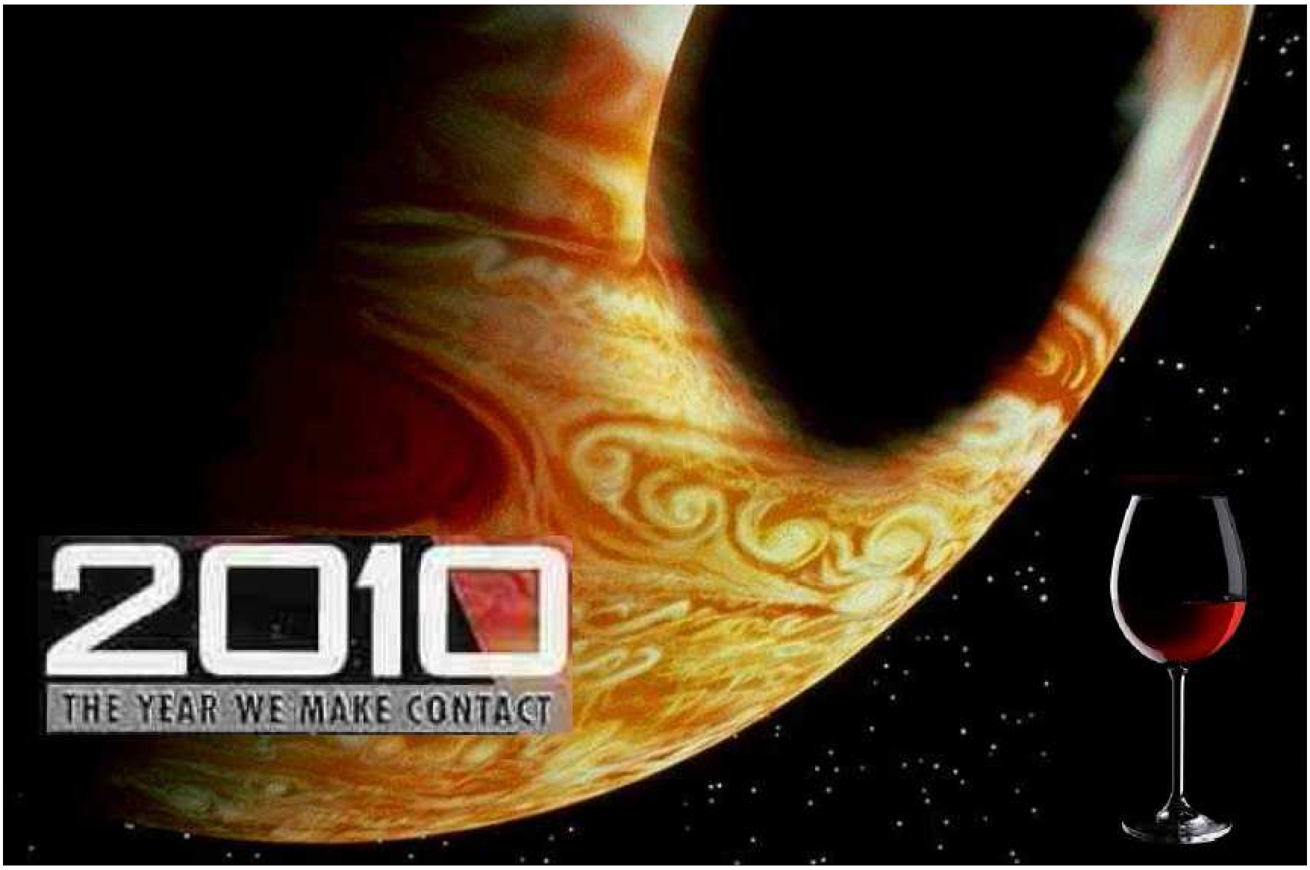
Wine Business Solutions

The Wine Paper 9

November 2009

Preparing for a New Decade


2010
THE YEAR WE MAKE CONTACT

One of the best (and sometimes the worst) things about this job is being in perpetual motion. I've just returned from 27 days straight on the road having visited Central Otago, Marlborough, Hawkes Bay, Tasmania and South Africa. The good thing about getting around and talking to so many people is that you start to see the way in which global oversupply impacts everyone but you also see huge differences in the way in which people respond.

What are the big opportunities for wine producers in the next decade, the "teenies" if we can call them that? From previous editions of the Wine Paper you would have seen that the fastest growing market for imported wine with a retail price of $US10 or more is China, according to the IWSR.

