Wine Business Solutions

The Wine Paper

Issue Five – December 2008

Contents

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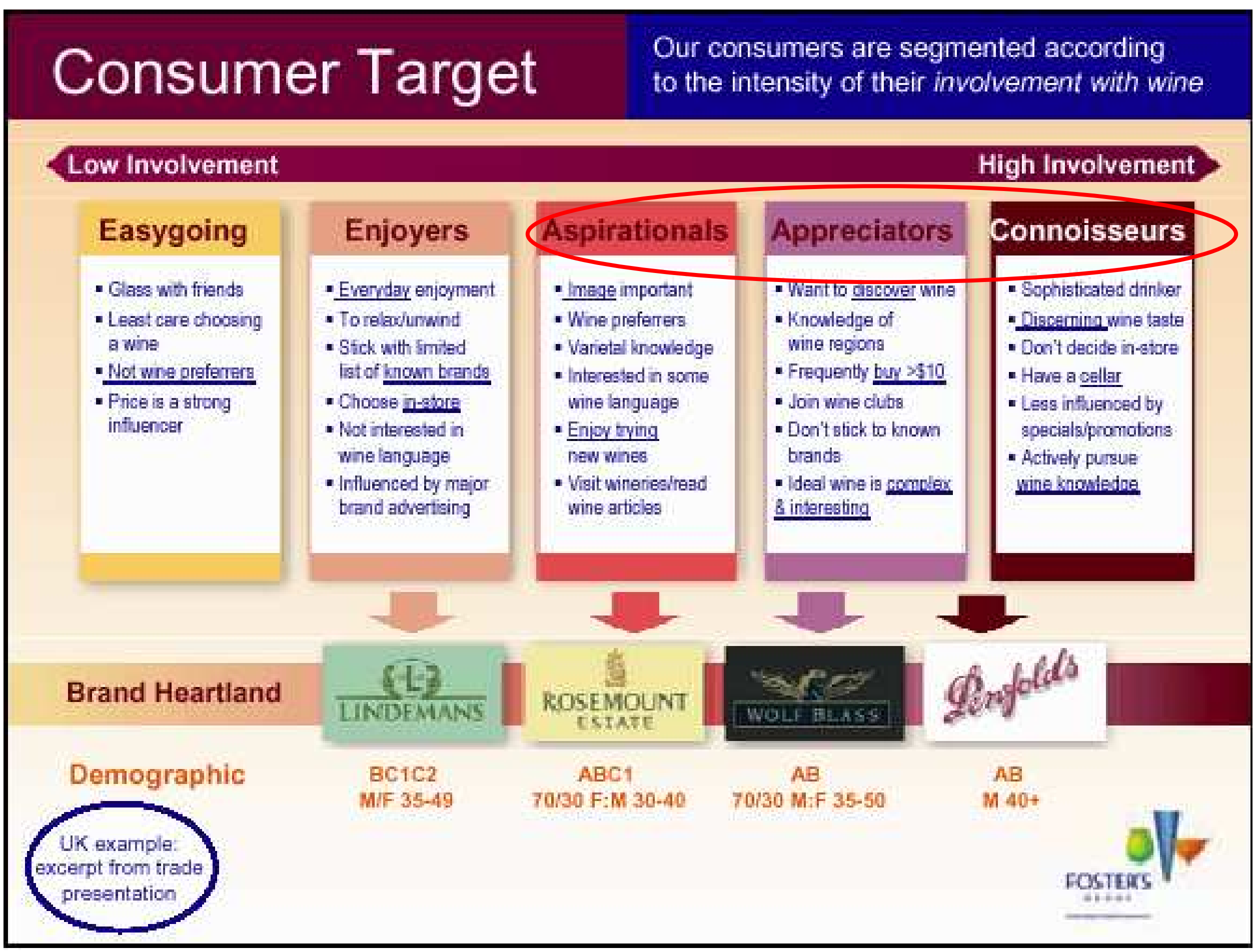
So where are the best markets anyway?

So often we hear that this market is good and that market is bad or indeed that the demand for wine from a particular producer country is good in this market or it isn't. What are we supposed to believe?

Most of the disagreements of this nature that we see played out in the press are the result of two people arguing different market segments against one another.

