011) argues that while the intent of these laws was to safeguard fair competition, they now impose disproportionate constraints on small and independent breweries. These producers are often restricted in their ability to sponsor events, engage in collaborative promotions with bars or restaurants, or operate multi-functional retail spaces like taprooms. The regulatory rigidity impedes innovation and consumer outreach, particularly in an era where experiential branding and community integration are critical to business sustainability. Thus, tied house laws in California have evolved into a legal paradox: designed to protect competition but often disadvantaging its most entrepreneurial players.

2.4 Key Legal Milestones and Enforcement Mechanisms

The trajectory of alcohol regulation in California is marked by critical legal milestones that have shaped the structure and oversight of the craft beer sector. One of the most influential developments was the codification of the Alcoholic Beverage Control Act in 1955, which established the California Department of Alcoholic Beverage Control (ABC) as the primary regulatory body tasked with licensing, inspection, and enforcement. This framework gave the state authority to operationalize and adapt federal mandates from the repeal of Prohibition into enforceable local statutes. Over time, the ABC has expanded its reach to accommodate new business models, including tasting rooms and contract brewing arrangements.

Enforcement mechanisms have historically emphasized deterrence through licensing suspensions, monetary penalties, and permit revocations. Shadbegian and Gray (2017) argue that the brewing industry's compliance culture is shaped by a regulatory environment that mirrors broader environmental enforcement strategies—emphasizing documentation, inspections, and cooperative monitoring. However, the enforcement of tied house laws and distribution restrictions often lags behind market innovation, creating uncertainty for small-scale producers. Kleiman (2016) notes that overly rigid enforcement mechanisms risk stifling entrepreneurial activity, especially when policies are applied uniformly without accounting for the distinct challenges faced by craft brewers. As the industry evolves, a recalibration of enforcement strategy—balancing deterrence with flexibility—remains critical to harmonizing compliance with sectoral growth.

3. REGULATORY IMPACT ON MARKET ACCESS AND DISTRIBUTION

3.1 Challenges Small Breweries Face in Accessing Distributors

Small breweries operating in California face substantial barriers when attempting to access distribution networks, a critical component for scaling operations and entering broader markets. The two-tier system mandates that breweries use independent distributors to reach retailers, but these intermediaries often prioritize high-volume producers who offer better margins and established brand equity. According to Matumba, and Mondliwa, (2015), this structural preference results in a distribution bottleneck, where small craft brewers struggle to gain shelf space or tap line access, particularly in competitive urban markets. These limitations significantly impede growth trajectories and can force small operations into limited geographic ranges, despite having the production capacity and consumer demand for expansion.

Lillywhite and Albrecht (2017) highlight that distributor operate under risk-minimization logics, often requiring upfront incentives, minimum volume commitments, or exclusivity clauses that small breweries cannot meet. As a result, many emerging brewers must self-distribute under narrow legal allowances or rely on informal networks that expose them to compliance risks. The lack of distributor engagement also undermines marketing visibility and weakens a brewer's ability to develop consistent retail relationships. These structural disadvantages are not merely logistical but reflect a broader asymmetry in bargaining power between craft producers and legacy distribution channels. Such asymmetries reveal systemic constraints embedded in California's regulatory and economic landscape, disproportionately affecting the competitiveness of independent brewers.

3.2 Distributor Consolidation and Implications for Craft Brewers

Distributor consolidation has emerged as a major structural challenge for the craft beer industry, particularly in California, where the mandated separation of production and retail under the two-tier system places disproportionate power in the hands of increasingly centralized wholesalers. As mergers among distributors continue to reduce the number of independent players, market access becomes skewed in favor of large-volume producers as shown in Figure 2. Herz (2019) observes that this consolidation concentrates retail influence, allowing dominant distributors to prioritize macrobreweries with long-term contracts and strong profit margins, while marginalizing small craft breweries that cannot offer equivalent commercial incentives.

