

Wine Business Solutions



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# **The Wine Paper 20**

**March 2012**

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## ***Cracking the On-Premise Code***

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As with everything involving numbers, the devil is in the detail. It troubles me, for example, to hear senior wine company executives returning from the UK repeating supermarket propaganda that 7 people control 92% of buying. They may control 92% of Supermarket sales which are 80% of off-premise sales which in turn are 80% of the total market. That leaves you around 54 Million cases (roughly the size of the entire Australian market including cask wines) of sales that the supermarkets do not control.

Further, it is critical to look at price points when evaluating market potential. In Australia, for example, bottled wine sold over \$15 retail now represents about 22% of volume (39% of value) in the Off-Premise according to Nielsen. As virtually no wine at all with a retail price of less than \$15 is listed on wine lists and the On-Premise represents around 19% of the total market, this means that more than half of the total opportunity for premium wine is in the On-Trade. The best brands realise this and target a minimum 50% On-Premise sales.

Yes, Dan Murphys (Australia's largest retail group) has more total market share than the entire On-Premise sector but again, you must consider price points. If restaurants sell half, the average winery sells around 10% direct, independents still play a role – how much fine wine do the chains sell actually? Unless you are a Top 30 company by size of production, there is absolutely no life or death need to list your wine in multiple retail, not when the restaurant and cafe sectors are the fastest growing part of the economy. One does need to be careful however as wine sales volumes over \$15 in the Off-Premise grew 12% last year according to Nielsen. Profitable, sustainable and last is the way to view chain retail options.

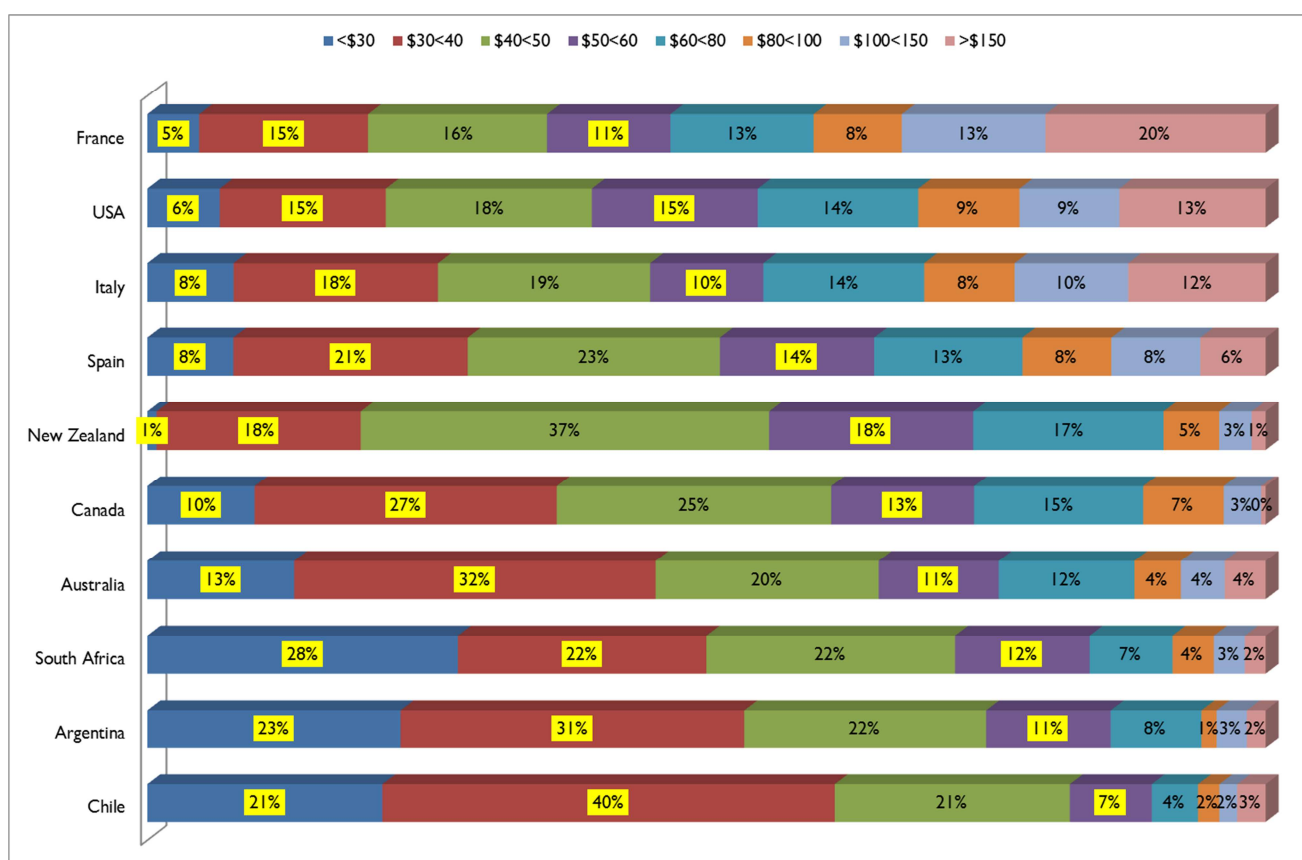
Wine Business Solutions now benchmarks the [Australian, UK and Canadian On-Premise](#) markets and there are significant differences between them. In 2010, Canada imported nearly 40 Million cases of wine. Value was up 15% on 2009. Ontario and Alberta both grew in value by more than 25% making them two of the world's best performing wine markets during that year. Imports make up 68% of consumption. Per capita consumption is just 16 litres per head meaning that another 25% growth is easily possible given the normal pattern of consumption in other developed commonwealth countries.

