Wine Business Solutions

The Wine Paper 31

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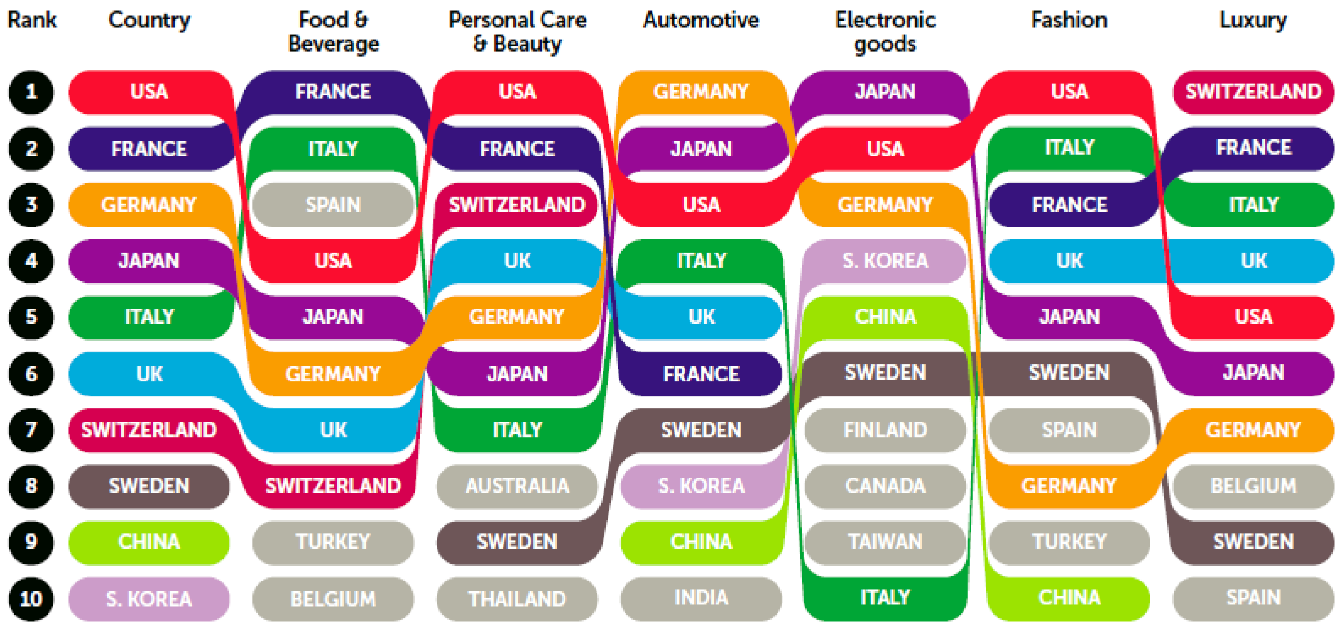
Building Strong Country Brands

What could be more important than having a strong country brand? Research confirms common sense. Country brands matter. They're becoming increasingly important in terms of consumer purchase decisions. People's perceptions of 'made in' country brands are getting sharper.

Take France for example. France has the strongest country brand in wine and food. France has more visitors than any other country. France makes more money out of selling wine than anyone else. France wins.

And whilst some commentators might contend that Australia, for example, should not try to be France, France is the benchmark, make no mistake.

Figure 1 – Ranking of 'Made In' Brands – Source, Future Brand from Quantitative and Qualitative Research



So what does it take to create a strong country brand in the wine space? The single most important thing to understand, I believe, is that there are at least 5 different wine products that are, in effect, different businesses. The way in which the fruit is grown, the way in which wine is made, the people who are buying it and what they want from the experience of wine are all totally different.

All of these different businesses have a vital role to play in terms of defining a country's brand. It's how they work together as a team that determines whether your country brand is successful or not. More importantly, it is about whether the different sized businesses understand a) all of the other business models and how they work and b) how they should play given their strengths and weakness in the current context.

Figure 2 – Major Wine Business Types

All countries are involved in the bulk wine business. There is no avoiding it. As wine is a product of nature, there will always be times of surplus and there will always be wine that doesn't make the grade. Increasingly though, winning in the bulk market is about purpose-built product and mastering efficiency.

