Wine Business Solutions

The Wine Paper 32

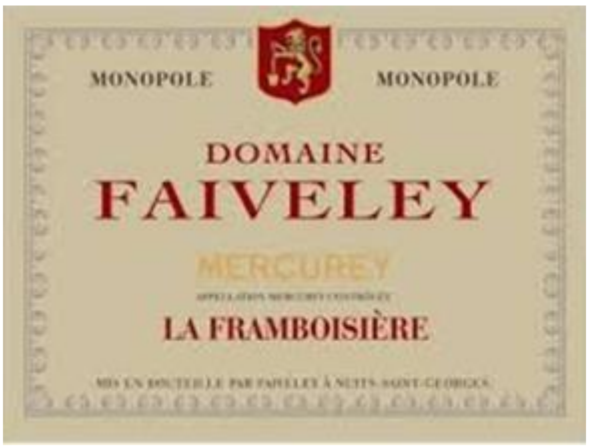
September 2014

Gaining Competitive Advantage

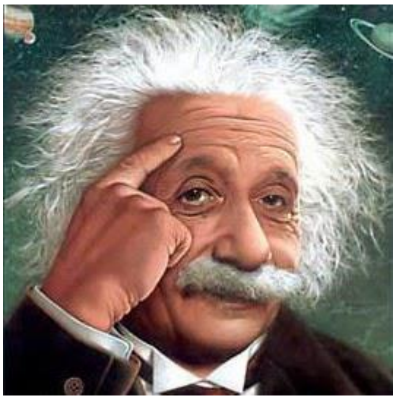
I was recently asked to address the South African wine industry on gaining competitive advantage through innovation. I started out by suggesting that there were four big myths about innovation.

#1 That you have to be some sort of creative genius to innovate. I always find that the best ideas are the ones that have been hitting you over the head (like Jacques Kallis with his cricket bat) for years. The ideas are so often there. They're obvious. They just need you to act.

Take wine designed to have a particular flavour profile. There is hardly a producer in South Africa that does not have a chocolate / mocha / coffee / toffee wine of some sort. Having a flavour profile that is instantly recognisable and therefore communicable gives you a massive advantage. Just ask producers in Marlborough. One of the biggest hits in Europe this summer has been Faiveley's 'La Framboisiere' (Raspberry Patch). Imagine that. Faiveley, one of the founding fathers of Burgundy targeting a flavour profile? And still this idea is not good enough for Australian producers...



#2 That innovation is a young person's game. In truth and as [confirmed by research](), the greater the diversity of people you connect with, the more experiences you have, the more ideas you can meaningfully integrate.



Hardys only reached their 'new product launch success rate peak' towards the end of the almost 15 year period that their senior sales and marketing team had been together prior to the Constellation takeover. Take also the Galvanised Wine Group and their succession of successful brands. Tony Parkinson was in his 60s already when he dreamed up Mr Riggs, The Black Chook and others. Tony, using his firsthand experience of the US market, knew the difference between laconic and jingoistic, a subtlety missed by the hundreds of start-up would-be wine brands that crashed and burned looking to cash in on Australia's popularity driven by Paul Hogan (Crocodile Dundee).

