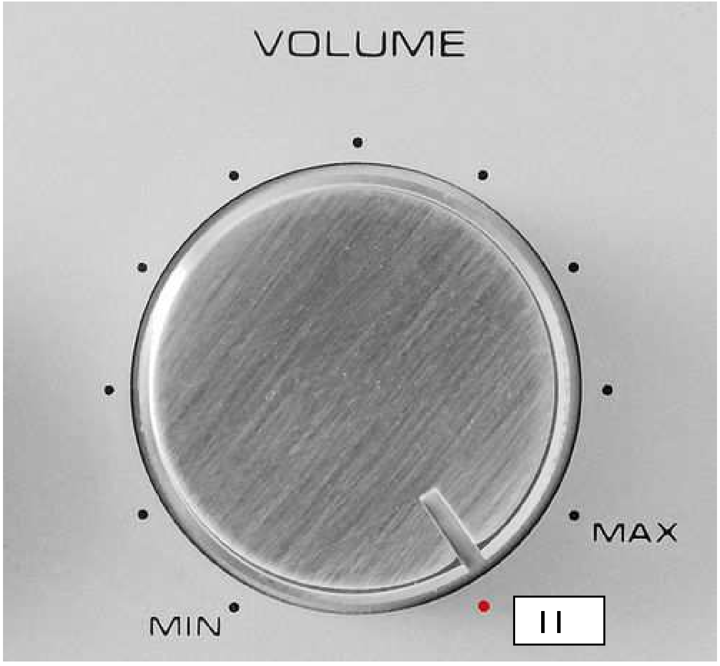
Wine Business Solutions

The Wine Paper 11

May 2010


VOLUME
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Luxury level wine represents one the greatest opportunities to build profitable business sustainably. The mathematics are compelling. If the only wine you produce is at ultra premium price points ($US35 plus) and you only sell direct to customer, then you need just a few hundred cases of sales to generate quite a decent income. Smart winemakers can execute this model at very low cost.

As pointed out to me in our recently held South African workshop, it's not necessarily an easier task. The incremental effort required to individually hand sell your offer may balance up that small volume required to achieve a profit. Beyond $35, you can no long rely on your friends and family to buy your wine.

The essential difference between taking this path and trying to foist more wine on the world at $US20 per bottle or less, however, is that whilst the world is certainly saturated with good wine, it is difficult to argue that there is too much truly great wine. The path to profitability is fairly certain for ultra-premium wine worthy of its price tag whereas wineries that can not make money at $20 per bottle now will almost certainly not improve their position by increasing production. Further, there are huge benefits to wine producing regions and countries if a ground swell of quality obsessed individuals is detected. There are no issues, typically, in getting people to write and tell one another about that.

So what is the secret? How do we create luxury brands that will improve both our fortunes and those of our fellow countrymen? New Zealand, Australia and South Africa can all do it but each has its own very different set of challenges.

New Zealand's principal issues have been a lack of vine age, a lack of brands that specifically target the high end and a focus on Sauvignon Blanc. There is nothing wrong with Sauvignon Blanc per se and there is no reason why wine worth $60-80 plus can not be crafted, it's just that it is not generally an age-worthy varietal and therefore, collectible. New Zealand's lack of its own auction system is another hurdle.

With investment by brands like Craggy Range, the efforts of the Gimblett Gravels group and the cult following being developed for brands like Dry River, the country's offer is starting to get there. At the moment however, New Zealand is still weak at the top end and so countries like Italy and France and even the US can more easily command listings and increase their luxury wine market share.

Australia definitely has the wine and the brands but, as has been well publicised, is struggling at the moment due to a backlash against the image some of the volume brands may have created. There are other factors that Australia needs to address that have not attracted quite so much attention in the press.

For whatever reason, Australia has not been successful at attracting serious foreign investment in creating luxury brands. South Africa, South America, the US and to a lesser extent New Zealand have all benefited from foreign billionaires pouring hundreds of millions into wine estates. This lifts the image of the entire industry and you simply can't source those types of funds through any other means.

Talking to Grupo Maturo founding partner Alberto Antonini, perhaps this is partly due to Australia not believing it needs outside help. Alberto has clients in practically every wine producing country but none in Australia. "We learned a lot from Australia" he told me "We improved our quality in Chianti in winemaking and viticulture by taking Australia's lead. But now it is perhaps time for Australia to learn something from us – How to use tannin and acid to create wine with structure that will work with food, for example…"

The next major issue inconsistency between the 'friendly carefree' brand positioning created by Tourism Australia and the quality image luxury wine producers seek. Addressing this is as simple as doing as the State governments have done very well and projecting a very different, wine and food quality driven message only this time for the whole country and doing so over a sustained period.