The effect of this market concentration is a stratified distribution system where emerging or mid-sized breweries are often denied shelf space, limited in promotional opportunities, and excluded from major retail networks. Tremblay and Tremblay (2011) note that economies of scale inherent in distribution logistics further exacerbate this exclusion by favoring uniform product lines and high-volume transactions—conditions incompatible with the diverse and small-batch nature of craft brewing. Consequently, craft brewers must either self-distribute within tightly regulated thresholds or rely on direct-to-consumer channels, both of which are heavily constrained by state law in California.

This growing disparity erodes competitive pluralism and stifles innovation, effectively entrenching the market dominance of a few conglomerates while suppressing the growth potential of independent breweries. Policy reforms are therefore necessary to mitigate consolidation's adverse effects and restore access equity within the distribution tier.



Figure 2: Centralized Distribution Warehousing and Its Impact on Craft Brewery Market Access (Crowell, 2013).

Figure 2 Shows a warehouse stacked with numerous metal kegs and a forklift operator managing the inventory, symbolizing the critical role of distributors in the craft beer supply chain. This Figure illustrates how the concentration of distribution power in fewer, large-scale warehouse facilities can pose significant challenges for small and independent breweries. As distributors consolidate and centralize their operations, they gain substantial control over which products gain access to retail markets. This consolidation often results in prioritization of high-volume mainstream brands, reducing shelf space and market visibility for smaller craft brewers. The image highlights the logistical and economic scale that dominant distributors leverage, which can marginalize innovative and localized craft producers by limiting their distribution opportunities. Consequently, many craft breweries are forced to seek alternative distribution methods or focus on direct-to-consumer sales, as traditional wholesale channels become increasingly less accessible. This warehouse operation thus visually encapsulates the structural barrier consolidation creates within the two-tier system, where the gatekeeping role of distributors significantly shapes the competitive landscape for craft brewers.

3.3 Case Examples of Successful or Failed Distribution Attempts

Case studies from California's craft beer industry reveal a spectrum of outcomes in distribution efforts, shaped largely by the structural rigidity of the two-tier system and the bargaining disparities between small producers and large distributors. Notably, breweries like Sierra Nevada Brewing Company succeeded by establishing early relationships with independent

distributors, enabling brand expansion while retaining autonomy over pricing and marketing. These initial partnerships, formed before consolidation trends tightened distributor selectivity, allowed for broader geographic reach and scalable production models (Cabras & Bamforth, 2016).

Conversely, many smaller or newer breweries have encountered significant barriers in securing distribution. Reid, and Gatrell, (2017) document multiple cases where microbreweries were compelled to retreat to taproom-only operations after being rejected or deprioritized by major distributors. The reasons typically include low volume outputs, perceived inconsistency in production, and an inability to meet performance guarantees that larger distributors demand. In some instances, breweries that entered exclusive distribution agreements found themselves contractually bound to underperforming partners, thereby limiting growth and marketing flexibility.

These examples expose the imbalance in distributor-producer dynamics and illustrate how access to distribution can dictate a brewery's trajectory, regardless of product quality or innovation. Ultimately, the gatekeeping role of distributors often serves as a critical chokepoint that disproportionately favors established brands, leaving smaller entrants vulnerable to stagnation despite consumer demand or creative differentiation.

3.4 Comparison with States That Have Modified Their Distribution Laws

A comparative analysis of state-level alcohol distribution reforms highlights that regulatory modernization significantly enhances the competitiveness of craft breweries. States such as Colorado, Oregon, and North Carolina have implemented legislative changes that relax traditional distribution constraints, fostering a more inclusive and entrepreneurial brewing environment. These reforms include expanded self-distribution rights, relaxed tied house provisions, and increased allowances for tasting rooms and off-site sales. Zelizer, (2006) report that such progressive regulatory adjustments are correlated with measurable growth in brewery counts, retail channel diversification, and overall market vibrancy.