In looking at the best paths to market, who the best distributors are and what the most successful wine brands, styles and regions are as part of our research, two critical questions emerged:-

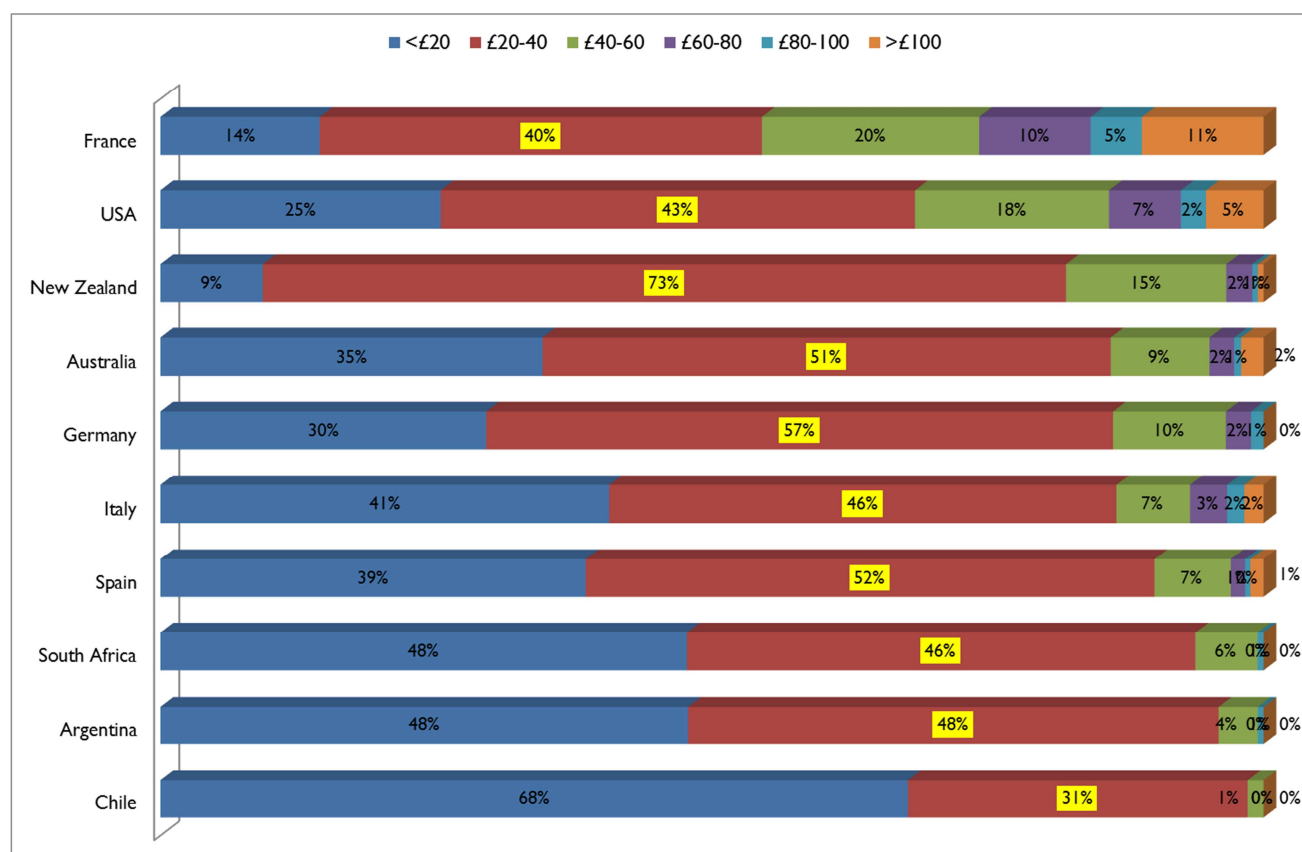
1. How is each country brand positioned in each market?  
and
2. How much money can you expect to make selling to them?