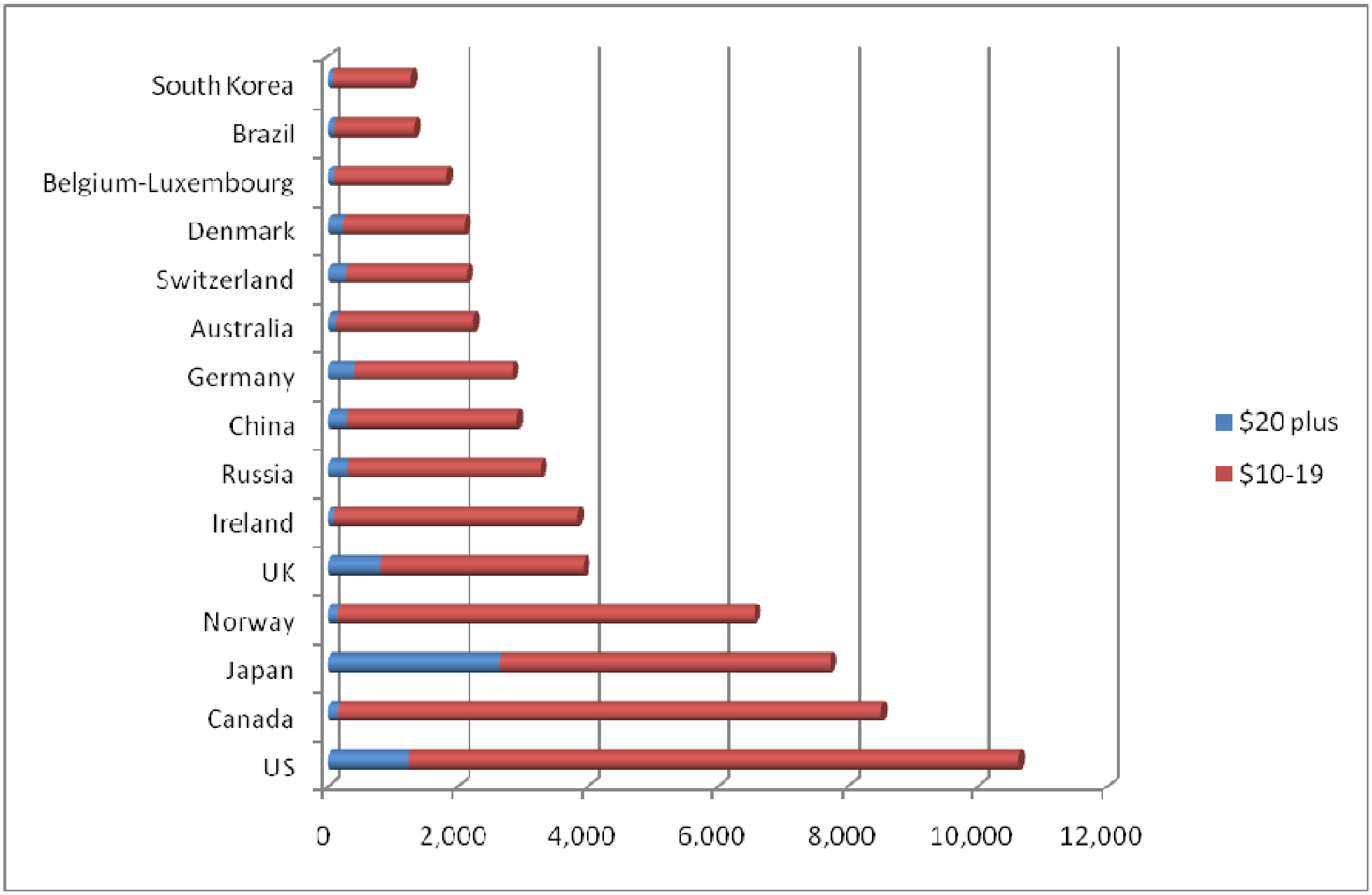
As small to medium producers you, our valued clients, are generally only interested in two price categories - Super Premium ($US10-19) and Ultra Premium ($US20 plus) – along with their three attendant consumer segments;

- Aspirational (mainly women tagged "Generation Next" by Wine Australia)
- Appreciators (mainly men target by Wine Australia's Regional Heroes campaign) and
- Connoisseurs (almost exclusively men and the subject of the Landmark Australia program)



We therefore don't have that much to understand, particularly if we could just filter out these price segments by market. Luckily, the International Wine and Spirt Record have done this for us across 80 markets in a new publication entitled The IWSR Global Wine Handbook 2008. If we focus on the total market for wine exports retailing at over $US10 per bottle, the following are the 15 largest destinations.