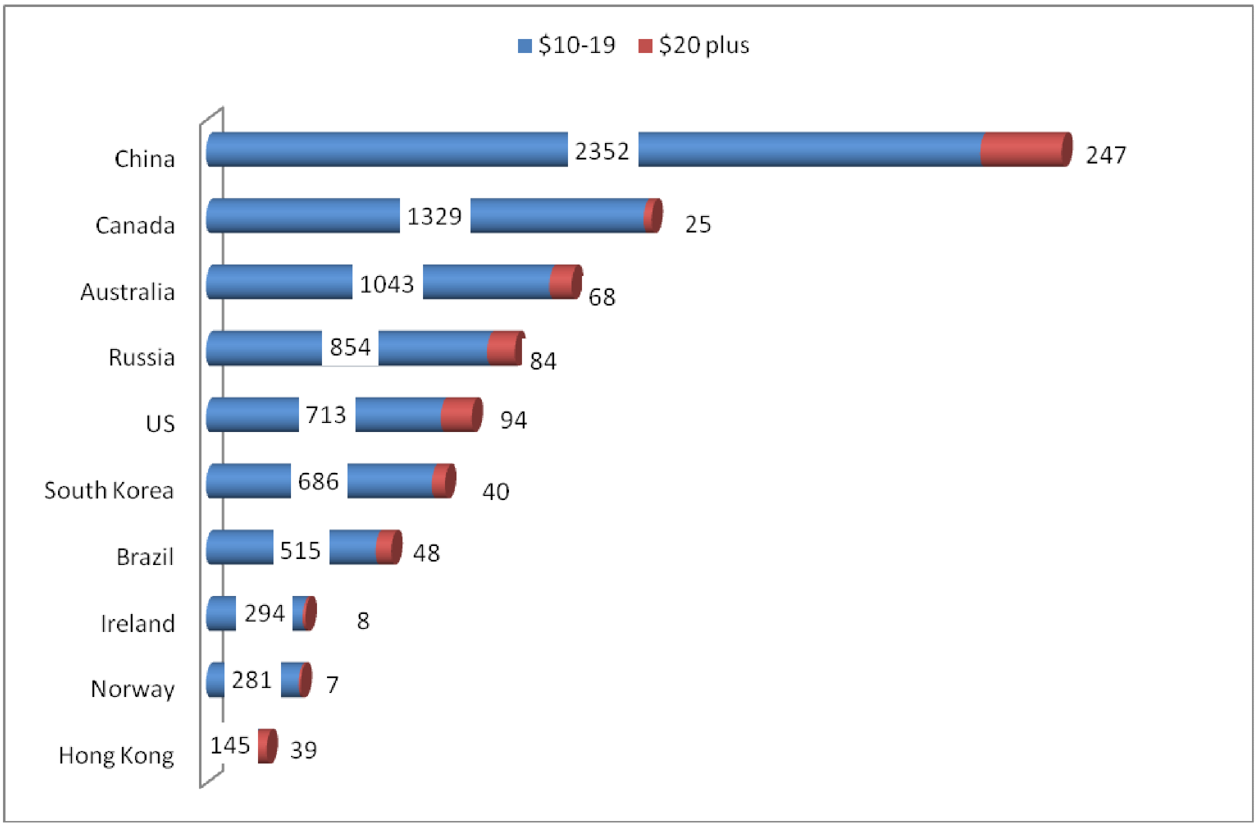


Figure 1 – Change in the volume of wine imports 2006-2008 – '000 9 litre cases – source IWSR

One most positive thing reading through the IWSR data is that prior to the last year's financial crisis, the market for imported wine was growing strongly in all but a few large, older markets. Practically every small nation on earth was steadily increasing the amount of quality wine it was drinking. We always recommend focusing on a few targeted opportunities and doing things properly but where those opportunities may lie is becoming more interesting. Through one of my better clients, I recently met a guy who sells wines in a dozen or so developing African countries. I think that people who are prepared to go slowly and build brands in these markets are going to do very well in the next ten years.

Certainly there are some regions whose winemakers are feeling more beaten up than others right now. Tasmania is one place where they actually have an undersupply and more development is in the pipeline. Aiding their cause is a massive swing around in Australian drinking habits.