It is somewhat revelatory to look at the makeup of listings by price points in the different markets.

**Figure 1 – Proportion of Listings at Price Points by Country – Canadian On-Premise**



**Figure 2 – Proportion of Listings at Price Points by Country – UK On-Premise**



What we did was sort supplier countries by listing over £40 in the UK and \$C60 in Canada. What you will notice straight away is the rank order is very similar in both markets. What this tells us is that what wineries charge is rarely decided by what the market will pay. Usually it is determined from each country's cost base, what they can sell their wine for in their domestic market and even plain just what their neighbours are doing. Here in lies the wine producer's greatest opportunity, globally.

The Californians understood this first and best following France, notwithstanding that the scramble for land in regions like Napa forced land prices up to a level where they had to charge high prices to survive. New Zealand faced the same situation as it established but hasn't had the confidence to become a major player at ultra-premium prices to date. This reflects the local market's propensity to pay, more so than terroir and capability.

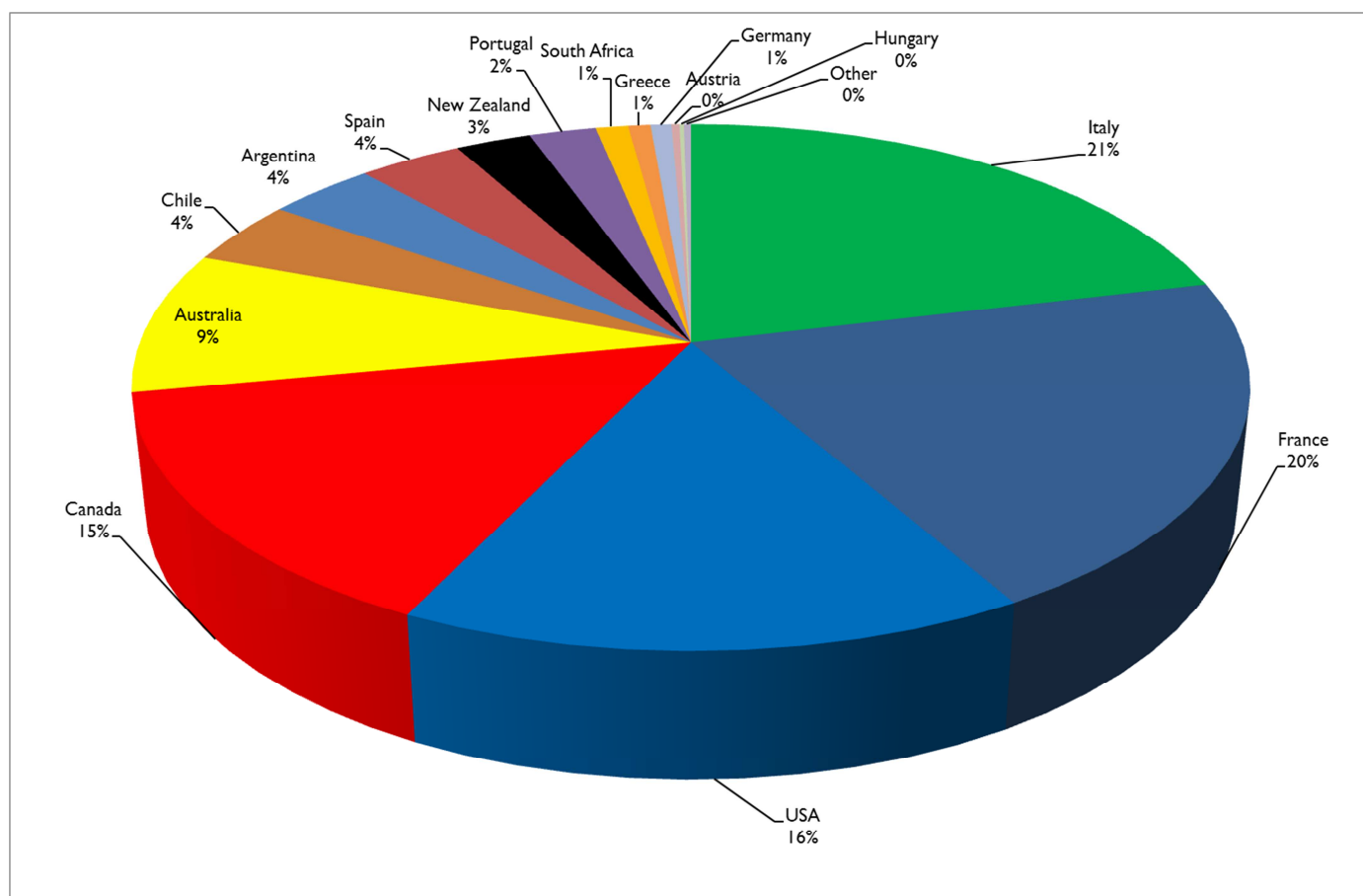
The main difference between the UK and Canada is the positioning of Spain and Italy, both of whom have learned hard lessons from the UK market where supermarkets can typically "smell blood in the water at 12 kilometres" and have no trouble locating distressed suppliers who want to do business at unsustainable prices. Italy especially but also Spain have a better image in the Canadian market as a result of a better offer, driven by quality regions, leading to superior price positioning.