'000s case 2007 – source IWSR



As you would expect, the US represents the biggest opportunity. Somewhat surprisingly, the Canadian market is almost the same size but it, along with Norway, Japan and others, has a tax structure that pushes a lot of would be sub $US10 product through the magic $US10 mark. Ireland is a revelation when considered alongside the UK. Ireland does have a very high cost of living across the board but it is a healthy market particularly for Australia, the number one supplier. Russia and China are clearly no longer "hoped for" markets. At over 2 million cases each of sales above $US10 per bottle, these markets constitute rapidly growing reality for premium wine exporters.

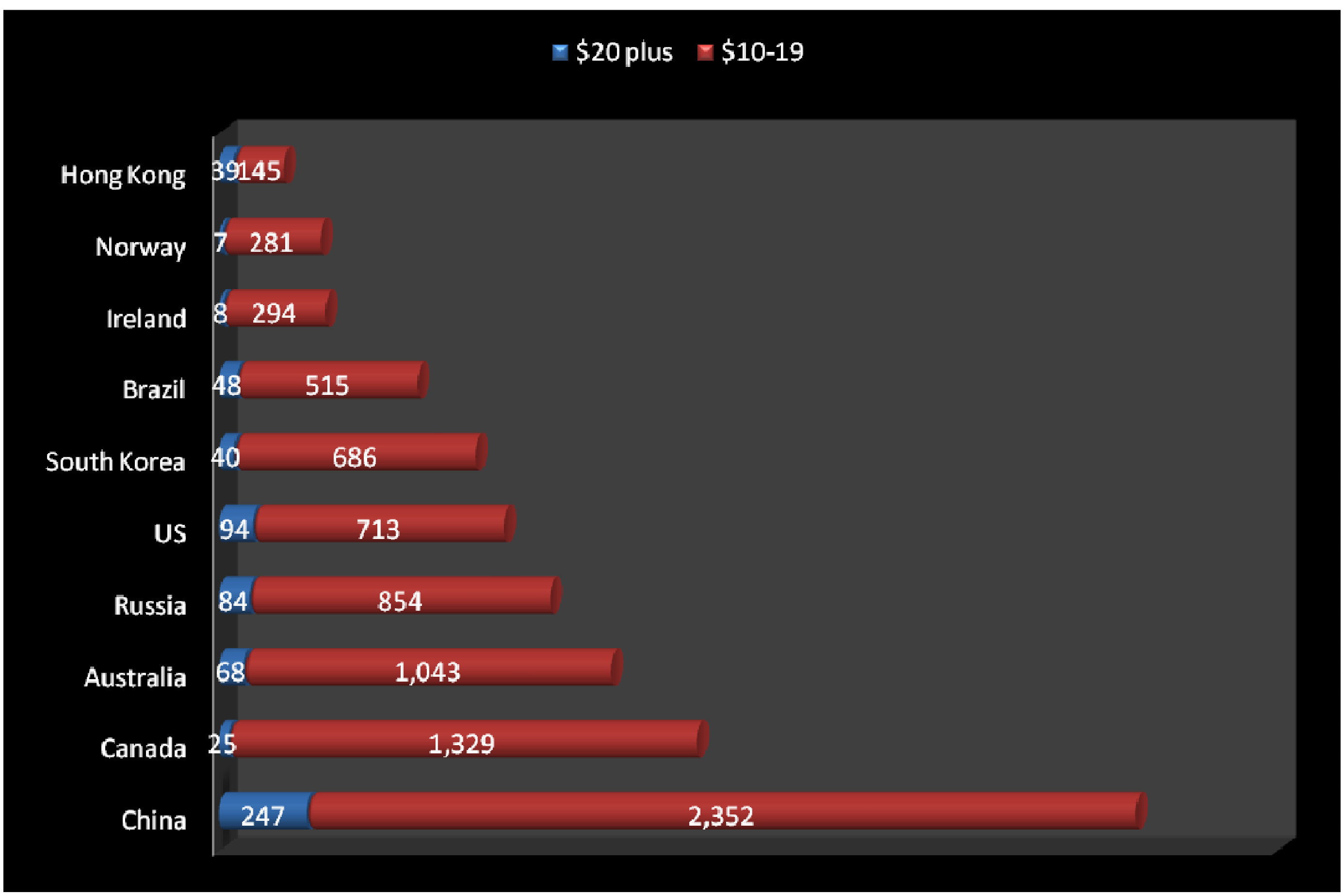
Germany is perhaps the classic example of looking at whole of market data and missing a major opportunity, particularly where Australian wine is concerned. Germany is the number one market for Spain, Italy and France, a point not lost on South Africa who out perform Australia here.