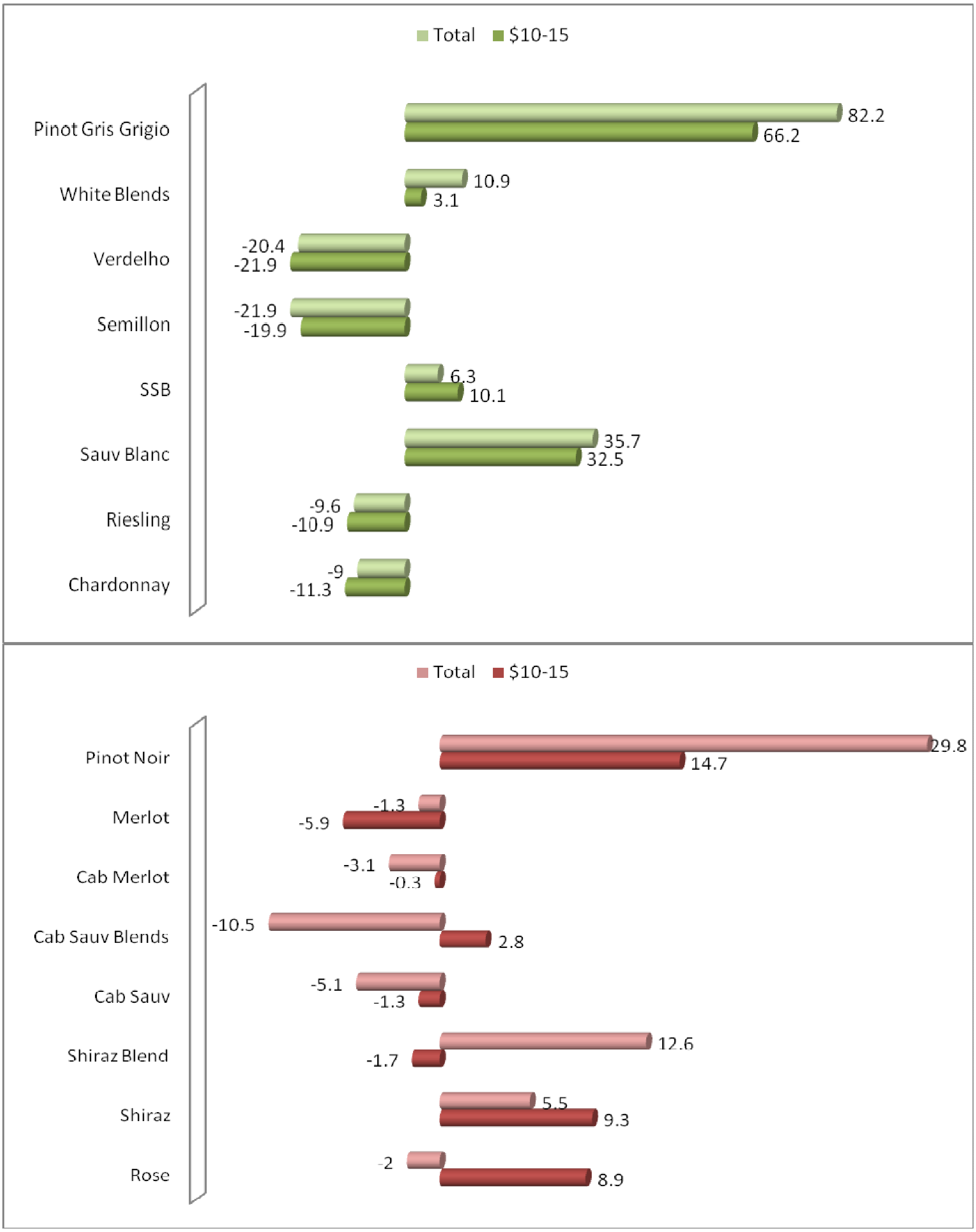


Figure 2 – Volume change by varietal and price point YTD June 2009 – source Nielsen

As you can plainly see, total Pinot Gris sales have almost doubled from last year to this and the biggest white wine category, Sauvignon Blanc has added nearly 36% to total annual volume sales.

Australians still like their big ripe Shirazes, particularly those blended with Viognier and Grenache but it is Pinot that leads the pack in terms of fastest growing red wine styles.

In 25 years of crunching wine industry numbers, this is the most dramatic shift in consumer taste I have ever seen. All bodes well not only for Tasmania and New Zealand who driving most of the change but regions like Orange in NSW, South-Western Western Australia and Elgin (South Africa) can also look forward to better days.

The move away from overripe, over extracted wine is a global one. Well balance higher alcohol wines will, of course, continue to have their place but cool climate wines are definitely "cool" right now and likely to become more so as the 'tsunami' of food and lifestyle television directed at our consumers finally translates into them thinking harder about what wine goes with the food we are all eating.

There has been more than enough written about establishing environmental credentials being a 'given' rather than a point of competitive advantage. Travelling around Australia as lead quest speaker on the Finlaysons Roadshow this year was a great way to gauge Australia's response to the challenge. I have to say that I was "surprised at the surprise" when this message was put to many producers. WBS does not recommend to clients that they make establishing environmental credentials the primary focus of their business. We do suggest however, that it will be vital to build some message around sustainable practices into your winery communications as a means of, at very least, staying with consumers in the next decade.

The biggest opportunity of all, as has been my theme for some time, lies in better targeting the Aspirational wine drinker with products that fit with their lifestyle, particularly in the US where a huge market of new drinkers with money is emerging. In order to do that, we'll need to come up with some truly innovative thinking.