Australia is in an even worse place in the Canadian market than it is in the UK due to the prevalence of its commercial brands which no longer have any distribution in the Australian and UK On-Premise. In US chain restaurants and in the liquor board controlled Provinces of Canada, big companies can still do the sort of old school business deals that smaller companies have trouble competing with. This has a negative impact on the quality of the country offer. Seven of the top ten most listed South African brands in Canada, for example, belong to Distell. In markets like Australia, the UK and Alberta (no control board there) where individual restaurants make the buying decisions, the large companies have no chance.

In Canada, Australia has to fight it out with suppliers to the bottom of the market working from a much higher cost base. Whether this is the fault of the large companies or the quality estate producers (of whom there are many in Australia) not being more proactive, is a point of conjecture. Ultimately, no one wants to be where South Africa, Argentina and least of all Chile are, unless cost leadership is assured.

In Canada it is Italy that just squeezes out France as the most listed supplier country. The USA has a strong and growing position in most Provinces. Favourable exchange rates are overcoming historic tensions between the two countries. Canada holds 15% of listings and Australia under 9% (exactly the same as its share in the UK). Chile just eases out Argentina and Spain, all of which have around 4%. New Zealand has 3% and South Africa just 1 in 100 listings.

**Figure 3 – Share of Total Wine Listings by Country – Canadian On-Premise**



**Figure 4 – Share of Total Value of Canadian Imports by Country- Source USDA**

Import Market Share of Canadian Wine Market (Value Basis)						
	2005	2006	2007	2008	2009	2010
France	27%	26%	25%	26%	24%	22%
Italy	17%	19%	19%	19%	20%	20%
<b>United States</b>	<b>12%</b>	<b>12%</b>	<b>13%</b>	<b>14%</b>	<b>14%</b>	<b>16%</b>
Australia	22%	20%	20%	17%	15%	15%
Argentina	2%	3%	3%	4%	6%	6%
Chile	5%	5%	5%	5%	6%	6%
Spain	4%	4%	4%	4%	5%	5%

The position of Italy in the Canadian market reflects how On-Premise listings tend to lead total sales. As above, total imports of Italian wine have been on a long upward trend as the (arguably) more ethereal wines of France give way to the more robust, savoury flavours of Italy.