In contrast, California's comparatively rigid adherence to the two-tier distribution model and strict enforcement of tied house laws has limited the operational autonomy of small brewers. Miller and Walker (2017) show that states with more liberalized self-distribution thresholds have seen accelerated brewery start-ups and more rapid brand development due to reduced dependency on large wholesalers. For instance, Colorado permits small breweries to distribute directly to retailers without third-party intervention, enabling cost efficiency and market agility. Additionally, deregulated states have nurtured innovative models such as brewpub hybrids, mobile taprooms, and collaborative sponsorships that integrate brewing with local culture and tourism as presented in Table 2.

These comparisons highlight the argument that regulatory flexibility need not compromise public accountability but can instead catalyze economic diversification and sectoral innovation—insights that are increasingly relevant to California's evolving policy discourse on craft beer distribution.

Table 2: Summary of Comparison with States That Have Modified Their Distribution Laws

Aspect	Regulatory Changes	Outcomes/Benefits	Contrast with California
States with Reforms	Colorado, Oregon, North Carolina have relaxed distribution constraints, expanded self-distribution, eased tied house laws.	Increased brewery counts, more retail diversity, vibrant markets.	California maintains rigid two-tier model and strict tied house laws.
Self-Distribution Rights	Expanded rights allow small breweries to distribute directly to retailers without intermediaries.	Greater cost efficiency, faster brand development, market agility.	California restricts self-distribution, limiting brewery growth and flexibility.
Innovative Business Models	Deregulated states support brewpub hybrids, mobile taprooms, co-branded sponsorships.	Enhanced integration with local culture, tourism, and experiential marketing.	California's restrictive laws limit these innovative, community-driven models.
Policy Implications	Regulatory flexibility catalyzes economic diversity and innovation without compromising accountability.	Facilitates entrepreneurial growth and regional identity development.	California's rigid framework risks stifling sectoral innovation and competitiveness.

4. EFFECTS ON MARKETING, BRANDING, AND RETAIL RELATIONSHIPS

4.1 Limitations Imposed by Tied House Laws on Promotions and Partnerships

Tied house laws in California, while originally intended to prevent monopolistic control and corruption in alcohol retailing, have evolved into rigid legal structures that significantly hinder promotional flexibility and strategic partnerships for craft breweries. These laws prohibit any form of financial entanglement between producers and retailers, effectively outlawing co-sponsored events, direct promotions, and most collaborative marketing efforts. Newman, and Barker (2018) emphasizes the paradox of these regulations: while they aim to preserve fair market conditions, they inadvertently suppress the very innovation and community engagement strategies upon which small craft breweries rely.

Anderson, Meloni, and Swinnen, (2018) add that the complexity of California's regulatory framework disproportionately affects emerging producers by constraining access to cost-effective marketing avenues. For example, breweries are frequently barred from sponsoring local festivals, concerts, or food and beverage collaborations if any form of exclusivity or financial benefit could be implied. Even non-monetary partnerships—such as donating branded merchandise or co-hosting educational events—can trigger violations under California Business and Professions Code § 25500.

These constraints severely limit adaptive branding strategies, forcing small breweries to rely on insular marketing approaches that lack reach and resonance. As large, well-capitalized competitors benefit from pre-existing distribution power and market access, newer entrants are left navigating a promotional minefield that obstructs visibility, customer engagement, and long-term growth potential.

4.2 Impact on Taprooms, Tasting Events, and Sponsorships

Taprooms and tasting events are pivotal instruments for craft breweries seeking to establish consumer intimacy, reinforce brand identity, and build local market penetration through direct-to-consumer strategies. These spaces function as immersive brand environments where breweries can communicate their ethos, values, and product innovation. Murray and Kline (2015) argue that taprooms not only serve as critical revenue streams but also as hubs for hospitality-oriented branding and beer tourism. However, California's stringent tied house laws significantly limit the scope of such venues by restricting the nature of event sponsorships, cross-promotions, and collaborations with licensed retailers.