David Coombe was a top level advisor to the Hawke government in Australia for more than ten years who later became export director at Southcorp. I remember him expressing to me his immense frustration that Sourthcorp directed so much resource at Singapore (then 250,000 cases) and so little at Germany (then 83 Million and today 130 Million cases). There are good wine shops and restaurants in Germany. The only issue is that overall demand for imported wine is declining lsightly in the face of a resurgent local industry. However that shouldn't deter anyone with a consumer relevant offering at premium price points.

Australia has in the last two years become a major market for imported wines. And not just for New Zealand. There are now over 100,000 cases of South African wine imported into Australia, for example. Brazil and South Korea perhaps fall into the "best kept secret" category in terms of wine imports.

It then starts to get really interesting when you look at the growth rates for Super Premium and Ultra Premium wine. The chart below highlights the change in imported volume from 2006 to 2008 (forecast) ex IWSR. (*Note that 2007 proportions by price point were used. The chart below therefore treats these proportions as constant which may or may not be the case but it should give us a fairly good guide.)*

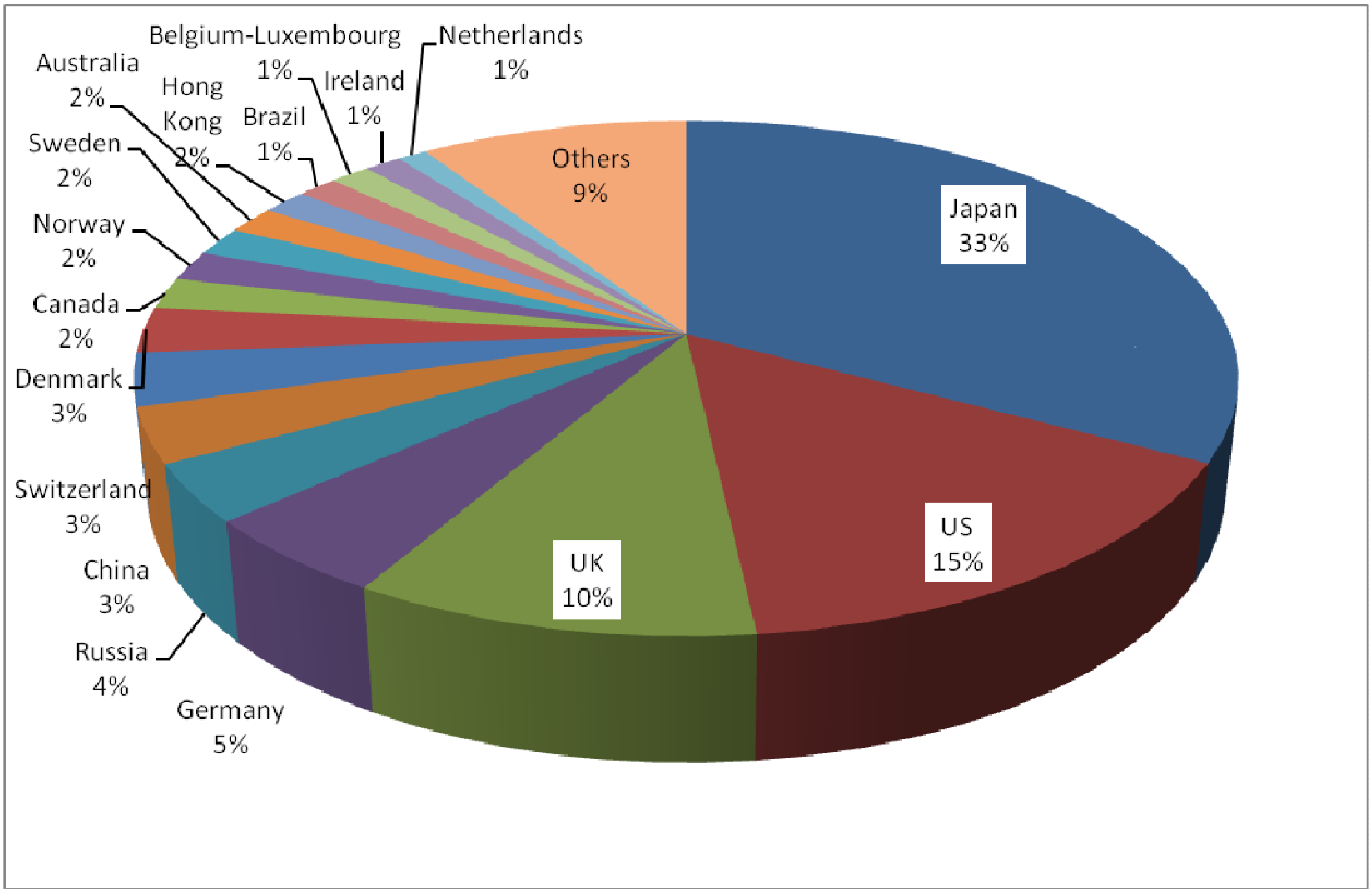
Change in volume of imports 2006 vs 2008f - 000s 9l litre cases