There is a choice, although not everyone gets this, about participating in all of the other segments. There is absolutely no need, for example, to participate in the branded wine segment and it is a very good idea not to unless both your company's and your country's production is extremely large. Three branded producers (Gallo, Constellation and The Wine Company) all but control this business in the US. In other countries, supermarkets (who are increasingly the only route to market for this product other than convenience stores) ensure that this is a poor to unprofitable business for the majority of suppliers.

New Zealand, as a country brand, pretty much refuses to play. It is forced to get down and dirty when there is oversupply, of course, but this activity can be viewed as Beverage wine with 'Marlborough' as the identifier. No one is trying to build a brand under $12.

Austria, except for the German and Austrian markets, has even skipped the Aspirational market. Why bother when you can go straight to the heart of the sommeliers, fine wine retail owners and engaged consumers who will set the trends for the next 20 years or so?

Napa is not even worried about the wine Appreciator types who know that there is better value in Sonoma and Santa Barbara etc. For now, they have their 'luxury brand' that trumps all.

Each segment has large profitable businesses within them. Not everyone gets that, either. Last week, for example we saw the release of the updated version of Constellation's [Project Genome](). Whilst it is a considerable improvement on the first exercise, it retains some major flaws.

The best thing it does is identify that there are still around 19% of 'wine drinkers' that they call "Overwhelmed" who don't fit neatly into any of the boxes in Figure 2 proving that just because you 'build a good mouse trap' doesn't mean that people will buy it, particularly if they can't understand how it works.

This latest iteration of Project Genome claims that the top 10% (Enthusiasts) spend an average of $13 per bottle. When they originally undertook this exercise they said that the average Enthusiast was a woman and that half of them hadn't bought a bottle of wine over $15 in the last 6 months.

If you consider that the US wine market is worth $36 Billion and that 5% of that ($1.7Billion) is shipped direct to customer at an average of $37 per bottle, if you then add on what those businesses sell at cellar door as take out and then at least double that total to include those businesses' retail and on-premise sales, you get a very different picture of what just this one part of the US premium wine market is actually worth.

Project Genome is what happens when you run a 'pizza wheel' through your customer base and use grocery data as the anchor. (Nielsen claim, for example, that the entire market for wine over $20 a bottle in the US is worth $400 Million. The Marlborough flipping mussel farming industry is worth more than that…) What all this ignores is that we are only talking about 1-2% of consumers, maximum, who are the market for premium wine and that they never spend $13 on a bottle of wine.

This has led to some fantastically stupid decision making. This is the sort of analysis that lead Hardys/Constellation and other listed Australian companies to believe that there was no premium market worth pursuing. They then went about driving their whole business under $10 a bottle in a rush for growth thereby ensuring that there was nothing creating a halo effect. As we all know, Constellation swiftly thereafter ditched the business for around a tenth of what they paid for it.