This regulatory rigidity disproportionately impacts small breweries that depend on local engagement to gain visibility and scale operations. Kellershohn (2018) notes that experiential marketing tactics—such as live music sponsorships, food vendor collaborations, and branded community events—often fall into regulatory gray zones when held on or with retail partners, exposing breweries to compliance risks. The result is a fragmented outreach strategy that deprives brewers of full access to tools that would otherwise strengthen consumer relationships as presented in Table 3.

These limitations obstruct the effectiveness of taprooms and tasting events as brand-building platforms. They restrict organic community integration, limit brand storytelling opportunities, and weaken competitive positioning in a saturated market. Consequently, breweries are often compelled to operate below their creative and promotional potential due to legal boundaries that discourage experiential innovation.

Table 3: Summary of Impact on Taprooms, Tasting Events, and Sponsorships

Aspect	Description	Effects on Breweries	Regulatory Constraints
Role of Taprooms	Serve as revenue generators and immersive brand environments fostering consumer intimacy.	Enable direct-to-consumer sales and hospitality-oriented branding.	Strict tied house laws limit promotional activities and partnerships within venues.
Experiential Marketing	Includes live music sponsorships, food collaborations, and community events linked to breweries.	Enhances local engagement and brand visibility.	Activities often fall into regulatory gray areas, increasing compliance risks.
Brand-Building Platforms	Taprooms and tasting events act as hubs for storytelling and community integration.	Strengthen customer loyalty and competitive positioning.	Legal restrictions reduce opportunities for organic brand storytelling and growth.
Operational Limitations	Breweries face challenges in fully utilizing taprooms and events for marketing and outreach.	Results in fragmented outreach and stunted creative and promotional potential.	Regulatory rigidity discourages innovative experiential marketing and collaborations.

4.3 Constraints on Innovation and Brand Identity

Innovation and brand identity are central to the survival and competitive edge of craft breweries, yet California's rigid regulatory infrastructure—particularly tied house laws—poses significant constraints on these core strategic elements. Baginski and Bell (2011) argue that these laws limit the operational freedom of small breweries, stifling their ability to express individuality through branding and experiential marketing. The prohibition of co-branding, sponsorships, and promotional partnerships with licensed retailers curtails the storytelling practices essential to niche differentiation in the crowded craft beer market.

Carroll and Swaminathan (2000) reinforce this perspective by noting that the success of the microbrewery movement hinges on resource partitioning, wherein small producers carve out consumer niches through uniqueness, locality, and symbolic branding. However, California's prohibition-era remnants constrain this differentiation by imposing legal risks on partnerships that fuse beer with lifestyle-oriented events, social causes, or cultural movements. For instance, a limited-edition brew created in collaboration with a local arts festival may violate tied house rules if financial transactions or advertising are shared across tiers.

Additionally, the inability to bundle products with branded merchandise or offer interactive experiences at third-party venues weakens brand cohesion and limits consumer immersion. These constraints suppress the dynamic branding that defines craft beer innovation, making it more difficult for new entrants to distinguish themselves in a market increasingly dominated by regulatory inflexibility.

4.4 Workarounds Used by Breweries to Maintain Customer Engagement

In response to restrictive regulatory conditions, including tied house laws that prohibit direct partnerships with retailers, California's craft breweries have implemented a variety of workarounds to maintain customer engagement and brand relevance. These strategies reflect a deliberate balancing act between compliance and innovation. Danson, Galloway, Cabras, and Beatty (2015) observe that independent breweries increasingly employ experiential marketing, digital storytelling, and content-driven campaigns to connect with consumers without violating statutory limitations. This approach allows breweries to sidestep legal prohibitions on cross-tier promotions while still cultivating a strong consumer presence.

One effective method involves using social media, brewery websites, and mobile applications to announce product launches, exclusive tasting sessions, and brand narratives. Clemons, Gao, and Hitt (2006) further emphasize that online reviews and peer-to-peer engagement have amplified brand loyalty in the craft beer industry, enabling microbreweries to compete based on uniqueness and authenticity rather than distribution dominance. Taprooms serve as an additional asset, where breweries host in-house events—such as trivia nights, charity drives, and educational workshops—within spaces they control directly as shown in Figure 3.