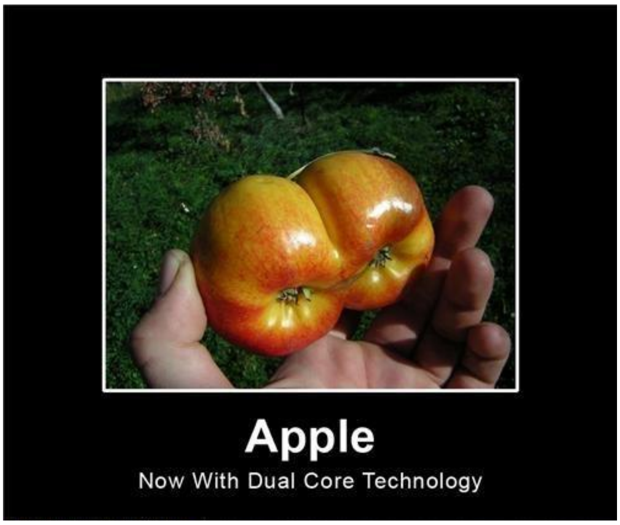
Mr. Riggs

THE BLACK CHOOK

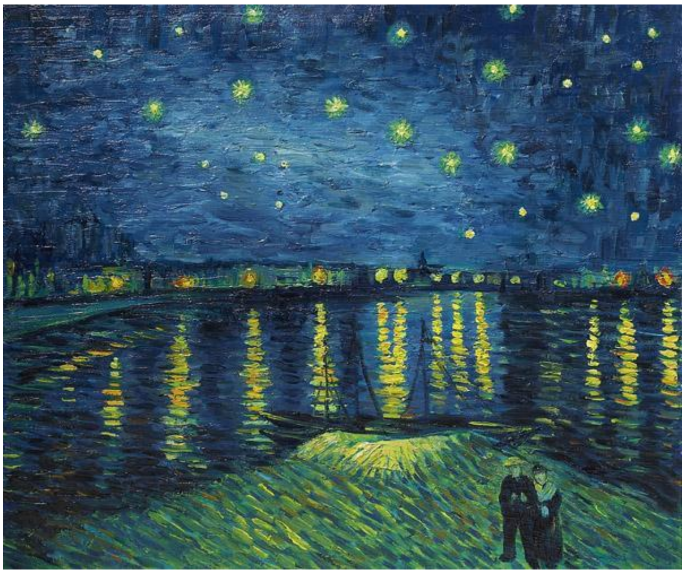
Where so many businesses fall down, of course, is that they stop innovating. Brands built around the mood of a moment will never succeed like Champagne does targeting a perpetual sentiment – the desire to 'be fabulous', as it were.

#3 That your customers will be a critical source of innovation insight. If that were true, the listed companies' 'innovation projects' would be churning out world beating wine ideas like there was no tomorrow.

Apple didn't become the world's largest company by listening to customers. They built products that they knew to be beautiful, that did a relatively small number of things well and that actually worked: something that their competitors failed to master. The truth is, your customers don't know what they want but listen to them and watch them closely for long enough and you will.



#4 That being innovative involves being 'entrepreneurial' (i.e. taking the sort of risks that no sane experienced, educated person would). In the immortal words of Vincent Van Gogh "Great things are done by a series of small things brought together"



"Learn more about your customers faster than the competition. Turn what you learn about customers into action faster than the competition." – Jack Walsh on Competitive Advantage.

Cost as competitive advantage is, I find, not a particularly well understood concept. Having lower production costs does mean that you can sustain lower prices but having a lower price is rarely a winning strategy. What it also does is enable large companies to better fund 'market management'.

This includes key account management, category planning, in-store promotion scheduling and preferential treatment where merchandising is concerned etc., over and above the normal Advertising and Promotional activities that smaller scale operators struggle to fund. It's how Colgate wins the war to sell you toothpaste.

Accolade is the largest supplier to the UK market. It is massively advantaged in this way. I was talking to the new Australasian Market Manager for Accolade, Nick Doumanis. We were discussing the need for a new off-premise market research insight that is accessible to small to medium wineries. (We'll hopefully be able to announce something in relation to that shortly.) You might wonder why someone working for a large company would be concerned about the welfare of his smaller competitors. He feels that a well-informed industry makes for a better industry and I strongly agree.

Competition is vital but there is such a thing as entirely negative competition where companies that don't understand cost dynamics enter segments they shouldn't as they have neither the scale (and therefore the right cost base) nor the sector knowledge, to win. This produces the worst possible outcome for everyone.