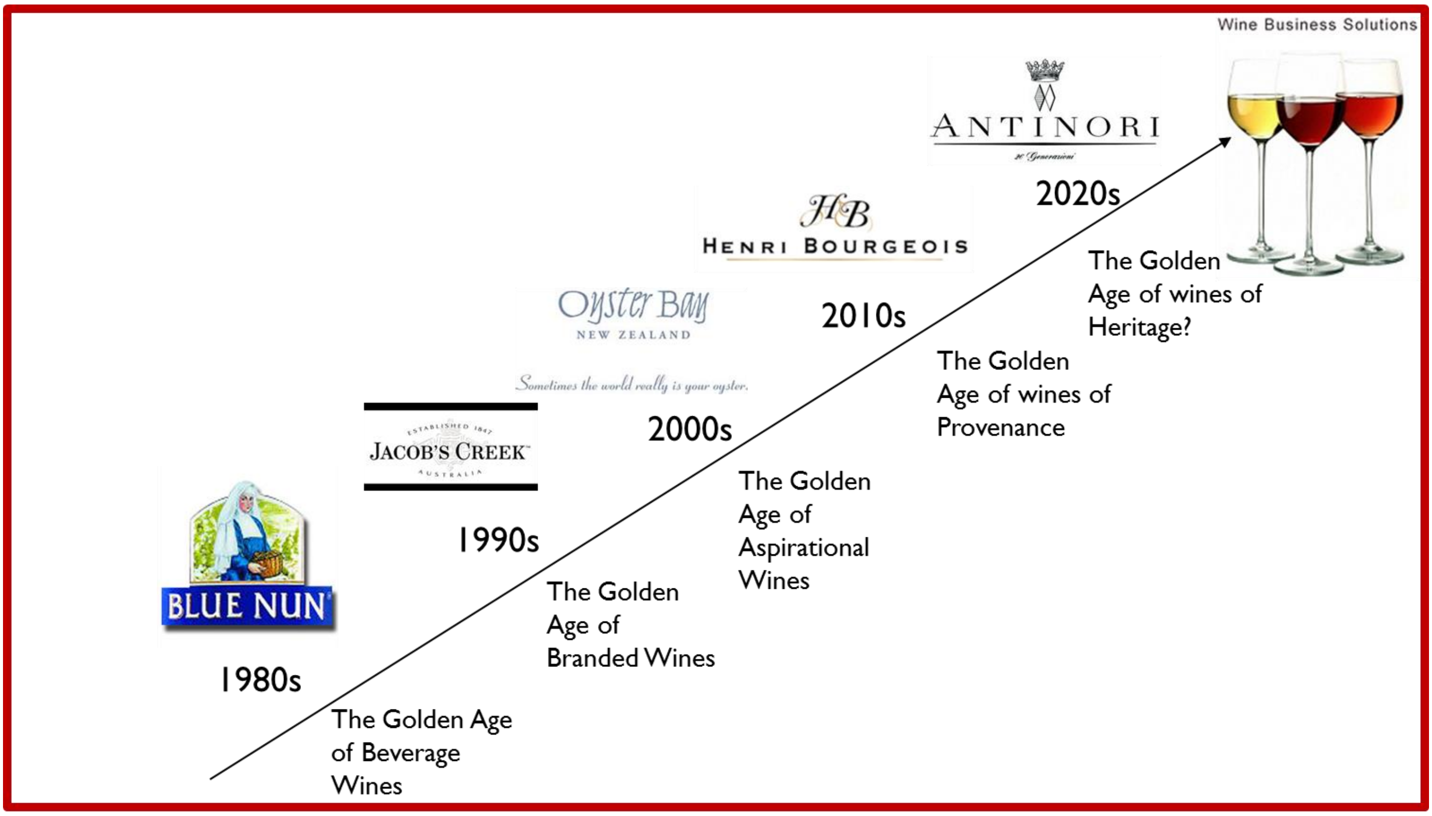
The worst thing you can do when running a wine business is to think that it is beer. The second worst thing you can do is to think that it's spirits. You cannot sell an ocean of generic plonk with a sprinkling of 'masstige' / luxury wine. TWE splitting these two businesses is hardly going to help (but it might help sell them). The language used demonstrates that those running these companies either don't understand wine or wish that it would go away. Making real money from real wine takes time and hard work. You must make 'wine that tastes like wine for people who like wine'. That is the one segment of the market that you can't ignore if you are to have a country brand that works.

The wonderful thing about watching wine mature over 30 years is that you can see exactly where it has been and exactly where it is going. Now, of course, all segments of the market are alive and well at any given time and all want new and improved products - beverage drinkers want more convenience, branded wine drinkers want more assurance, aspirational drinkers want better looking products, wine appreciators want more interesting products and luxury wine buyers want wines that are more collectable.

Each segment is, of course, more or less evolved in each market as well. With technology enabling the rapid spread of ideas, however, that gap is closing and the key mature markets now follow one another very closely, in terms of the wine styles each segment wants at any time. Global brands are almost possible.

Underneath all this, like a slow moving tidal wave, there has been a steady increase in sophistication that has gradually changed which segment is growing fastest and where the money is. According to Aztec, right now for example, the $15-20 and $25 plus segments are growing at mid double digit rates in both the US and Australia. The 100 Rand plus segment is growing at 20%, according to Nielsen, in South Africa and so on around the world. Problems have arisen and will continue to arise for companies and countries who don't see this coming and who don't respond.