Moreover, partnerships with food trucks, local artists, or non-alcoholic producers offer collaborative avenues that fall outside the legal definition of a tied relationship, allowing creative co-branding without triggering regulatory violations. These workarounds demonstrate the adaptability of small brewers, who transform legal constraints into innovative consumer experiences that preserve brand identity and drive engagement.

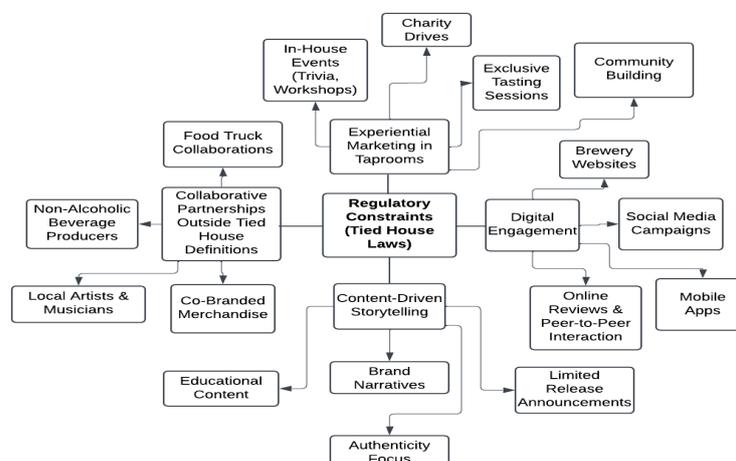


Figure 3: Workarounds Employed by California Craft Breweries to Maintain Customer Engagement.

Figure 3 illustrates the multifaceted workarounds California craft breweries employ to navigate restrictive tied house laws and maintain strong customer engagement. Central to the diagram is the regulatory constraint posed by these laws, which prohibits direct partnerships between producers and retailers. From this challenge, four key strategies emerge: digital engagement, experiential marketing in taprooms, collaborative partnerships outside tied house definitions, and content-driven storytelling. Digital engagement leverages social media, websites, mobile apps, and online reviews to foster brand loyalty and bypass promotional restrictions. Experiential marketing focuses on hosting in-house events like trivia nights, charity drives, and exclusive tastings to deepen local community ties. Collaborative partnerships involve alliances with food trucks, local artists, and non-alcoholic beverage producers, creating co-branded experiences without violating legal limits. Finally, content-driven storytelling allows breweries to share authentic brand narratives and educational content that resonate with consumers. Together, these adaptive strategies exemplify how breweries creatively balance regulatory compliance with innovative marketing to preserve brand identity and expand consumer relationships in a legally constrained environment.

5. LEGISLATIVE REFORMS AND INDUSTRY ADAPTATION

5.1 Recent or Proposed Changes to California Laws

As of 2019, California's regulatory landscape for craft beer production and distribution was gradually transitioning from rigid post-Prohibition structures toward more adaptive, industry-responsive frameworks. Tamayo (2009) documents that this shift was fueled by the increasing economic footprint of the craft beer sector and strategic lobbying by organizations like the California Craft Brewers Association. One of the most notable reforms involved franchise law modifications, which allowed breweries under defined production thresholds to terminate distribution contracts under fairer conditions. This change directly addressed long-standing concerns over distributor dominance and contract inflexibility.

In parallel, legislative proposals such as California Assembly Bill 1541 sought to broaden brewers' rights to self-distribute their products in limited quantities, bypassing traditional wholesaler networks to directly reach retail markets. Though contentious, this proposal represented a growing recognition among policymakers of the need to accommodate flexible distribution models. Legislators also began exploring exceptions to tied house restrictions for educational and charitable events, enabling brewers to engage in community-based marketing without violating statutory limitations.