It happens most often when small to medium sized wineries decide to commercialise the bottom rung of their production rather than selling it off prior to labelling it.

Always the numbers look good initially. When you then investigate sourcing fruit from lower quality regions to increase supply to this brand tier, the numbers will doubtlessly look better still. What is usually forgotten (or not understood) is the massive pressure to discount when selling at commercial price points, the impact that that then has on the bottom line (a 5% decrease in revenue can mean up to a 20% decrease in profits) and the hidden costs of distraction from core business.

What does building a cost competitive advantage look like in practical terms? Some time ago I had a conversation with Mike Nido when he was GM of Warburn Estate, a company that supplies over 4 Million cases of wine to Woolworths alone. They are also the biggest importer of Marlborough Sauvignon Blanc into Australia.

Mike asked me – “How many hectares of grapes did you manage when you were running that business in Marlborough”.

I said – “Around 200”

He ask me “How many people did you employ to manage it?”

I said – “Around 18 full time equivalents”

He said - “We would have one. We have one machine that will perform virtually all vineyard tasks. We’ve taken a nozzle from the aviation industry so that we can fill its fuel tank in under 45 seconds and we have our efficiencies across the vineyard measured to the minute”.

This is where South Africa in particular but also Argentina and, to a lesser extent Chile, have to be careful. When Stuart McNab, TWE’s Global head of production got up at Savour and said that Australia could produce bulk wine that is globally cost competitively, he did it with some hesitation knowing that few in the room would believe him given the strength of the $A. The facts are that broad scale fully mechanised viticulture can easily trump the most efficient labour based production models.

Jim Moularadellis agrees. Jim and his brother Bill (Kingston Estate) are probably better known in South Africa than they are in Australia as they are major players in the global bulk wine trade. He sees the business of small scale growers selling uncontracted fruit, and wineries selling off wine that doesn’t make the grade, in the same light as I see small to medium wineries commercialising wine that is not fit for premium product. These ‘problem solving’ measures by non-specialised business operators are simply no match for large scale, purpose built, fully mechanised grape growing and winemaking. He also points out that without a free trade agreement with the EU, his wine costs are $150 / R1500 per tonne more than they would be otherwise. (R1500 per tonne would be considered a good farm gate price by some growers in South Africa.)

This should sound a warning. The future of commercial winemaking is in large scale mechanised viticulture. The true source of competitive advantage is access to water, cheap land (of which Australia has endless amounts) and diplomacy (which the Australian Government has not shown so much of to date).

On the other hand, having the ability to produce products that sit at the bottom of the market can be a curse as efforts must then be re-doubled to ensure that your higher-end wines are better differentiated, have better distribution, better promotion and a better image than anyone else’s. France masters this.

This is where a far sited approach must again be shown by co-operatives and larger producers as, unless they provide the sort of magnanimous support discussed earlier to the country’s top quality producers - making sure that it is always the best wines and winemakers that are the first face to the market - developing the right overall country brand image so as to sell commercial wine profitably will not be possible.

There can only be one lowest cost competitor in each category. For everyone else, it's about how well you can present your wines as different to everyone else's. You can't be 'better' until you are seen as different.

It distresses me when I hear industry researcher types claiming that there is nothing much the industry can do to shake off its rather crusty image and that that is how people like it. The coffee people doubtlessly thought the same thing prior to their industry going into long term global decline as a result of the assault made on it by tea.

In my South African presentation, I talked about the way in which Merrill Fernando (Dilmah) had stolen our aprons, our glasses, our whole product presentation concept. I asked – what we could steal back from tea?

What if we had their decanters?

Their gift boxes and merchandising?

Their skills in raw materials presentation?

I then showed a random Google Images search for 'Wine'.

And compared that with a Google Image search for 'Tea'.