One of my clients in South Africa, Bertus Fourie, is a former chief winemaker with the KWV and has pioneered a unique wine style called "coffee pinotage". Bertus deliberately worked to create wine that actually smells and tasted like coffee (and very good wine, of course).The net result is that the three leading brands of Pinotage in South Africa, Diemersfontein, the KWV's Café Culture and Vinimark's Barista all are coffee pinotages which Bertus has a hand in. The category has been redefined.

In many ways, it's a similar story to Marlborough Sauvignon Blanc. You give people a taste that they recognise and like (usually passionfruit in Marlborough's case), you provide it consistently and people not only feel confident in purchasing it, they feel good about themselves for being able to recognise it and they have a reason to tell others about it – a brand, in other words.

DO WE HAVE A BRAND YET?

One of the main ways wine producers typically measure success is through their respective country's export performance. Theoretically, if you have strong export sales growth, year upon year, then developing strong regional brands and your own individual brand identity under the national umbrella should happen almost automatically - Right?

For years, Australia, New Zealand and South Africa have used the volume and value of exports as the principal indicator of their respective country's brand health. As long as those total export volume and value figures pointed ever skyward, not a lot of focus was given to regional and individual brand strength within each country category.

Why are regional and individual brands critical to the success of a country category? Varietal or wine style followed by region is the way in which most wine shops and wine lists in the world are organised. University of Adelaide research shows that "Region" is the principal means by which men in the UK choose wine from a wine list, for example. It then comes down to "which producer do I know and trust" (which, let's face it, for the average consumer most of the time is none of them) or "which one is the waiter / sommelier / floor staff recommending?"

Now you could argue that wine sold at a retail value of less than $12 / R60 usually doesn't have a region indicated but in Australia, for example, only 3.7% of wine on wine lists is without regional designation. In the UK, this figure is 30% and I would guess that if we did the same research in the US, it would be somewhere in between.

So, in that most important of environments, one of the very few places new customers can try your wine – the On-Premise – if you're not from a recognised region you might as well be on page four of a Google search.

Why are individual brands important to country and regional brand health? I once read a very interesting article in Decanter talking about how there were no great wine regions without great brands. You can certainly make the case anecdotally as this article did. The underlying reasons for this are more fundamental, in my view, and apply to all product categories. Brands that are established, of consistent quality and readily available provide consumers with what they value most – confidence. A brand is brand, after all, when it is the reliable answer to an important question.

So how are we doing when it comes to building regional and individual brands internationally?

When you look at how New Zealand performs in the UK On-Premise, it's tempting to say "here is a model for everyone else to follow". Not withstanding that the country's wine production exists in a relatively limited number places and that most wine is sold at price points where region is important, Marlborough's regional strength in particular comes through loud and clear *(the most listed region for Sauvignon Blanc, 2nd for Pinot Noir, 3rd for Riesling and in the top dozen or so for Chardonnay, according to WBS research).*

The top 20 Kiwi brands have 56% of all listings from New Zealand (so people are seeing known and trusted names consistently) and the country's flagship brand, Cloudy Bay, is both the most listed and most expensive wine from New Zealand. So a model of how to build a country brand with the support of strong regional and individual brands, you might say.

But what about the US? How does New Zealand perform as a country category there? An analysis of Nielsen off-premise data shows that Constellation has a whopping 54% of the total country category and that three wines – the Sauvignon Blancs of Monkey Bay ($9.95), Nobilo ($11.95) and Kim Crawford ($16.50) have almost half the market on their own.