All of a sudden China looks a lot more worthy of the focus Australian winemakers in particular have been giving it. [Russia](), [South Korea]() and [Brazil]() reveal themselves as worthy of more attention.

*(Note – we have hyperlinked each one of these markets to the relevant Wine Business International page. If you scroll to the bottom of each of these pages, you will see that you can download a full market report in *.pdf)*

If you are running a high end business and are only interested in the market for wine over $US20 per bottle retail – which markets are best?

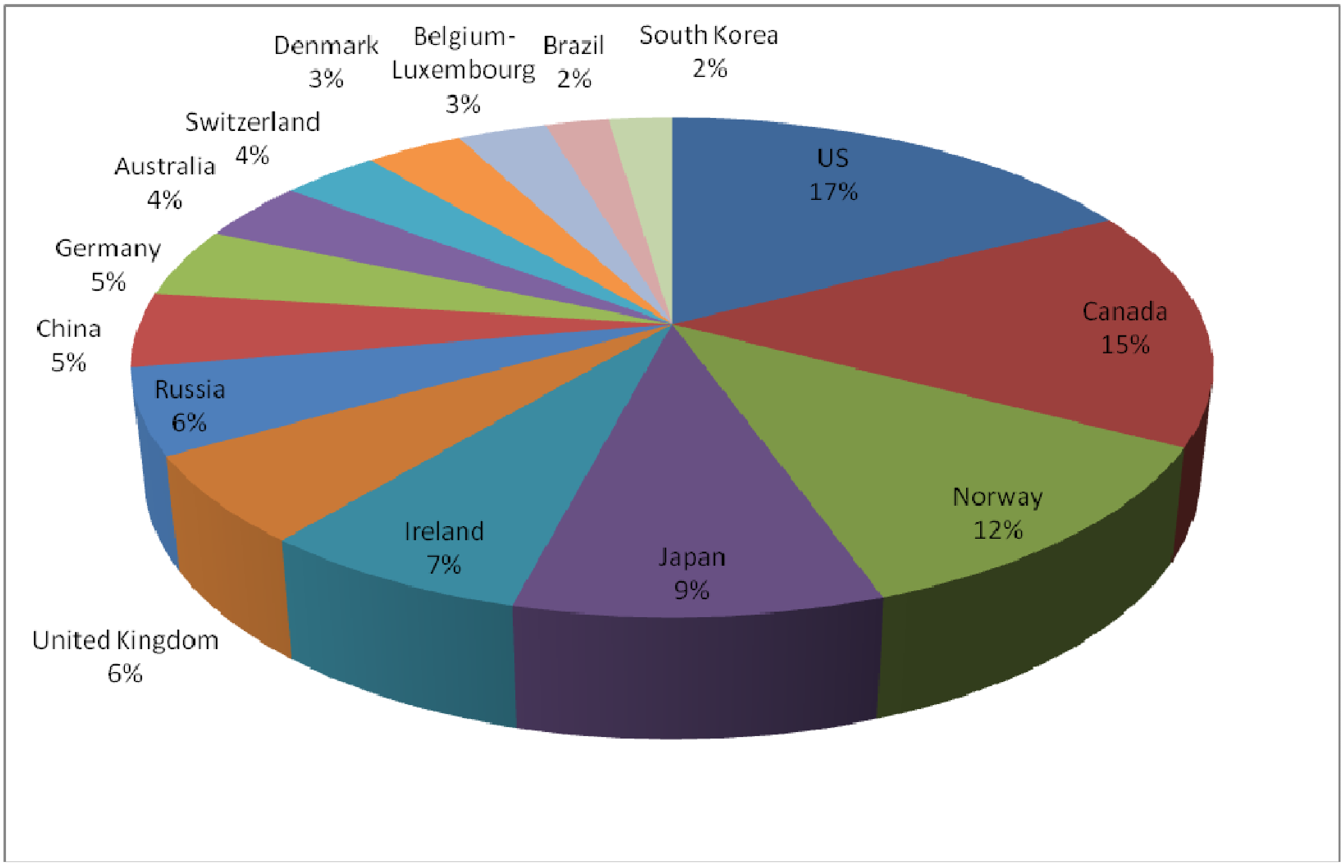


Japan, where Louis Vuitton do around 37% of their global business is also where a third of all wine over $US20 is sold. Yet Australia (and South Africa more so) has never seemed to have been able to manage the patience necessary to make it in this market. New Zealand boasts that it has the highest average price of any nation as a wine supplier to Japan. Coupled with its clean green image, they are well poised for future growth.

These 15 markets constitute around 7.3 Million cases of sales representing 91% of all luxury wine sales opportunities. The top 5 - Japan, US, UK, Germany and Russia - account for more than two thirds.

"The business" for most of our winery clients, however, is in the $US 10-19 zone. Here there is a bigger spread of opportunity with Norway and Australia perhaps being the surprises. The chart below shows the share of the top 15 markets that constitute 87% of this 63 Million plus category.

Again it is interesting to compare Canada with the US, Ireland with the UK and Belgium- Luxemburg with the Netherlands who fail to even make the cut.



For more detailed information, you can purchase The IWSR Global Wine Handbook 2008 off their web site for just £225 - www.iwsr.co.uk .

Redefining your business model

Christmas is just around the corner and it will soon be that time again when we can all take a moment to sit on a beach somewhere and contemplate how we might do things differently and better in 2009.

We often hear people talking about business models. Usually it is in reference to someone not understanding someone else's business model. But what is a business model actually? What does it look like conceptually and what are its component parts? If you plug "business model" into Google Image Search, you're going to see a mind boggling array of utterly different interpretations. I've never seen it summed up so well, however, as in this month's Harvard Business Review as featured on the next page.