You can see that tea presents as fresh, lively and new, ancient and traditional, accessible and everyday - everything you would want people to believe about wine. "I bloody love tea!" one cup exclaims…

Compare that with those wine images and you can see why supermarket buyers are so insistent that wine can do better. The three pictures down the right hand side do not contain real wine grapes, there are no decent wine glasses, no one knows how to pour a glass of wine and all the closures, barrels and accessories look like an absolute dog's breakfast. On one hand, this may show that there is a big opportunity to start a business in wine related photography. On the other, you'd have to say that the category presents as unloved.

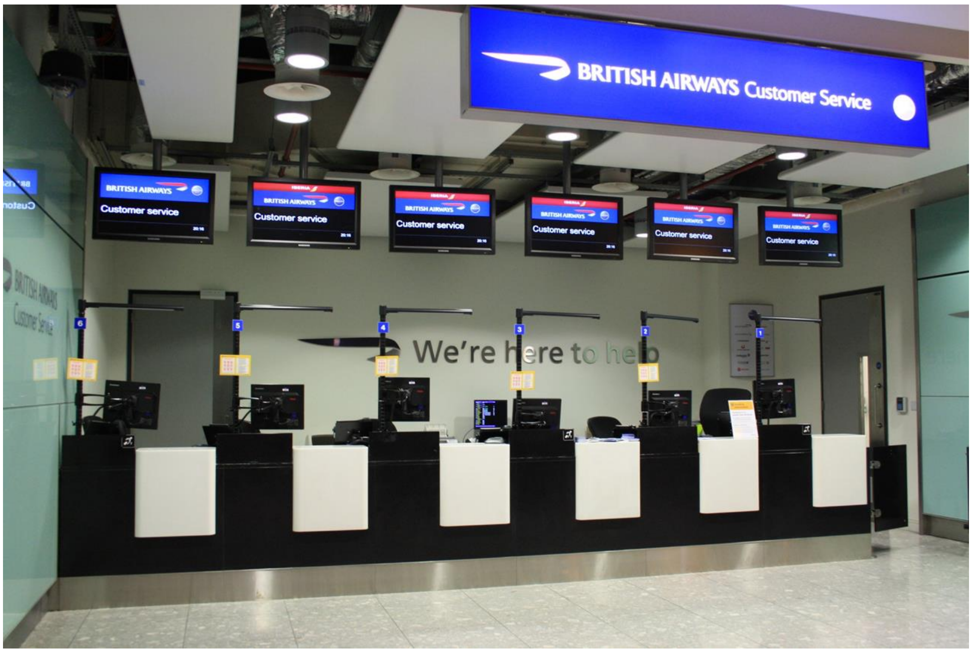
So whilst there is plenty of competition around packaging, particularly in the fine wine space in countries like Australia, one should never be fooled into thinking that there is not a whole lot more that can be done and that needs to be done in order that the category stays relevant to emerging consumers.

Is absolute quality a competitive advantage? We've discussed quality leadership previously and how those that set out from the outset to be the best in their region always succeed but here's another story.

I was in Volnay (Burgundy) recently talking to a small producer there. I asked him if he had export markets. He told me he had ten – Japan, Belgium, the UK etc. I said to him that even though he was young, all of that travel must really be challenging. "What do you mean?" he said. "I don't travel." In other words, "everyone knows where Burgundy is and my wine is good so they will come". His wine was good. I told our wine obsessed local landlords as well as clients who were staying in Pommard and a member of our tasting group who has the 2nd biggest cellar in Australia, who just happened to be in area etc. Rather old school and you might think a little arrogant but brilliantly effective.

Can service be your competitive advantage? I would suggest very strongly that it can. As a fundamental of service, being open is a very good start. France, for all its other competitive advantages, has a problem. It's not. It's not open because it is too early. It's not open because it's too late. It's not open because it's lunch time (which can last from 12.30 until 4 pm). It's not open because it is Monday, Tuesday and sometimes Wednesday. It's not open because we don't do that sort of thing here. In all of our many visits to France, we have never spent more than half of what we would have if businesses kept operating for even basic hours. Spain and Italy, conversely, have restructured their economy and their attitude and are roaring ahead.