Figure 3 – Wine World Evolution



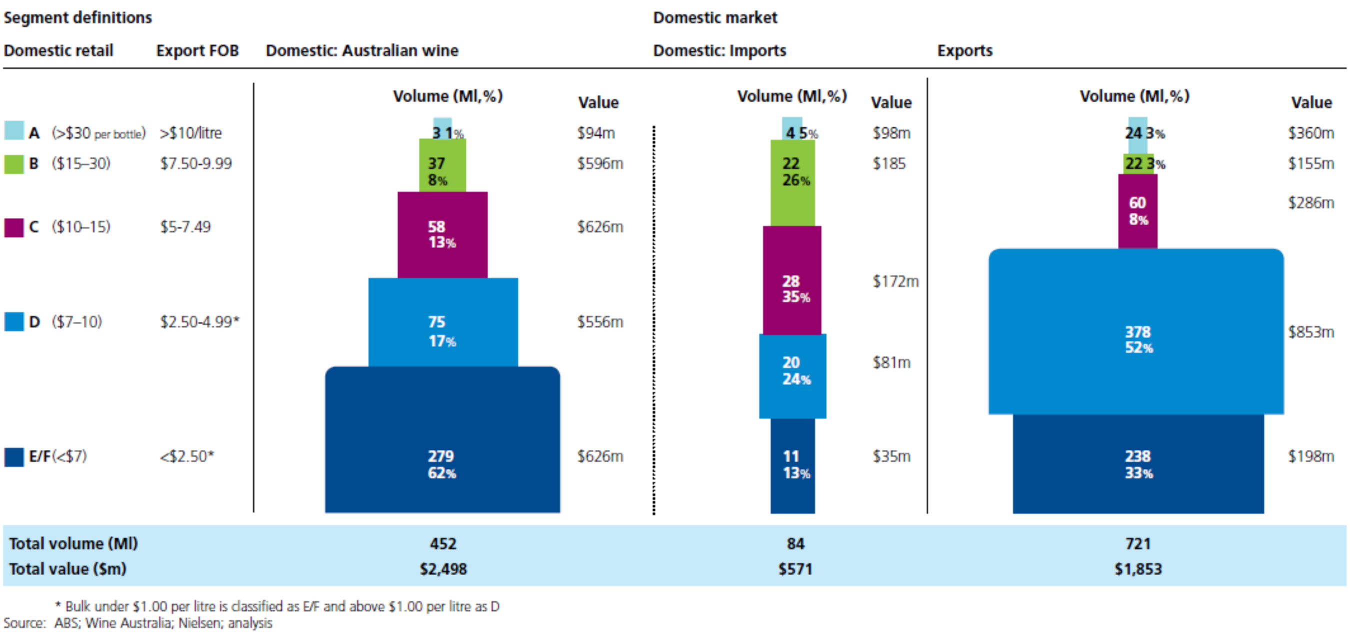
They say that the truth is in the numbers and the numbers from the WFA's 'Expert Report' into the Australian wine industry tell a story and a half. It is one of those rare and wonderful pieces of analysis where these 5 businesses are actually separated out and measured over time.

Most of the major strategic mistakes I see countries, companies and analysts making stem from mixing these business segments up and/or rolling this information together. As you will plainly see, each of the sectors has its own financial dynamics and have very different trajectories. Grossed up volume and value numbers are positively dangerous in terms of working out how to play in mature markets.

It infuriates me that I continue to hear people in the most powerful positions in the industry say that they don't understand why people are not buying Australian wine. One of these people once said to me that it was as though there was "this beautiful girl and no one wants to dance with her".

Splitting the segments and comparing what Australia exports with what it imports is like comparing a European super model with that girl and seeing that the reason no one is dancing with her is that she can't walk through the door.

Figure 4 – Australian Domestic Consumption vs Imports vs Exports over time – Source 'Expert Review'



Australia is still massively overrepresented at the bottom of the market internationally. Looking at the evolution of the main price categories over time tells more of the story:

From 2007-12, the <$7 segment grew volume strongly as a result of the shift to in-market bottling. All non-European producer countries experienced a similar transition from bottled to bulk.

By the end of 2012, Australia was selling roughly the same volume retailing at under $10 in export markets as it was in 2007 for around half a billion dollars less. Accolade and Treasury, of course, recover a small manufacturing margin in the UK but other than that, the only reason the largest companies haven't had to undertake more savage write-downs is that the domestic market for wine under $10 performed so strongly. Investing in New Zealand also helped.