When developing a business plan, a lot of people turn a marketing plan into a whole of business plan by simply extending it across admin., winemaking operations and the vineyard. This can be useful and is certainly better than nothing but this type of plan does two things badly. Firstly, it tends to reinforce what you are already doing (as opposed to challenging it) using a prescribed approach it its construction. Secondly, it doesn't have at its heart, a focus on how the business actually makes money.

The diagram from the HBR article over-page pulls this all together neatly in a way that could easily be the basis for your 2009 business plan. It starts (as we do in our Top Ten Tips) by the forcing the question - "What is our consumer value proposition?" and breaks it down into three parts.

1. The question about target market is best answered using the segments mentioned earlier in this Paper. If you're selling $15 bottles of white wine, most of your market is going to be urbane women in their 30s. Is your packaging, brand image and message relevant to them? If you are selling $20 bottles of red in the US, what message is relevant to that audience?
   Note - The Wine Paper 3 looks at this in detail…

2. The job to be done? You don't have a brand until it is the answer to an important question and you do it so well that people tell each other about it. That's what [yellow tail] did. They realised that there was a huge market out there of people who liked the idea of wine but didn't like the taste of it. We all need to be continually asking what we can do for people that isn't being done now?

The Elements of a Successful Business Model

Every successful company already operates according to an effective business model. By systematically identifying all of its constituent parts, executives can understand how the model fulfills a potent value proposition in a profitable way using certain key resources and key processes. With that understanding, they can then judge how well the same model could be used to fulfill a radically different CVP – and what they'd need to do to construct a new one, if need be, to capitalize on that opportunity.

Customer Value Proposition (CVP)

- **Target customer**
- **Job to be done** to solve an important problem or fulfill an important need for the target customer
- **Offering,** which satisfies the problem or fulfills the need. This is defined not only by what is sold but also by how it's sold.

PROFIT FORMULA

- **Revenue model** How much money can be made: price x volume. Volume can be thought of in terms of market size, purchase frequency, ancillary sales, etc.
- **Cost structure** How costs are allocated: includes cost of key assets, direct costs, indirect costs, economies of scale.
- **Margin model** How much each transaction should net to achieve desired profit levels.
- **Resource velocity** How quickly resources need to be used to support target volume. Includes lead times, throughput, inventory turns, asset utilization, and so on.