Williams (2017) observed that such policy developments reflect a national trend in which states are recalibrating alcohol laws to support entrepreneurial activity while maintaining regulatory oversight. California's incremental reforms thus signaled a broader intent to modernize legacy statutes in order to foster a more competitive, inclusive, and innovation-friendly craft beer industry.

5.2 Industry Advocacy Efforts (e.g., California Craft Brewers Association)

By 2019, the California Craft Brewers Association (CCBA) had established itself as a central force in advocating for legal reforms aimed at empowering the craft brewing sector. Representing hundreds of independent breweries, the CCBA has actively engaged in shaping regulatory policy by lobbying against outdated restrictions embedded in California's distribution and tied house laws as shown in Figure 4. Elzinga, Tremblay, and Tremblay (2017) emphasize that the rapid expansion of craft brewing in the U.S. is closely tied to coordinated industry advocacy, with organizations like the CCBA functioning not only as lobbying bodies but also as vital intermediaries between brewers and policymakers.

The CCBA's strategies have included testifying before legislative committees, organizing grassroots campaigns, and forming alliances with hospitality and consumer rights groups. Notably, the association has pushed for increased self-distribution limits, more liberal taproom operation policies, and reform of franchise laws that trap small brewers in inequitable contracts. Lowry (2019) argues that trade associations serve a dual role in both influencing policy design and legitimizing industry needs within public discourse, a dynamic clearly observed in the CCBA's contributions to California's evolving alcohol policy.

In addition to advocacy, the CCBA has provided legal guidance and regulatory interpretation to its members, empowering them to operate more confidently within complex statutory environments. Collectively, these efforts have not only raised the visibility of independent brewers but also embedded entrepreneurial flexibility into the legal fabric of California's craft beer industry.



Figure 4: Logo of the California Craft Brewers Association—Championing Regulatory Reform and Industry Growth (Baker, 2016).

Figure 4 displays the official logo of the California Craft Brewers Association (CCBA), a prominent trade organization representing independent craft breweries throughout California. The CCBA serves as a pivotal advocate for the craft brewing industry, championing legislative reforms and regulatory adjustments that address the unique challenges faced by small and mid-sized brewers. The association plays a key role in lobbying for policies that increase self-distribution limits, relax tied house laws, and improve operational flexibility for member breweries. Beyond advocacy, the CCBA provides essential legal guidance, educational resources, and networking opportunities, strengthening the capacity of craft brewers to navigate California's complex alcohol regulations. The emblematic wheat and hop imagery within the logo reflects the association's deep roots in brewing tradition and its commitment to supporting sustainable growth and innovation in the state's diverse craft beer landscape. Through coordinated industry action, the CCBA has become an influential voice in shaping a more equitable and dynamic regulatory environment, helping to balance public interests with entrepreneurial success.

5.3 Role of Legal Flexibility in Promoting Small Business Growth

Legal flexibility has become increasingly recognized as a key enabler of small business growth, particularly in heavily regulated industries such as alcohol production and distribution. In the context of California's craft beer sector, legal mechanisms that introduce discretion, graduated compliance models, or conditional exemptions from rigid statutes can enhance entrepreneurial agility and innovation. Young, Welter, and Conger (2018) argue that flexible regulatory frameworks reduce the cognitive and financial burdens of compliance, enabling small enterprises to shift resources from bureaucratic navigation to product development, marketing, and strategic growth.

Such flexibility can take several forms, including adaptive licensing policies, proportional enforcement, or temporary pilot programs that allow breweries to test new sales models—such as limited self-distribution or expanded taproom services—without long-term legal risk. Fairman and Yapp (2005) emphasize that small businesses perceive flexible regulation as both a sign of procedural justice and a motivator for voluntary compliance, particularly when regulatory authorities act as partners rather than punitive enforcers. In California, instances where Alcoholic Beverage Control agents have employed discretionary oversight to accommodate promotional events or clarify ambiguous legal language have led to improved relationships and policy feedback loops.