Figure 5 – Value of Australian Wine Industry Domestic Production and Consumption, Imports & Exports – Source 'Expert Report'

Segment and definition			Domestic production consumed domestically[3]				Export values[4]				% of total domestic production		Import values[5]			
Grade	Domestic retail price/bottle	Export FOB/litre	2007	2012	Change	%	2007	2012	Change	%	2007	2012	2007	2012	Change	%
A	>$30	>$10	64	94	30	46.9	365	360	(5)	(1.1)	8.5	10.4	73.8	97.9	24.1	32.6
B	$15–30	$7.50–$9.99	358	596	238	66.5	271	155	(116)	(42.8)	12.6	17.3	166.3	184.9	18.6	11.2
C	$10–15	$5.00–$7.49	667	626	(41)	(6.1)	854	286	(568)	(66.5)	30.4	21.0	82	171.7	89.7	109.5
D	$7–10	$2.50–$4.99	329	556	227	69.0	1,323	854	(470)	(35.5)	33.0	32.4	40	81	41	102.6
E/F	<$7	<$2.50	586	626	40	6.8	191	198	7.0	3.7	15.5	18.9	27.3	34.5	7.2	26.2
Totals			**2,004**	**2,498**	**494**	**24.7**	**3,004**	**1,853**	**(1,151)**	**(38.3)**	**100**	**100**	**389.3**	**569.9**	**180.6**	**46.4**
Total domestic production			**5,007**	**4,350**	**(657)**	**(13.1)**	**Market share of imports**						**16.3%**	**18.6%**		
Total domestic consumption (domestic and imports)			**2,224**	**2,975**	**751**	**33.8**										
Total domestic production and consumption			**5,227**	**4,827**	**(400)**	**(7.7)**										

1 All value are FOB or wholesale equivalent
2 Export figures include bulk; domestic figures include on- and off-premise
3 Total value and volume from ABS. Distribution by segment in glass based on Nielsen data on retail glass bottle sales. All cask and soft-pack assumed to be E/F
4 Based on export data by price point from Wine Australia. Segment definitions held constant in destination currency terms
5 Total value and volume from ABS. Distribution by segment based on Nielsen data on retail glass bottle sales
Source: ABS; Wine Australia; Nielsen; analysis

Figure 6 – Volume of Australian Wine Industry Domestic Production and Consumption Imports & Exports – Source 'Expert Report'

Segment and definition			Domestic production consumed domestically[2]				Export volumes[3]				% of total domestic production		Import volumes[4]			
Grade	Domestic retail price/bottle	Export FOB/litre	2007	2012	Change	%	2007	2012	Change	%	2007	2012	2007	2012	Change	%
A	>$30	>$10	1.7	2.5	0.8	47.1	21.8	23.9	2.1	9.6	1.9	2.3	1.9	3.5	1.7	89.8
B	$15–30	$7.50–9.99	26	36.8	10.8	41.5	31.4	22.3	(9.1)	(29.0)	4.7	5.0	15.1	21.8	6.6	43.9
C	$10–15	$5.00–7.49	73.1	58.2	(14.9)	(20.4)	143.6	59.6	(84.0)	(58.5)	17.6	10.0	12.3	28	15.7	128.3
D	$7–10	$2.50–4.99	49.8	75.1	25.3	50.8	434.0	377.5	(56.5)	(13.0)	39.4	38.6	7.3	19.8	12.5	170.1
E/F	<$7	<$2.50	292.7	279	(13.7)	(4.7)	155.4	238.1	82.7	53.2	36.4	44.1	7	10.9	3.9	57.2
Totals			**443.3**	**451.6**	**8.3**	**1.9**	**786.2**	**721.4**	**(64.8)**	**(8.2)**	**100**	**100**	**43.6**	**84**	**40.5**	**93.0**
Total domestic production			**1,229.5**	**1,173**	**(56.5)**	**(4.6)**	**Market share of imports**						**8.9%**	**15.7%**		
Total domestic consumption (domestic and imports)			**464**	**492.9**	**28.9**	**6.2**										
Total domestic production and consumption			**1,250.2**	**1,214.3**	**(35.9)**	**(2.9)**										

1 Export figures include bulk; domestic figures include on- and off-premise
2 Total value and volume from ABS. Distribution by segment in glass based on Nielsen data on retail glass bottle sales. All cask and soft-pack assumed to be E/F
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Source: ABS; Wine Australia; Nielsen; analysis

Imports actually grew fastest in the $7-15 categories, contrary to claims by many that New Zealand is mainly harming the prospects of premium Australian wine producers. Imports, and New Zealand especially, are therefore mostly the problem of the large family owned companies.