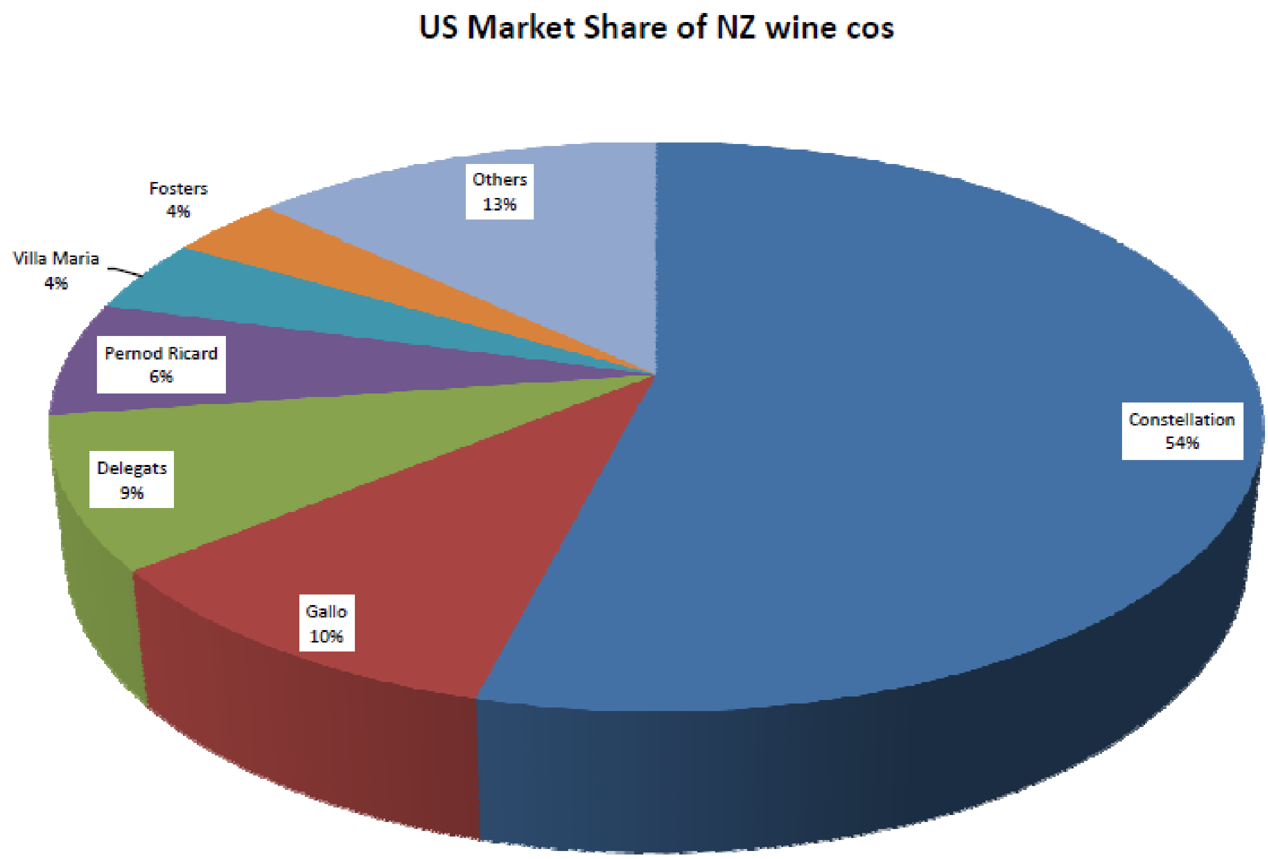


Figure 3 – New Zealand wine sales in the US Off-Premise – Source Nielsen

Gallo is next with over 10% through its Starborough and Whitehaven projects.

The success of the New Zealand wine category in Australia can be said to be almost entirely due to the large number of high quality producers selling wine at $20 per bottle average for a good decade before Delegats realised that the best way to optimise returns from any market is to price up to the limit of what the Aspirational wine consumer will pay for an everyday drink – currently around $15 per bottle.

If we look at the current status of the New Zealand category in the US, it's clear that this hasn't happened at all, that it is a category totally dominated by companies with distribution muscle and that the smaller, higher quality producers who are needed to create the right image and a good strong country brand simply haven't turned up in sufficient numbers.

The net result is a price per litre that has almost halved in the last decade, a lot of very ordinary wine being sold at low prices by people with short planning horizons leaving a big question mark hanging over the future for New Zealand wine in that market.