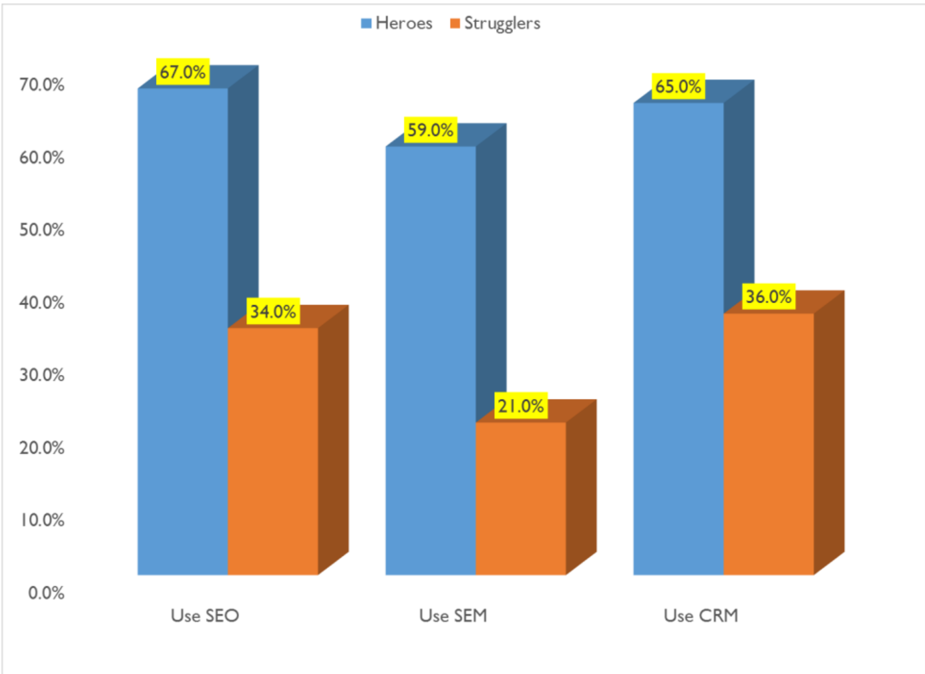
We have a number of Australian clients who are using being open outside of the normal 10am-5pm tasting hours as competitive advantage. Being open for the whole weekend would fix the bottom line of most South African businesses.



What about good old fashioned customer service? Europe, in the cities, is much like Australia in that finding good people to staff hospitality roles is getting more difficult. The US supposedly has good customer service but the tip system always makes the process feel uncomfortable and the customer somewhat cheated in the end as they rarely intended to pay what they end up paying.

Countries like South Africa and Chile have a massive advantage in that being a waiter is largely seen as good job worth doing well. Moving more of these people en-mass across to cellar door would mean that South Africa is in a good position to offer a world beating wine tourism experience. Australia would need major labour reforms to achieve the same result.

Is technology a real source of competitive advantage? If everyone adopted everything equally then no, but that never happens. Those that consciously go about getting the most out of technology are massively advantaged. This is well supported by research. Wise Academy in the US looked at the top 10% of direct to customer performers verses the rest (not sure how 'wise' it is to label 90% of your potential audience 'strugglers' but you get the drift).



What their research shows and what our direct to customer research confirms, is that by simply having your web site optimised, by doing a little search engine marketing and practising some CRM, you would already be well ahead of competition. This is why we, in turn, invest so much time in staying abreast of technological change as a key element of our consulting and your competitive advantage.

Is innovation itself the competitive advantage? Well of course it is. Growing, improving, winning is all about challenging every single thing we do every day and trying to do it better. That's what drives us.

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.

Wine Business Solutions

Phone +612 9744 8332

info@winebusinesssolutions.com.au

http://winebusinesssolutions.com.au