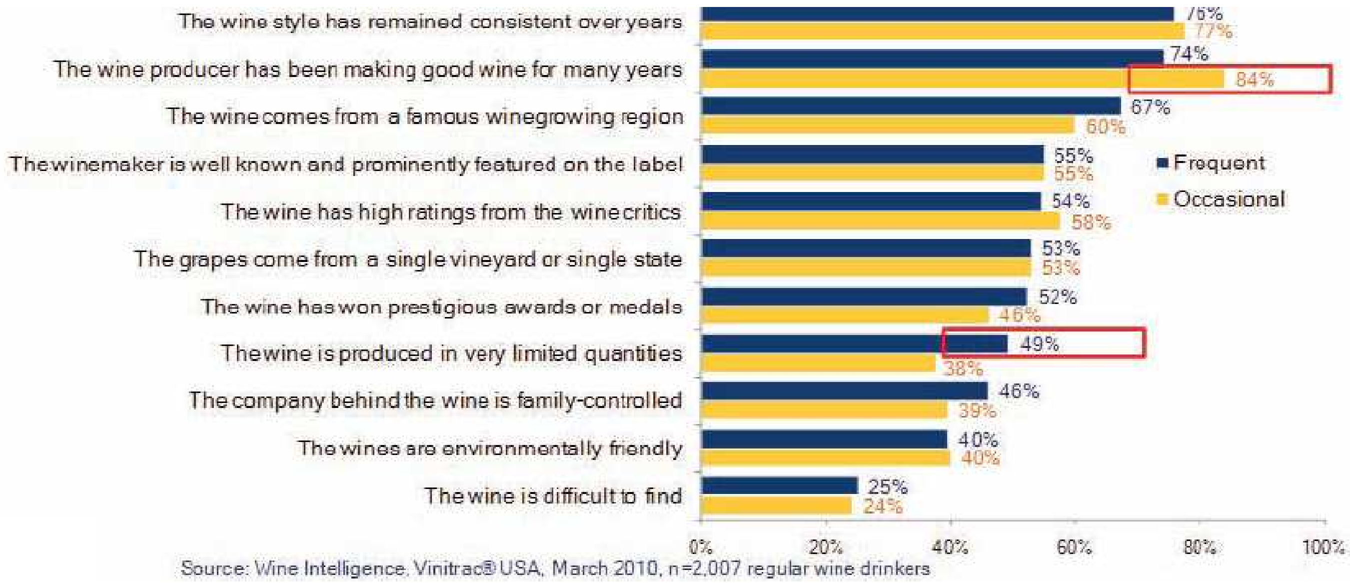
South Africa is in perhaps the best position of the three countries in terms of heritage, the natural 'amphitheatres' the Cape provides and the great number of truly beautiful wine estates. It has another advantage that many in Australia and New Zealand may not be aware of. They simply present better. Because of the very high level of competition, the dependence on wine tourism and the understanding of the critical nature that first time visit (as so often highlighted by Dr Johan Bruwer), the presentation of the properties and the service level is, by and large, outstanding.

The key issues for South Africa are around wine quality and in particular leaf roll virus, something the top estates (Vergelegen, Lourensford and Rust en Vrede for example) are working to eliminate. South Africa also has no Langton's style regular local wine auction although the Nederburg annual auction does attract international attention.

Unlike Australia (strong currency) and New Zealand (high land prices) there is a fundamental disconnect in South Africa between the price structure in the local market resultant of costs and what international consumers will pay. Canada, for example, imports 45 times as much wine sold for $US10 or more than is sold in South Africa. Producing to local market standard can introduce compromises in key areas like packaging that wouldn't be considered if selling at better price points in international markets. Australia and New Zealand occasionally run into the same issue but for slightly different reasons.

Because these countries have historically been more 'egalitarian', anticipating what the luxury buyer wants is actually more challenging for many winemakers. Too often Australasian producers fall into the trap of using their own frame of reference when anticipating what luxury wine drinkers are prepared to pay.