The $10-15 segment is the one where Australia has been hit hardest in international markets, as it is the one most prone to disadvantage by strong currency. If, for example, you have to sell your $30 wine for $35, who would care? Likewise, if you put $6 quality into $10 wine, the market will eventually punish you, as has happened to the listed companies, but as the audience is less discerning, it takes some time for this to filter through. But tell your importer that your $13 wine is now an $18 value proposition and you will likely be laughed out the door, such is the difference in quality and the importance of it at those price points.

The $10-15 category was also the worst performing in the domestic market as the Australian offer was completely out of line with what the Aspirational wine drinker wanted – Sauvignon Blanc, Pinot Gris, quality Rose, slightly sweeter styles etc. The family companies had the message about the Aspirational consumer emerging loud and clear from Tesco's Dan Jago in 2007. The response was unprintable. (Well actually it was printed. That was the problem. It was the only time in the last ten years when the wine industry made the front page of the Sunday papers).

Fortunately, time has marched on and there is a new, more sophisticated customer emerging in the Anglo Saxon dominant markets that still represent half the global opportunity for imported wine. Whilst Australia lost ground in the $15-30 category in international markets, the demand for Australian premium wine in the domestic market has grown strongly and imports have had little impact. Better still from small to medium companies' point of view, the listed companies have all but given up this ground. The problem is, Australia needs larger companies to be strong at these prices as it is they that have best market access.

This, believe it or not, should have been the golden age for Australian small to medium wine producers. It is only the intense competition born of oversupply and the dominance of the supermarkets of the retail channel that has stopped these wine businesses from doing as well as their US counterparts have been.

This speaks to opportunity in that, if the Australian audience now believes in the Australian premium offer in the face of intense global competition, then there has to be more fans winnable in international markets. Indeed it is $18-35 wines that Australia does, arguably, as well as anyone else. This is fortuitous as this is happening right at the time that the food savvy wine Appreciator is emerging as the dominant force in world wine.

The big question then is, what must be done to take advantage?

The first and most important thing is that the listed companies get the message about making 'wine that tastes like wine for people who like wine', something they have a long history of doing but have somehow lost during the last 10-15 years. Wine that tastes like wine is Chianti, Burgundy, Rhone wines, Rioja (sometimes), Alsatian wines, Austrian wines, Central Victorian Shiraz (which one listed company makes extremely well), Shaw and Smith Shiraz etc.

Wine that tastes like wine is not tannin adjusted, acid adjusted, oak staved, American oaked or worked till the histamines could split your sinuses. Wine that tastes like wine, comes from a place, is made by people and tastes mostly of grapes. The majority of listed company wines that win show trophies are still not wine that tastes like wine and their commercial production at premium price points is, most certainly, not that.

The other critical thing is not to push product into places where it is not supposed to go. If you think that in the UK and Canadian markets, you have less than a 50% chance of finding an Australian wine on a wine list that is from a recognised region (i.e. a wine that people who like wine would drink) versus a 95% chance in the domestic market, is it any wonder that Australia's brand image is so poor? This was taking care of itself in the UK as the listed companies abandoned the On-Premise. In their place, however, have come a band of opportunist trying to ring the last drops out of Australia's ailing brand franchise with a bunch own label stuff with names that sound like they were conceived in an outback shearers outhouse much as happened in the US in the early 2000s.

In the North American On-premise, it is a different story. As you can still 'invest' money and get results from the monopolies and restaurant chains, the major companies can still force their product onto wine lists. This ends up being self-defeating as markets always evolve towards 'wine that tastes like wine'. Restaurants then respond rather than taking the money and giving customers something they don't want.

For large family companies, there are two paths but both requiring a radical shake up. The first requires facing facts and realising that their scale and the sorts of volumes needed to run down their bottling lines and make their business model work determines that their customer most likely wears a dress. Whilst some of the large family businesses have known this for a long time, the Aspirational customer has just gotten a whole lot more demanding lately in terms of what takes her attention. Turning up in old man's clothes just ain't going to cut it. Jim Delegat's business once looked like an old Australian family business but by being brave enough to put a line under that and giving new markets what they wanted, Oyster Bay became the biggest selling brand in Australasia and one of the best performing wine businesses globally.