KEY RESOURCES

needed to deliver the customer value proposition profitably. Might include:

- **People**
- **Technology, products**
- **Equipment**
- **Information**
- **Channels**
- **Partnerships, alliances**
- **Brand**

KEY PROCESSES,

as well as rules, metrics, and norms, that make the profitable delivery of the customer value proposition repeatable and scalable. Might include:

- **Processes:** design, product development, sourcing, manufacturing, marketing, hiring and training, IT
- **Rules and metrics:** margin requirements for investment, credit terms, lead times, supplier terms
- **Norms:** opportunity size needed for investment, approach to customers and channels

3. The note about the offering is critical. So many wine producers believe that their offering is what they grow in their vineyard and what is on their web site (i.e. every single thing on their web site). By buying the grapes you need and selling the ones you don't, it is possible to make wine people want to drink today, as opposed to what was popular when the grapes were planted 10 years ago. By bundling a limited number of products together, packaging and presenting your offer in a different way, it is possible to develop tailored offers for different markets without redesigning your entire portfolio. Of course if you have a small neat, tidy, contemporary offering that will work with your chosen target audience in any market anywhere, as the likes of Oyster Bay do, that will simplify things significantly…

As to the profit formula, much has been written on this subject in previous editions of the Wine Paper. The Revenue Model is principal amongst the levers of profitability. Knowing the key price points in each market and channel and then pricing up to the limit of what the market will consider fair value is the single biggest determinant of profit and, therefore, business competitiveness.

Managing costs and getting a good return on the assets employed in the business is also key. Not a lot of focus gets given by small winemakers to things like economies of scale and resource velocity etc but those that do work on minimising the amount of assets employed in the business and maximise inventory turnover etc get results (e.g. Kim Crawford pre Vincor and Galvanised Wine Group).

The difference between revenue and cost is, of course, margin and Deloitte have done a lot of good work in benchmarking what that should be for the wine industry. Generally, if you can sell your wine for twice what is cost to make then you have yourself a sustainable business model and you should avoid activities that drag your average lower.

That then leads us on to thinking about how we deliver on that customer value proposition in a way that is repeatable and scalable – what new key processes and resources we'll need to create to make this happen.

WSB has taken a bit of its own advice here so as to create an altogether better service and product offering. But more about that in the early New Year…

Blowing open the Hatches

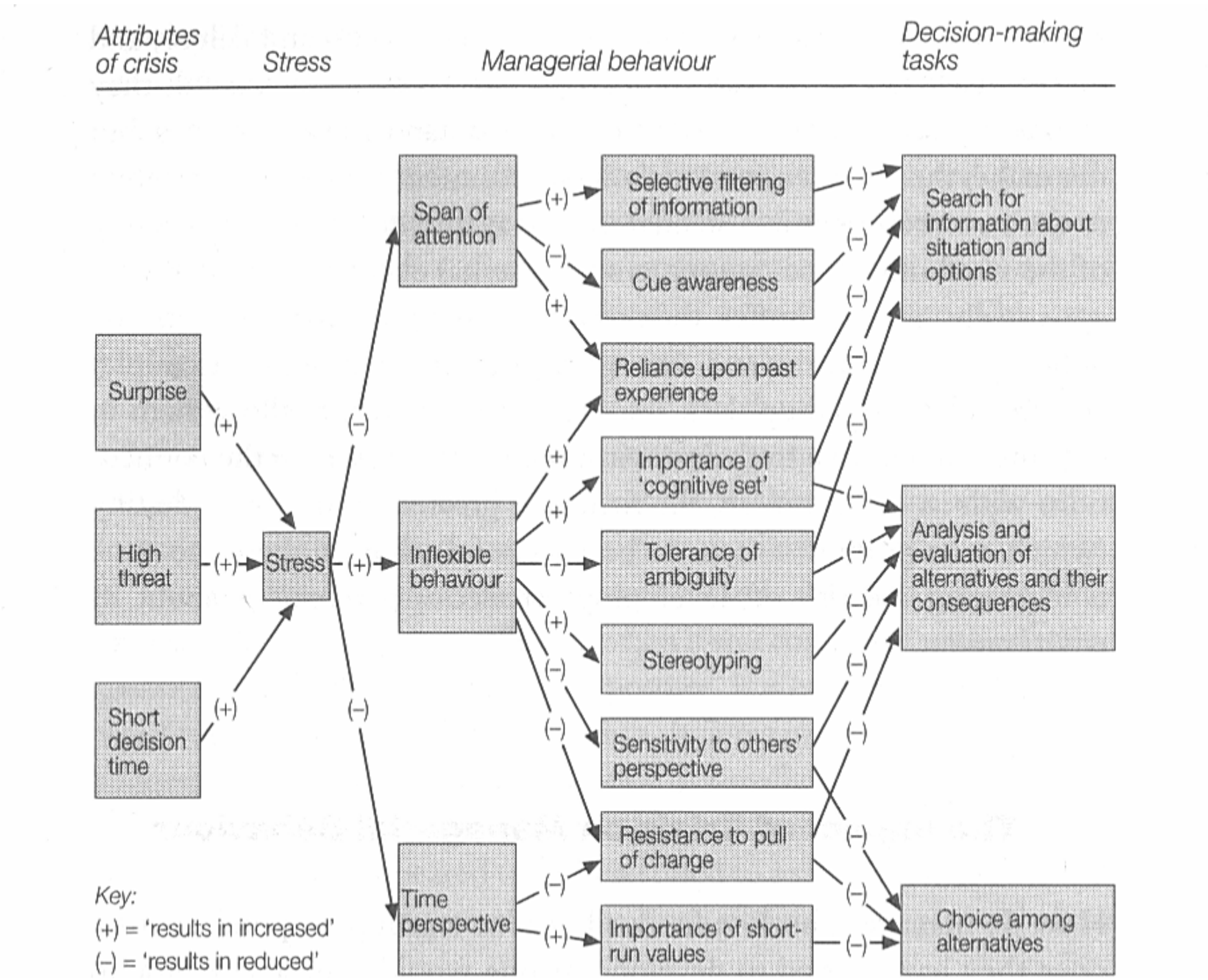
For a lot of wineries, there is no escaping the fact that 2009 is shaping up to be a challenging year. When times are tough, you often hear people talking about "battening down the hatches". Some of the principles involved are good sound business practice in a downturn but some of what passes for conventional wisdom can be disastrous. The article focuses on what **not** to do in a recession.