The prognosis for Australia looks grim, based on these numbers. Large producers point to the ability to hold market share in the UK Off-Premise as reason not to be concerned about poor On-Premise distribution. In the USA and Germany, the lack of quality distribution of image building brands has been disastrous. In Canada (and indeed China) where the market is still growing quickly, there is a desperate need for Australia's leading regions to spend big now to avoid being locked out later.

In order to estimate returns, we need to perform at least three types of analysis. The first, more obvious one is – if you wanted to achieve \$US100 per case FOB, for example, and have a choice of selling to say Australia, Canada (we'll use Ontario in this example) or the UK – what price would a bottle of that wine sell for in a restaurant? To do this, we used a 60% restaurant margin as an arbitrary average across all markets.

**Figure 5 – On-Premise Pricing – Australia, Ontario, UK**

Australia			Ontario			UK		
FOB \$US	\$ 100.00		FOB \$US	\$ 100.00		FOB \$US	\$ 100.00	
\$A	\$ 95.24	1.05	\$C	\$ 100.00	1.00	£	£ 63.69	1.57
Import Duty	\$ 100.00	5%	Agents Commision	\$ 111.11	10%	Freight in	£ 65.49	£ 1.80
Frieght	\$ 103.00	\$ 3.00	Duty & Excise	\$ 116.85	\$ 5.74	Warehousing	£ 67.89	£ 2.40
Distributor Margin	\$ 153.00	33%	Freight	\$ 121.93	\$ 5.00	Freight out	£ 70.89	£ 3.00
WET	\$ 197.37	29%	Control Board Mark Up	\$ 209.15	71.5%	Duty	£ 91.17	£ 20.28
Restaurant Margin	\$ 490.00	60%	Other Taxes	\$ 254.46	17.8%	Agent Margin	£ 114.00	20%
Per Bottle	\$ 40.83		Restaurant Margin	\$ 640.00	60%	Wholesaler Margin	£ 142.00	20%
Listed Price Incl GST	\$ 44.92	10%	Per Bottle	\$ 53.33		Restaurant Margin	£ 355.00	60%
						Per Bottle	£ 29.58	
						Listed Price Incl VAT	£ 34.76	17.5%
\$US	\$ 47.16	12%	\$US	\$ 53.33		\$US	\$ 54.57	2%

In Australia, all countries except New Zealand pay 5% import duty. Freight, even from Europe is relatively inexpensive. Distributors are creeping up their margins to counter more pressure for discounts and 33% (includes handling and freight outwards) is now about the norm. This reflects oversupply and distributors trying to cover overheads after losing chain retail business which is increasingly managed directly. Ultimately, this is not sustainable. Then there is the Wine Equalisation Tax which was brought in to fill the hole when sales tax was abolished. Australia has just 10% GST.

The UK has very high internal freight and handling costs, usually uses at least three tiers of distribution to get wine to On-Premise customers and has a massive chunk of duty that is a fixed amount indexed upward, annually. On top of that there is 17% VAT.

Ontario, and Canada more broadly, is closer to the UK's level of end pricing than Australia's. Freight is a very profitable business for the control boards who typically mandate the charges by country. The LCBO use a standard mark up of 71%. Local wineries get a (contentious) 10% discount. Then there is a whole raft of other taxes. The elements of tax and supply chain are neatly manipulated so that restaurants end up paying close to full retail when they purchase from the control boards which they must do by law.

You can see that at \$US100 FOB, a bottle from that case of wine would typically cost around 12% less in Australia and 2% more in the UK than it would in Ontario. Put another way, a bottle sold at the same price in all three markets would get you 12% more in the Australian market on average and 2% less in the UK when compared to selling that bottle of wine in Canada.

The next, far more important question is - What will each market pay? Price is the ultimate measure of regional and country brand franchise.