Wine Intelligence has just released a report into what generic factors are most important to the luxury wine buyer. Using data pooled across the UK, US and Switzerland they concluded that so-called regular luxury wine buyers represent just 12 percent of luxury wine consumers; though when it comes to money spent, they purchase 60 percent of all luxury wines. They then compared the triggers for each group and found that the following were the most important factors:



1. Heritage. The question asked but not answered by Wine Intelligence's Loulie Halstead is how can you create that? There are many good examples in South Africa of people who have done just that, companies that are no more than ten years old and yet have "been passionate" since the seventeenth century. Barossa newcomer Langmeil got there instantly by claiming to source from Australia's oldest vineyard. Thorn Clark did a similar thing by talking about their six generations of involvement in the Barossa wine industry which of course is a very different idea to continually running a winemaking operation.

2. Provenance. This is practically no issue for New Zealand, a problem of around 30 regions in Australia that do not make it on to the consumer awareness radar and a massive issue for South Africa. There are solutions, however. And it does not involve talking about an individual property's terroir as, on its own, it can never be a stronger idea than an individual brand. Also, it is practically meaningless to talk about an individual site's varied terroir as few of even the most ardent enthusiasts will want to remember that level of detail unless standing on the property.

Certain regions do have strong differentiating characteristics, however that can be leveraged, such as the high percentage of old bush vines in the Swartland, for example.

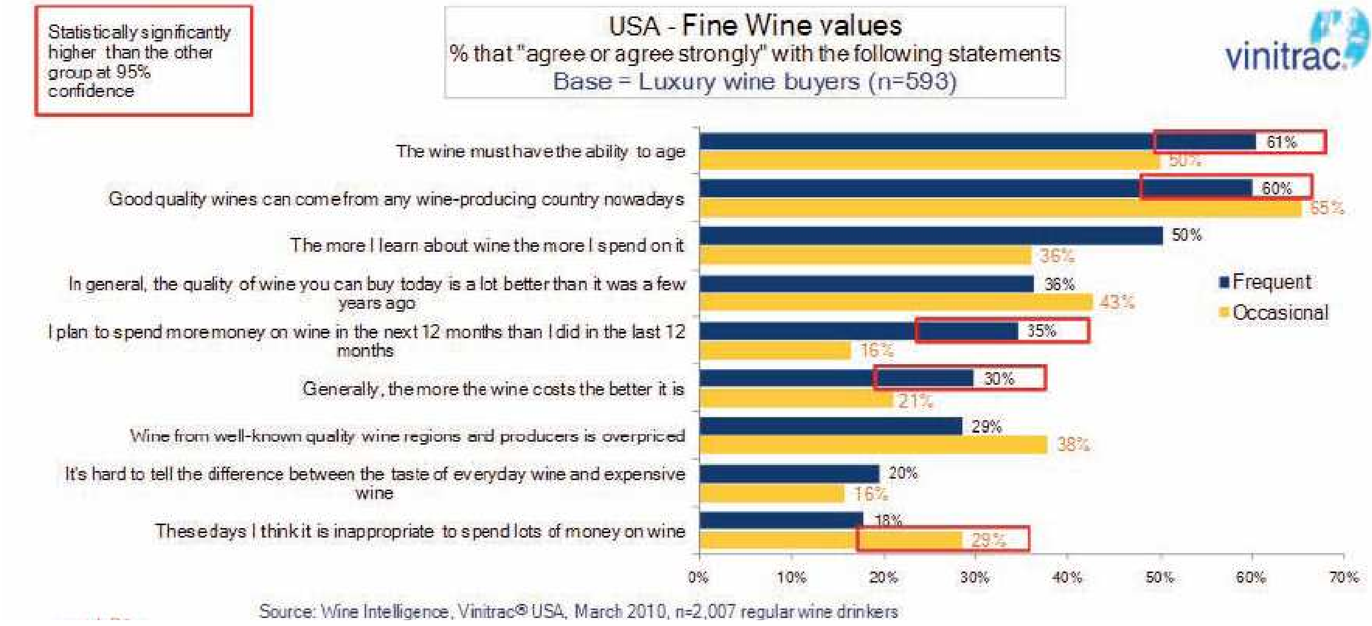
3. Handcrafted. Almost all luxury products from shotguns to high end motor vehicles have a handcrafted story. Practically ever small winery globally makes this claim. This is merely assurance, however, not a brand's individual compelling story. You need more than that to create a brand.