Figure 7 – The Packaging Revolution in the Champagne and Prosecco Sectors

The second and probably more palatable option (given that the owner of one of these businesses once told me that he would rather wear pink pants than make pink fizz) is to really nail down the opportunity for 'wine that tastes like wine' for the emerging wine Appreciator- those Millennials that the Americans are so obsessed with.

Who's doing the best job of that globally? For mine, it's Spain. If we are talking rippingly good red that is juicy, tasty, spicy, that will work with food in a way that will keep any lover of wine happy but can be afforded by emerging drinkers, wines like Borsao's provide a model. This is a style that Australia could easily match or better through Shiraz / Grenache and other blends carefully managed. Borsao a business pushing toward the Million case mark and whilst it helps to have Robert Parker call Borsao "possibly the single greatest dry red wine value in the world" wine like these could wear $3-4 more without missing a beat.

Figure 8 – Wines of Borsao

Then there are the 2600 smaller producers, many of whom are making wine that the world wants. What of them? Just as Australia never felt the effects of the global recession, these producers never came under the sort of pressure that has turned Spain and Italy into Australia's toughest competitors.

Whilst some were busy blaming the dollar for the drop off in export sales at these price points, Italy grew its exports by a value equivalent to today's entire value of Australian wine exports. According to the IWSR, Italy's exports increased by $1.7 Billion from 2007-11. And this wasn't dumping. They did this mainly at prices that would have made Australian exporters proud.

The problems are that by providing a tax rebate only for domestic sales and that the domestic market for these wines is strong as well as direct to customer sales being 8-10 times as profitable as selling through three tiers of distribution in the US, the will to export is weak. My efforts to appeal to my Australian client's sense of national duty are, unsurprisingly, bearing little fruit...

My feeling is that the only way to stop that part of the market ending up like the US, where very little wine sold at those prices is exported, is to change the way that the tax rebate is applied and develop better incentives.

If Australia cannot improve the way in which it gets these wines to market and in front of the most influential then any chance of a recovery of Australia's brand image and sales looks bleak. Scrapping the WET rebate, as is planned, will certainly provide incentive to export but many of these companies will go broke first if this is not extremely well managed.

Finally, what of 'luxury wine'? As the numbers show, they operate in their own world. They were virtually unaffected by the global financial crisis and exchange rates etc. The issue is that where once the wines that got collected and the wines restaurants were most interested in were one and the same, the rise of the wine collector (as opposed to the wine drinker) has driven a wedge between these two ideas.

It is great that Penfolds has become one of the most collectable brands in the world but those wines are about as far away from what young sommeliers are interested in as it is possible to get. This in part reflects that collectable wine has become too expensive to drink. There is a bigger issue, however, in that as restaurants and their customers become more sophisticated, they have realised that these collectable wines are just about the worst thing possible to drink with food, when they are young.

This is a massive problem for Bordeaux, over and above the collapse of demand in the Chinese market and a bad vintage (2011). If 'normal' people can't access these wines and no one gets to taste them in restaurants any more then how do you sustain your brand? Our research shows Bordeaux wines falling off wine lists in Australia, the UK, Canada and the US at what should be an alarming rate.

If Australia provides a great working case study in what not to do then what must other countries watch out for? New Zealand (and Italy) must be careful that by putting so much of their focus on the Aspirational drinker that they don't get left behind as the market moves on. I've published a paper on how to manage this that will be up on the NZ Winegrowers web site shortly.

South Africa has all sorts of opportunities to innovate and respond to changes taking place in world markets. I will be speaking at Vinpro and running a workshop there next month on that subject.

Austria has a model whereby selling less wine has led to more revenue whilst focusing on the right customer. Now there's a model that will see cash rolling into a wine business. We spoke about the importance of building on that strength when I addressed the industry there in January.

Tasmania has a great opportunity to take all of this learning and hit the ground with the right offer at the right time. We discussed this earlier in the month when I spoke at their first wine business conference.

The country that has greatest capacity to learn, renew and beat all is, of course, Australia. That has to start with the recognition that better exchange rates and an improved global economy are not going to fix anything. The core of the brand itself has to be taken to task, the offer has to change in terms of what gets presented to international markets, investment must be made and everyone needs to play their role. We'll be running workshops on that theme around the country in the coming months.

The "Top Ten Tips" for Building Better Wine Businesses.

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.

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