**Figure 6 – Average Price per Bottle Achieved (\$C) – Australia, Ontario, UK**

Country	Average Price	Average Price	Diff	Average Price	Diff
	Canada	UK		Australia	
France	\$ 131.71	\$ 100.13	-24%	\$ 146.22	11%
Italy	\$ 88.40	\$ 45.96	-48%	\$ 80.10	-9%
USA	\$ 88.35	\$ 65.56	-26%	\$ 101.54	15%
Portugal	\$ 84.32	\$ 48.43	-43%	\$ 68.04	-19%
Spain	\$ 68.15	\$ 43.18	-37%	\$ 60.44	-11%
Australia	\$ 56.63	\$ 51.00	-10%	\$ 57.59	2%
Austria	\$ 53.50	\$ 52.63	-2%	\$ 70.12	31%
New Zealand	\$ 53.44	\$ 49.44	-7%	\$ 58.03	9%
Canada	\$ 50.80	NA		NA	
South Africa	\$ 46.08	\$ 36.99	-20%	\$ 56.53	23%
Germany	\$ 45.70	\$ 44.12	-3%	\$ 69.19	51%
Argentina	\$ 44.29	\$ 36.07	-19%	\$ 48.34	9%
Chile	\$ 44.08	\$ 30.63	-31%	\$ 48.31	10%
Total	\$ 84.85	\$ 69.70	-18%	\$ 66.42	-22%

*Note – All price in \$C - Exchange rates used were £0.638 and \$A 0.947 – Source WBS research.*

Whilst you can see that all supplier countries achieve a better price in the Canadian market than the UK, some have performed better than others. As earlier mentioned, Italy and Spain in particular are much better positioned in the Canadian market than in Britain.

Portugal's numbers are different mainly because in the UK, they sell a lot more table wine. Austria and Germany, by contrast, enjoy a much better image in Australia.

France is also better positioned in Australia than either the UK or Canada. This is most likely because of the extreme counter point French wines offer when compared to some local wine styles. Taking into account the cheaper supply chain costs mentioned earlier and the strengthening \$A, it is no wonder that French wine is pouring into Australia.



Australian wine is actually cheaper in export markets than it is at home. You might then ask how that is possible. The third thing you have to consider when making this analysis is - what are people actually drinking when they buy a country's wine? In Australia, for example, 99% of Australian wine listings are from premium regions. In Canada, that number is 28% (*Note – excludes wines labelled South Australia and South Eastern Australia in both cases*). Australian producers often complain about export markets not appreciating Australia wine's true quality. This is the reason why.

If you want to succeed in the On-Premise in Canada, for example, the ideal as a producing region is to be associated with a sub region or style like Napa, Barolo, Montalcino or Chateauf-neuf-du-Pape that achieves great distribution at high price points and is well supported through the control boards' promotional programs. California, Piemonte, Tuscany and the Rhone respectively, absolutely slaughter this one.

**Figure 7 – Proportion of Canadian Wine Listings without Specified Region**

Country	Share
USA	3%
France	9%
New Zealand	11%
Canada	11%
Italy	21%
Greece	23%
Spain	24%
Australia	42%
Germany	49%
Austria	53%
Argentina	62%
Portugal	63%
South Africa	77%
Chile	80%

The US is in much the same position in Canada that Australian wines are in Australia - 97% of listings identify a region. Austria and Germany do poorly due to lack of familiarity with the language perhaps, even though Austria has only a half dozen regions. The Greeks somehow overcome this, possibly due to the large ethnic Greek population in Canada (or young Canadian sommeliers liking a challenge). As always, Argentina, South Africa and Chile are at the bottom of the pile largely because wines sold at their price points typically don't attract a consumer who wants to know about regions. South Africa, arguably, has the biggest problem as none of its key regions have any kind of specialisation in a particular wine style. Argentina, at least, has Mendoza and Malbec which has become as Marlborough and Sauvignon Blanc is to New Zealand.