Ultimately, legal flexibility fosters a regulatory culture that is responsive to economic diversity, reducing barriers to entry and sustaining the creative potential of the craft beer movement. This aligns with broader economic development goals that prioritize local innovation and business pluralism.

5.4 Case Studies of Adaptive Business Models or Legal Innovations

Several California-based craft breweries have adopted adaptive business models that respond strategically to legal constraints while leveraging operational flexibility for sustained growth. For example, the rise of alternating proprietorships—where multiple breweries share a licensed facility and brewing equipment—represents a cost-effective legal innovation that aligns with regulatory compliance while promoting collaboration and resource efficiency. Carroll, Swaminathan, and Freeman (2017) argue that such arrangements are legitimized through multi-audience validation, particularly when startups seek both regulatory approval and consumer authenticity in crowded markets. These structures allow smaller breweries to scale gradually while sidestepping the prohibitive capital investment associated with full-scale production.

Another legal workaround involves contract brewing, wherein a small brand partners with a licensed facility to produce its recipes while retaining control over branding, marketing, and retail relationships. Low and Abrahamson (1997) identify such models as key manifestations of strategic cloning, where entrepreneurs mimic legal templates with minimal resource overhead to achieve rapid market entry. Additionally, several breweries have pioneered hybrid taproom-retail configurations that include merchandise, food partnerships, and community events, effectively operating as multi-purpose venues within legal limits as presented in Table 4.

These adaptive strategies illustrate how legal innovation and business model flexibility converge to help craft breweries navigate structural bottlenecks. They highlight the broader finding that regulatory barriers, while persistent, often serve as catalysts for entrepreneurial creativity and institutional evolution within California's craft beer ecosystem.

Table 4: Summary of Case Studies of Adaptive Business Models or Legal Innovations

Adaptive Business Model	Description	Benefits	Legal/Operational Context
Alternating Proprietorships	Multiple breweries share a licensed facility and equipment, maintaining regulatory compliance.	Reduces capital investment, promotes collaboration, allows gradual scaling.	Complies with regulations by sharing licenses; provides legitimacy through multi-stakeholder validation.
Contract Brewing	Small brands contract licensed facilities to produce beer while controlling branding and marketing.	Enables rapid market entry with minimal resource overhead.	Strategic cloning of legal templates; avoids costs of owning full production facilities.
Hybrid Taproom-Retail Models	Breweries combine taprooms with merchandise sales, food partnerships, and community events.	Enhances consumer engagement and diversifies revenue streams.	Operates within legal limits to create multi-purpose venues promoting brand and community.
Entrepreneurial Legal Innovation	Use of creative business structures to navigate regulatory bottlenecks and institutional challenges.	Fosters resilience, creativity, and institutional evolution in craft brewing.	Regulatory barriers serve as catalysts for adaptive business practices and innovation.

6. CONCLUSION AND POLICY RECOMMENDATIONS

6.1 Summary of Key Findings from the Review

This review has demonstrated that California's regulatory framework—particularly the two-tier distribution system and tied house laws—poses significant barriers to the equitable growth and innovation of the state's craft beer industry. While these laws were originally enacted to prevent monopolistic practices and protect public welfare, their continued rigidity disproportionately affects small and independent breweries. The two-tier system restricts market access by forcing breweries to rely on increasingly consolidated distributors, while tied house laws limit promotional activities, brand partnerships, and co-hosted events. Case studies reveal a pattern of distribution failures, reduced retail access, and stifled brand differentiation. However, the review also highlights adaptive strategies employed by brewers, such as leveraging taprooms, digital platforms, and compliant collaborations. Incremental legislative reforms and trade association advocacy, particularly by the California Craft Brewers Association, have begun to address these challenges. Comparisons with other states reveal that

calibrated deregulation—such as self-distribution allowances and promotional flexibility—has led to measurable growth in those regions. The findings collectively suggest that while California’s craft beer industry remains vibrant, it operates within a structurally restrictive environment that limits scalability, experimentation, and competitive parity. The interplay between outdated regulations and modern entrepreneurial needs highlights the necessity for policy realignment to foster sustainable industry growth without compromising regulatory intent.