1. **Discount**. In 1991, the Champenoise managed the triple whammy of putting up their prices and increasing production at the same time as the world was heading into a major recession. For the first time in as long as anybody could remember, there was an oversupply of Champagne. Many of the Grande Marques discounted their prices and saw their sales more than double immediately. One brand, Moet, steadfastly refused. They suffered. Their sales in 1992 were off around 12% on 1991. But when the economy took off again on the back of tech. boom, Moet streaked away from its rivals all of whom have never recovered. One research study showed that firms with above average margins recovered 113% of their pre-downturn price-to-earnings level where firms with below average margins achieved only 101%.

2. **Create low price lines**. Many Australian winemakers have already been through the agony of taking excess bulk wine, turning it into a price fighting "brand" only to find out that they were competing with hundreds of others trying to do the same thing - The "gold rush" phenomenon. They were also running up against big companies' brands. If they were "successful", profits were soon eaten up by rising exchange rates. If they also committed capital to assets used to produce these products, they are now in serious trouble. Commercialising wine at low price points reducing margin across your business almost always results in huge amounts of activity and loss of focus for very little return. Sometimes it works, of course. Sometimes your [yellow tail]. Sometimes...There are a whole lot of Kiwi and a few South African winemakers about to learn this lesson first hand. Best not to be one of them unless your cost structure beats all.

3. **Slash costs**. Cost consciousness should be inculcated into culture like change and innovation. Staff should never be allowed to believe that these things belong in some sort of tool box only to be reached for when times are tough. Cost containment is critical to business survival in a downturn and sometimes hard decisions need to be made. Indiscriminate across the board cuts can, on the other hand, do huge damage to companies. I remember once a CEO of a medium sized winery committing to 20% cost cuts before he had even started the job. He didn't last long.

4. **Let pressure cramp your thinking.** People behave differently under pressure. Knowing this can help you avoid poor decisions. When people get stressed, they become less flexible, their attention levels drop and their time perspective shortens. This can lead to poorer quality decisions being made through less time being allocated to information search, less thorough analysis of the alternatives and their consequences and fewer choices being considered.
   There is a tendency for people to make themselves look busy even when it might be doing more of what got them in to trouble in the first place. "Urgent" tends to push out "Important" when the business barometer breaks boiling point.



What's the best thing to do if you're feeling the heat? You could do worse than to chill out with a nice bottle of wine over the Christmas break and ponder all those wonderful opportunities in a world where the growth curve for premium imports in almost all markets is still pointing north.

We look forward to helping you get the best out of your business in 2009.
Merry Christmas and a Happy New Year.

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

(from Wine Business Solutions article published in Wine Business Magazine, March 2007)

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 where ever possible. Everybody knows they should do this. Few do. The difference in 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.