4. Critical Acclaim. You simply can't do it without it. Brands like Shaw and Smith and Dog Point don't need to pay money to enter shows as they top most tastings they are put into. Brands like Mount Mary and Kumeu River possibly have enough franchise and belief amongst regular luxury wine buyers that they could survive never being written about again. Word of mouth alone would carry them. The source and power of the various sorts of critical acclaim are changing. Ultimately, however you do it, winning is all about making great wine, creating the right image and getting the right people to tell each other about it.

5. Family History Again, the question was raised by Wine Intelligence – "if you don't have that, how do you acquire it?" The answer? – Use someone else's family history. Somebody used to own your piece of land. That is not to imply for a second that the authenticity of your story is anything less than critical. The important thing to note is that it is not the fact that the properties are family owned of itself that is important so much as assurance of continuity. I was recently in South Africa and reading a Wine Spectator summary of the hottest brands of 2000. Unlike the European brands that have remained virtually unchanged for decades (Jaboulet, Trimbach, Antinori etc) nearly all of the Australasian brands have since disappeared. (eg Selaks – One of two more brands than Hardys needed out of New Zealand, Lindemans Padthaway – a victim of brand repositioning, Thornbury – a Villa Maria brand that, after acquisition, should probably never have been commercialised again). Yes it is true that you can not have a personal relationship with a factory but this is perhaps more of an issue for the wine Appreciator level person than the hard core Collector / Connoisseur. For them, brand credence flows from consistency however that is achieved. You can not do this using the FMCG model where brand management and strategic direction change as frequently as shampoo bottle packaging.

6. Rarity. Wine Intelligence make the point as WBS has previously that your core luxury wine drinks are split into two groups – Collectors and Drinkers. I class myself as the latter. Rarity typically only adds value for the former.

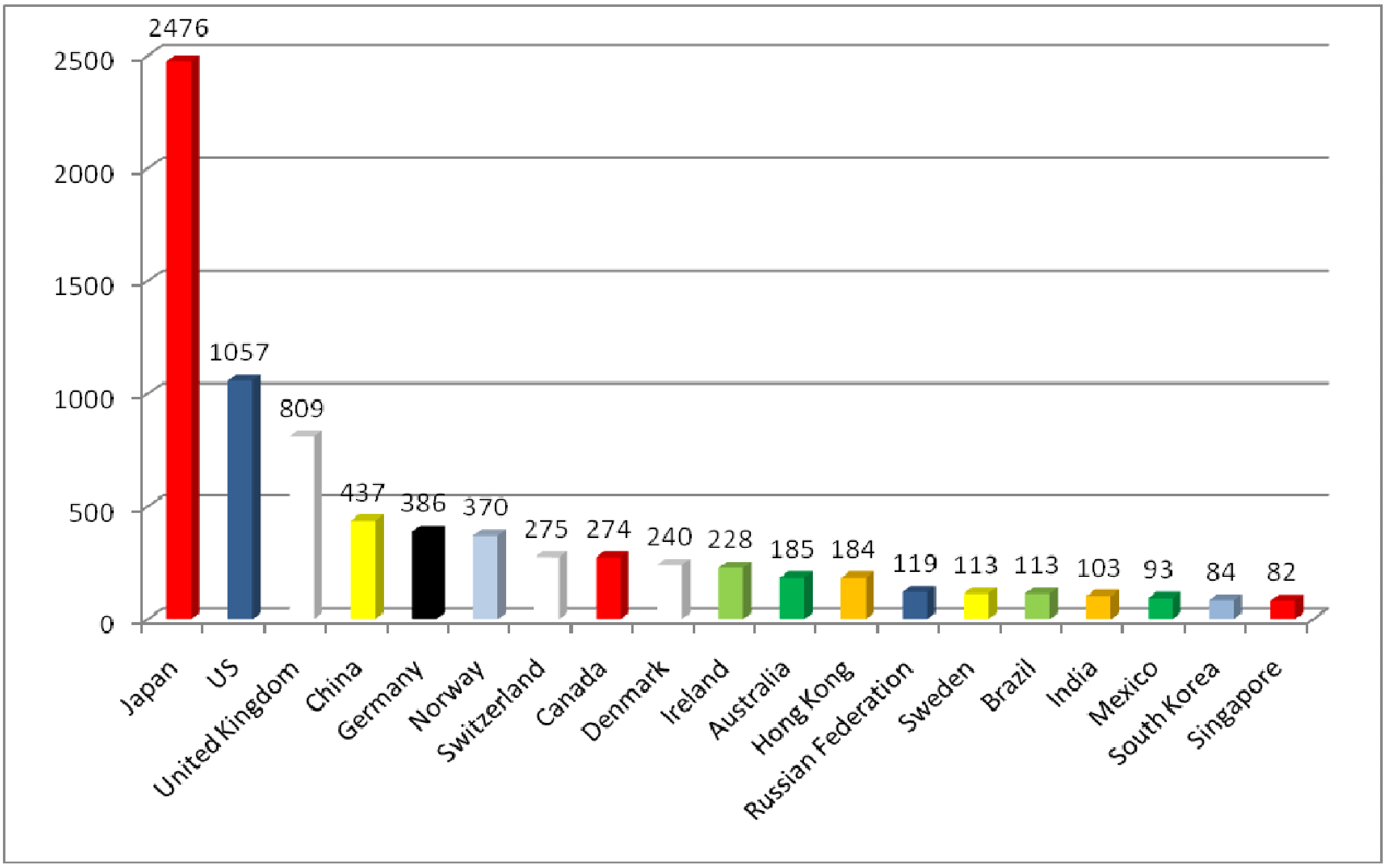
7. Ethical Responsibility Again as we have been saying all along, this falls into the category of assurance and whilst extremely important, is not the fundamental reason to buy for most consumers.