6.2 Broader Implications for Regulatory Reform in Other States

The challenges observed in California’s craft beer sector offer valuable insights for other states grappling with similar regulatory dilemmas. States that continue to enforce strict interpretations of the two-tier system and tied house laws may inadvertently limit the growth of local breweries, hinder innovation, and constrain economic diversification. In contrast, jurisdictions that have adopted progressive reforms—such as raising self-distribution limits, allowing limited producer-retailer partnerships, or redefining tied house boundaries—have witnessed increased brewery counts, enhanced consumer access, and greater entrepreneurial activity. These patterns suggest that regulatory flexibility can coexist with public health safeguards when policies are tailored to the realities of contemporary market dynamics. For other states, California’s experience serves as a cautionary example of how well-intended regulations, when left unmodified, can become misaligned with the evolving structure of the industry. It also emphasizes the importance of stakeholder engagement in shaping reforms that balance accountability with operational freedom. As craft brewing continues to gain cultural and economic significance nationwide, policymakers must recognize that a one-size-fits-all regulatory model is no longer sufficient. Instead, a differentiated approach that accounts for brewery scale, distribution capacity, and regional consumer demand can promote a more inclusive and competitive industry landscape while preserving the core principles of market fairness and consumer protection.

6.3 Recommendations for Balancing Public Interest with Industry Growth

To harmonize the objectives of regulatory oversight and industry development, policymakers should consider targeted reforms that preserve public interest while enabling craft breweries to scale and innovate. First, California and similar jurisdictions should reassess volume-based thresholds for self-distribution, allowing smaller breweries to reach local markets without the economic burden of third-party intermediaries. Second, tied house laws should be modernized to permit context-specific promotional partnerships—particularly for educational, cultural, and community events—without compromising the independence of retail operations. Third, enforcement mechanisms should be recalibrated to prioritize guidance over punitive actions, particularly when addressing first-time or good-faith regulatory ambiguities. Additionally, regulatory agencies should develop channels for ongoing dialogue with craft brewery associations to ensure policies remain responsive to sectoral needs. These steps would maintain the core objectives of alcohol regulation—such as preventing monopolization and promoting responsible consumption—while removing structural obstacles to small business growth. Lastly, public policy should embrace data-driven evaluation frameworks to monitor the impact of incremental reforms, ensuring that regulatory flexibility does not erode consumer protection but rather fosters a balanced, thriving market. By adopting this nuanced approach, lawmakers can uphold public accountability while enabling the craft beer industry to flourish as a driver of cultural identity, tourism, and regional economic development.

6.4 Future Research Directions

Future research should investigate the long-term economic, cultural, and regulatory impacts of reforming traditional alcohol distribution and marketing laws, particularly in jurisdictions with strong craft beer ecosystems. Comparative longitudinal studies assessing states with varying degrees of regulatory flexibility can illuminate which policy combinations most effectively support industry growth without compromising public health or market integrity. Additionally, more granular analyses are needed to explore how regulatory constraints influence firm-level decisions regarding innovation, product differentiation, and vertical integration. Research could also examine consumer perspectives on tied house restrictions and distribution models to assess whether current policies align with public interest and purchasing behavior. Another promising area is the intersection of digital marketing, e-commerce, and compliance in the craft beer sector—especially as breweries increasingly use online channels to engage customers under restrictive legal conditions. Furthermore, interdisciplinary studies involving law, public health, and business strategy could help identify best practices for reform that balance entrepreneurial dynamism with societal safeguards. Finally, greater attention should be paid to the role of trade associations and advocacy coalitions in shaping the regulatory landscape. Understanding the policy mechanisms that facilitate or hinder their effectiveness can inform broader strategies for achieving equitable and sustainable industry governance across multiple regions.

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