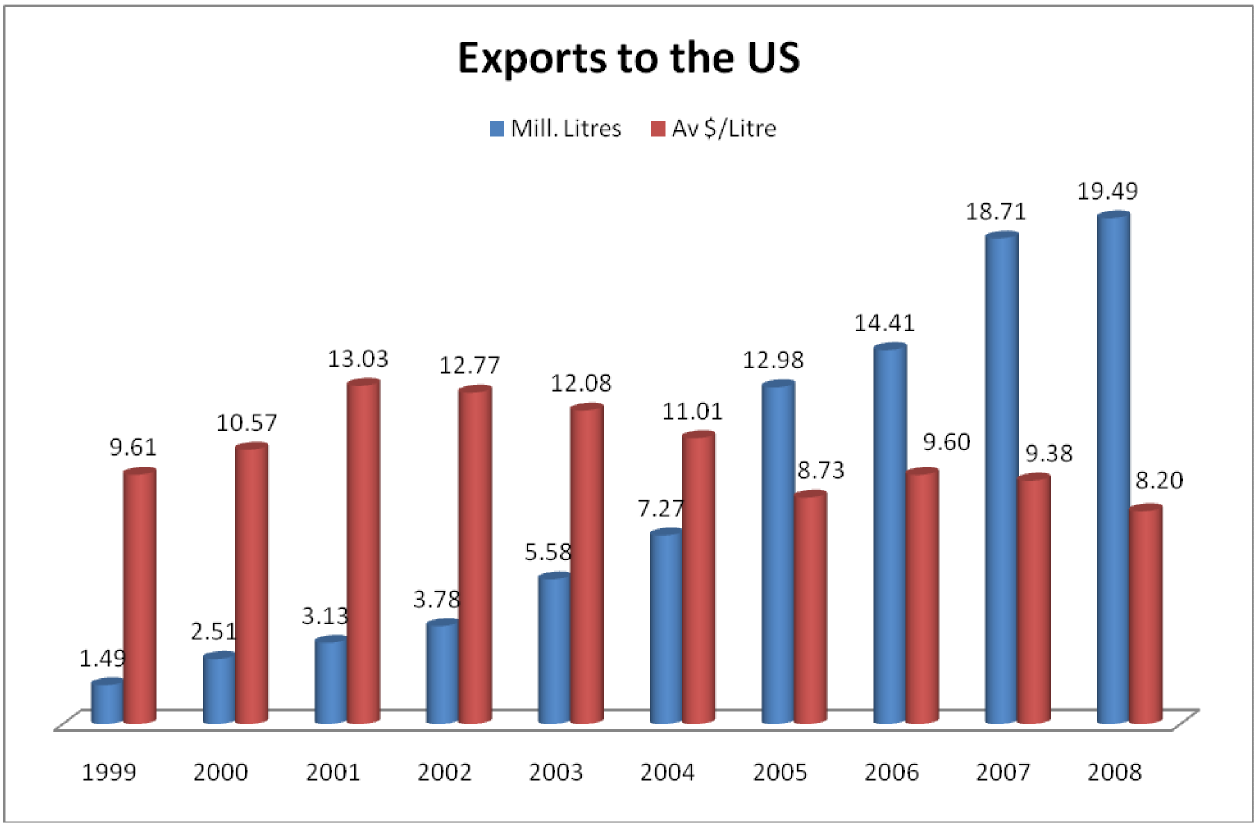


Figure 4 – Total New Zealand Wine exports to the USA - Volume average price per litre

As in Wine Paper 8, Australia faces a similar situation in the UK. Even though it is the Off-Premise category leader with a 23% market share (which is what most people look at), it only has 9% of wine listings. The average price of Australian wine on wine lists in the UK is £26 compared with £43 for all wine. If you want to find one wine from important regions like Coonawarra, Margaret River, McLaren Vale or the Hunter Valley, you would have to thumb your way past 300 other wines visiting, on average, 6 restaurants. Australia has no region in the top 15 most listed white or red regions in the UK.

South Africa in the UK is another interesting case. In 2006, a regular witch hunt was started because exports fell by over 20%. This was a very good thing, in a way, as WOSA were forced to justify their instance on maintaining a European focus despite the US being by far and away the best market for wine sold at profitable price points (more than $US10 per bottle retail for all but the largest of producers). When this fall in total export volume was broken down by brand however, it was revealed that the drop was almost entirely due to the reorganisation of the Kumala brand by Constellation in the UK.

Conversely, on my recent trip to South Africa I was expecting that everyone would be upbeat because exports to the UK are up 36% MAT June 2009 over the previous year. Two of our clients had brands in the top 20. Like a number of our clients in Australia and New Zealand, both are withdrawing from UK supermarkets because they can't make any money doing business with them.

	Values Sales - £ in 000s		
	MAT ending 28 June 08	MAT ending 27 June 09	% Change
Total South Africa	386,035	526,665	36.4
First Cape	48,290	100,691	108.5
Kumala	75,586	83,573	10.6
Private Label	62,631	77,853	24.3
Namaqua	44,559	53,508	20.1
Arniston Bay	17,508	24,545	40.2
Lindemans	841	18,585	2110.4
Pearly Bay	7,872	9,374	19.1
Stowells	12,416	8,638	-30.4
Boxwd-Cp	1,580	7,196	355.5
Stormhoek	2,451	7,072	188.5
KWV	5,006	6,740	34.6
Roberts Rock	5,674	6,118	7.8
Two Oceans	2,790	5,892	111.2
Boschendal	4,388	5,513	25.6
The African Horizon	-	5,386	-
Goiya	3,992	5,198	30.2
Spier	5,236	4,800	-8.3
Dumisani	5,176	4,741	-8.4
Nederburg	2,200	4,350	97.7
Eagle Crest	923	4,303	366.3

Figure 5- UK Off Premise sales value for S.A.s leading brands - *Note the inclusion of Lindemans as a "South African" brand.*

The morals of the story?

- Firstly you almost always need to dig deeper than headline numbers. Thanks to all of you who regularly send us data, our regular market visits and the research we conduct ourselves, we now have comprehensive business critical information on most markets you might care to contemplate.

- Secondly, strategic planning and marketing investment is vital to the success of wine regions which are always the centrepiece of a profitable country category.

  Australia now realises this and the AWBC's approach to market incorporates a focus on regionality. Not everyone gets this, of course, particularly those companies that don't make region a focus.

  Those same companies, however, are typically those struggling most to make money in the current climate and they will continue to struggle as the beverage and branded wine segments remain in chronic oversupply and their primary distribution channel (i.e. supermarkets) exercise the full weight of their advantage.