1. Get yourself a good distributor. Our [Wine On-Premise Canada 2012](#) survey captured data on 182 distributors. The Top 30 were responsible for 81.5% of all listings attributable to individual distributors. Knowing who this Top 30 are and how they operate is therefore going to be pretty important.
2. Get behind your regional brand. Put someone on the regional committee. From personal experience as Chairman of Wine Marlborough, I can assure that this is worthwhile.
3. Get agreement about what the region does best. It's not always a varietal. Think in terms of a unique wine style. Blended white and red wines are, by a country mile, the biggest overlooked opportunity by new world wine producers especially those from warmer regions.
4. Brand your ideas. New Chardonnay styles, Medium weight savoury red wines and all things that might change the fortunes of Australia and South Africa need concepts, need names, need marketing. Think of Chateauneuf-du-Pape, Chablis and Super Tuscan wines.
5. Choose hero regions. Even France and Italy can't sustain more than 8-9 in terms of general awareness.
6. Choose a single "superhero" subregion and put the focus on it. No one is ever going to know or care about your other 13.
7. Leverage regional icons. Where these don't exist yet, this sometimes requires the pricing / wine quality rule book to be thrown out the window and chasing a level of excellence (or at least an extreme point of difference) hitherto unsurpassed. Think of Fromm and Hertzog in Marlborough.
8. Do proper market analysis. Distributors get 30% (or more as we have discussed) no matter what they sell. They often believe that the lower the price the more they sell (often not the case). Wineries typically achieve 20% more profit with each 5% increase in revenue. When selling wine in the UK On-Premise, that ratio of profit to revenue increase is more like 8-10 times.
9. Pick world leading regions for your wine style. Benchmark against them on price, quality, marketing and investment - not your neighbours.
10. **Invest, Invest, Invest.** Rates of new product adoption in developing countries are increasing exponentially. One day soon all of the world's key wine markets will be mature. Our [Wine On-Premise UK](#) research again confirms that once market share positions are established in mature markets, changing them can be difficult.

# The “Top Ten Tips” for Building Better Wine Businesses.

*(From a Wine Business Solutions article published in Wine Business Magazine)*

**One** - Start by understanding your customer value proposition. Only part of this stems from your company's unique heritage and / or personality. To be successful, this needs to be strongly linked to what your customers ultimately want from the experience of your brands. There is some excellent research on this that is publicly available. Getting it right is therefore not out of the reach of small companies.

**Two** - Once you understand what customers value most, you can then remove what they don't want (thereby reducing costs and freeing up cash), focus your communication on what they do want (often at no additional cost), differentiate your company on the basis of fulfilling customer needs more accurately than any competitor (again often at no extra cost) and raise prices (because your offering is more highly valued)

**Three** - Always be asking the question – “If I could start with a blank canvas today – what would our wine business look like?” It's all too easy to let existing assets, existing product lines and existing ways of doing things blind us to what it is that our consumers value most. Often it's simplicity. Complexity usually adds to costs and often only serves to confuse customers. Retaining unnecessary or irrelevant product lines, assets or business processes is the worst contributor.

**Four** - Make everyone in the company accountable for securing customer preference. This is not just the job of marketing but of everyone in the company, the owner most particularly. Make this the focus of the way every employee innovates their job processes on a daily basis.

**Five** - Invest in relationships. This is particularly so with major distribution partners. Make sure sufficient time and money is invested before demanding results. Be prepared to invest up front in bringing them to your home base and entertaining them in order to build enduring friendships.

**Six** - Make all employees champions for profit. Develop a culture of honesty around net revenue. Make sure everyone knows the actual price achieved net of all discounts, rebates, bonus stock and anything else that might otherwise cloud the true profit picture. Keep them focused on reducing costs but let them know that a percentage increase in wine company revenue is, on average, twice as effective as the same percentage decrease in the cost of goods sold and 3-4 times as effective as the same percentage saving in operating expenses.

**Seven** - Optimise your pricing mix. Focus first on selling more, higher margin product in high value markets to high value customers. Beware of people in love with “big volume”. Big numbers make for big stories but often mean a lot of running around for no additional profit.

**Eight** - Build better business intelligence gathering systems – most companies are good at monitoring their own press. Very few have effective systems in place to monitor competitors, track changes in consumer preferences and turn customer feedback into customer value added.

**Nine** - Build 5-10 year Strategic Plans, forecast rolling 12 month budgets, link them to the most relevant KPIs and tie remuneration to these wherever possible. Everybody knows they should do this. Few do. The difference in the performance of companies that do is enormous.

**Ten** - Watch your cashflow – building a cashflow forecast is a relatively easy exercise with the right software and some quality assistance. Some people survive years of losses but you can only run out of cash once. In a cash hungry business like wine – Cashflow is not just King but Oxygen.