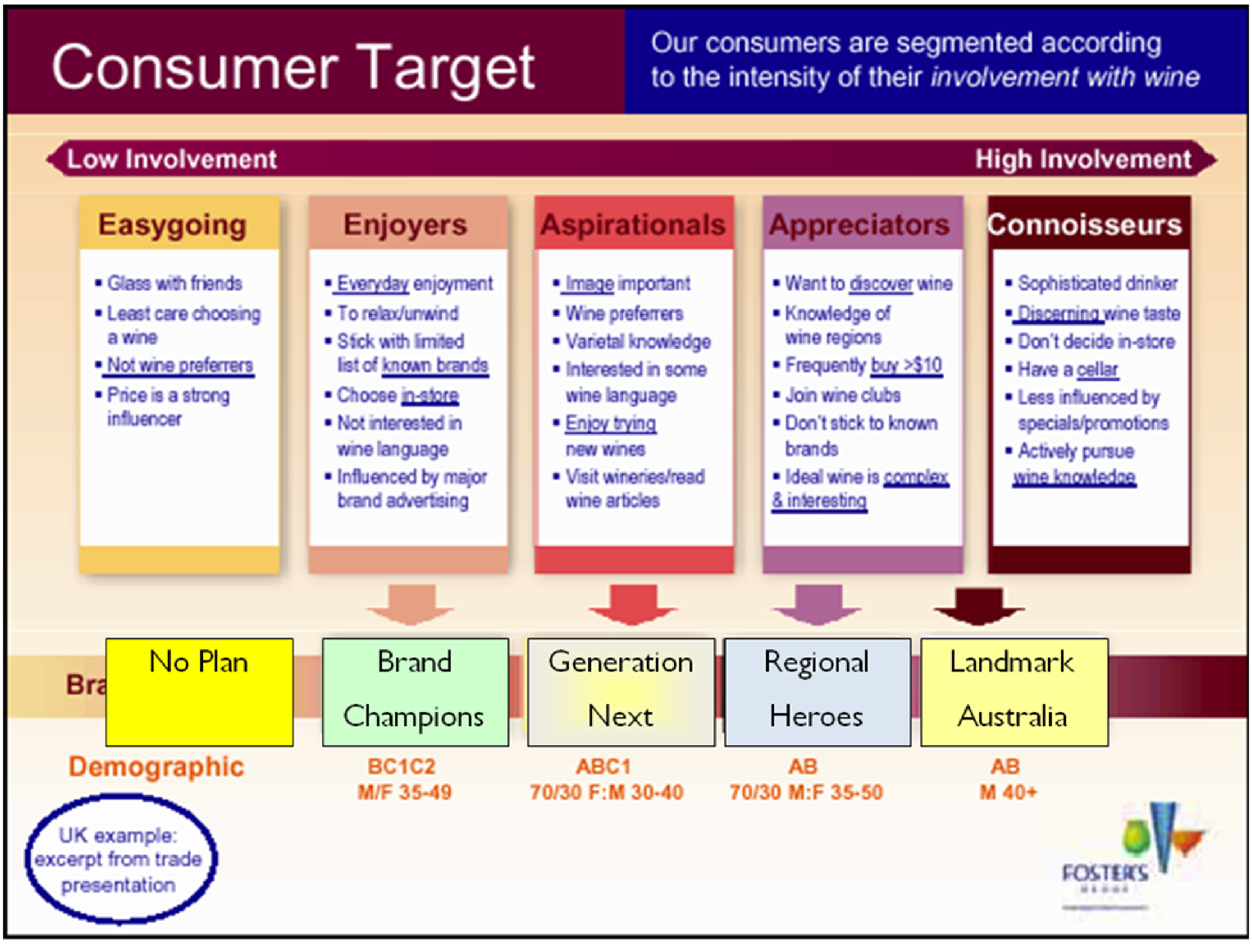


Figure 6 – The AWBC's segmentation of wineries overlayed upon Foster's consumer segmentation

Strategic planning has had a bit of a bad wrap lately. Some people blame the fact that the Australian industry projected vine requirements to meet future demand for the oversupply that country now faces. That's like the editor of the property section of your local newspaper for a property bust. It doesn't mean that Strategic Planning per se is bad.

Indeed, planning and marketing investment in regions and country categories is the single biggest determinant of success for small brands and large alike. Gallo, for example, spend more money on growing the South African category in the US than WOSA do. Developing concepts of regions will be the next big challenge for South Africa. But hey - look at the Gimblett Gravels challenging Bordeaux. Why didn't Coonawarra do this10 years ago, you might well ask?

Those regions with a co-ordinated approach to regional strategy and investment are going to be the winners in the next decade, of that there is no doubt. We, of course, are always happy to help in any way we can.

Regular readers will remember that I concluded the last Wine Paper by saying that this is “the year of hard work”. What good is a consultant that doesn’t take his own advice?” you might well ask...

Accordingly, I ceased all engagements that were not directly wine related earlier this year. The five years that I taught in the Graduate School of Business at UTS and the running of the Australian Turnaround Management Association’s education program were ‘great life experiences’ but it was time to move on.

I was certain that if I was to make WBS a real success, I was going to have to put it all on the line and dedicate 100% of my time, effort and energy to providing the best possible service to you, our clients.

This worked out better than expected and it certainly has yielded more and better work than anticipated. We’ve also been able to add to the team significantly. WBS now has a whole raft of supporters including the likes of Dr Johan Bruwer who, whilst not directly employed, make an invaluable contribution to the business.

I thought it may be helpful for you to know about some of the projects WBS has worked on this year lest there be something of a similar nature that you might like help with.

Strategic Planning

This is really the core of what we do, what we enjoy doing most and where we can be of most benefit.
I have just flown back from South Africa where WBS conducted a 2 day facilitated workshop session for one of the top 20 largest wineries. Some of the managers found the process challenging initially but in the end, I was overwhelmed by the response in terms of the number of creative, practical and potentially highly profitable ideas the team was able to come up with. Everyone enjoyed the experience and I am certain that it is going to make a big difference to that company’s performance.

Many companies avoid these types of sessions feeling that if they can’t do strategy themselves then the business owners must have hired the wrong people. Regardless of management competency, I can see great value in having an independent, professional facilitator run these meetings. It is also very rare, in my experience, that companies possess the level of business intelligence that we invest so much of our time and effort in gathering so as to better inform decision making. Broad based strategy consultants can do so much but they will never understand your consumers, customers and competition.

Regional Support

So as not to put our services out of the reach of even the smallest producers, WBS not only holds workshops like our "Making Money in the Wine Industry" series, we also organise and participate in regional events held for the benefit of an entire region's producers.

Figure 7 – Attendees at Wine Making Tasmania's recently held Client Day

For example**,** WBS was recently invited to participate in an event organised by Julian Alcorso's Winemaking Tasmania. More than 60 local producers attended**.** Nick Bullied MW presented benchmark wines form around the world and I presented ideas on opportunities for the Tasmanian wine industry from a business standpoint. The following day, Nick and I held intensive one-on-one sessions with individual business owners. The event, now in its fifth year, was a huge success and received great feedback. If you would like to do something similar in your region, please be in touch.

Portfolio Analysis

The single most important component of successful business strategy is a clear and compelling customer value proposition. The way this value proposition gets presented to a customer (trade or consumer) is through your offer **-** your range of wines, your brands and how they fit together logically. If it changes from one market to the next, if it is too big, too complicated and if it is not abundantly clear who the offer is for, it becomes massively harder to compete. As companies grow to become medium sized (average production around half a million cases) adding new business as opportunity presents itself, it is very easy for sales led organisations to muddy their long term business strategy.

So far this year, we have undertaken a portfolio analysis exercise for three medium sized companies in three different countries. In all three cases, we were able to identify unprofitable, unsustainable parts of the business that were holding these companies back and to identify opportunities for profitable growth that will lead to the creation of a unique, sustainable business model for each company.

Organisational design, resource allocation and succession planning

As businesses grow, it's easy to loose site of what resources the business needs to meet future challenges and implement your desired strategy. Thought needs to be given not just to who you replace key people with but how the management structure may need to change as part of becoming a bigger / better organisation.

WBS are not recruiters and we always recommend engaging specialist professionals when making new appointments. We do, however, frequently work with clients to help them determine what the ideal structure of the workforce and management team is so as to ensure optimal execution of their strategy. This is a much bigger picture and more critical set of decisions. We have had a least a half dozen assignments involving these issues during that last 12 months.

Strategic Alliances

As more people become dissatisfied with conventional way of going to market, many businesses look to create strategic alliances with non competing brands so as to fund sales initiatives in various markets around the world. As WBS's network continues to grow, we find ourselves in an ever better position to help wineries find strategic partners, to help distributors (many of whom are also our clients) find the best possible business partners and to form strategic alliances amongst themselves.

For example, WBS was instrumental in facilitating the strategic alliance of a number of the most successful State based distributors in Australia into a national group. Having a single admin function and national accounts team will not only make the group more attractive to potential wine company business partners, it will reduce their costs significantly as well.

Direct to Consumer Strategy

As it is the most profitable sales channel, all wine businesses should be thinking about how they can build their consumer fan base and engage more effectively with them so as to sell more wine direct.
Earlier this year, WBS worked with a major New Zealand prestige wine business to develop a global direct to consumer strategy. You can now sell direct to consumer in many markets so you no longer need to make overseas visitors feel like selling them wine is a "problem".

WBS is fortunate to have as clients, a number of leaders in the field of direct to consumer marketing who are prepared to share their learning with businesses who are not direct competitors.

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.