Perhaps the greatest opportunity to build global luxury brands stems from creating strategic alliances with non competing wineries who share the same values. Groups like Louis Vuitton Moet Hennessey achieve this through acquisition. You can do it through simple collaboration.

WBS has an extensive network of clients and contacts operating in this arena. Please just be in touch if you would like to explore further.

As the global economy recovers and people again turn their attention to building their position in the world's best markets, Japan must surely take some precedence for those pursuing profitable wine sales.



000s 9 litre cases of imported wine retailing at more than $US20 per bottle - Source IWSR 2008 data

Notwithstanding high taxes and a many layered distribution system, Japan is by far and a way the world's leading market for luxury wine. The total volume of wine imported in the calendar year to Dec 2009 increased by 7.6% but like a lot of markets, the value of those imports slipped (down 13.2%) reflecting tougher economic times. In line with global trends, growth in the off-premise and sales to inexpensive suburban restaurants were the main reasons for the change.

Key competing country strategy trends during 2009 included the following:

1. France's share of the imported bottled wine market fell below 40 percent (-2.5%) according to the USDA. France dominates higher priced market segments but was hurt by the recession.

2. Import volumes from Spain increased by 39.6 percent in CY 2009 due to an increased number of Spanish restaurants in Japan. This again highlights the critical nature of having a strong link to cuisine, something that Australian and South Africa in particular have struggled to foster.

Interestingly, some see Spain's current fashionability as a risk. Food trends are constantly changing. Positioning country brands for long term growth is perhaps better pursued through linking to more alimental aspects of Japanese wine and food culture in the way that New Zealand and Chile are attempting to do.

3. Imports of Chilean wine increased by 30.8 percent in CY 2009 due to the implementation of the Chile - Japan Free Trade Agreement which will reduce duties on Chilean wine to zero over the next twelve years. Again Australia had been slower than NZ and South America to pursue free trade agreements in the Asia Pacific. Whilst Chile as a supplier of wine is a relatively new idea to Japan, it is strengthened by a positive image as a food supplier through Japanese imports of Chilean seafood, meat and produce. With these advantages, Chile strongly competes in the lower price segments (500 – 1000 yen, $5.60 - $11.23) and has established a presence in Japan's inexpensive izakaya restaurants. New Zealand has also been able to exploit this relationship between fresh produce and perceived purity at higher price points helping establish Marlborough Sauvignon Blanc. Wine journalists in Japan have noted that Chilean wine is perceived to have less oak and less acidity which is favourable to Japanese consumers. Australia, therefore, get easily played off. As in most markets, however, Chilean wine is less competitive in higher price segments.

4. Retailers are seeking to procure wine through more direct channels on an increasing basis in an effort to increase margins. No surprises there. Wine in Japan can pass through as many as six pairs of hands before reaching the final customer.

5. Imports of German wine continued their decline in CY 2009 with a 13.4 percent drop in volume and a 17.6 percent decline in value. This marks an 83 percent decline in imports of German wine from the 1998 peak. The reason most often cited for the decline is a taste that is too sweet for Japanese consumers. Too often I hear winemakers confusing 'sweetness' with 'deftness of touch' which, for me at least, is the defining factor in Japanese cuisine.

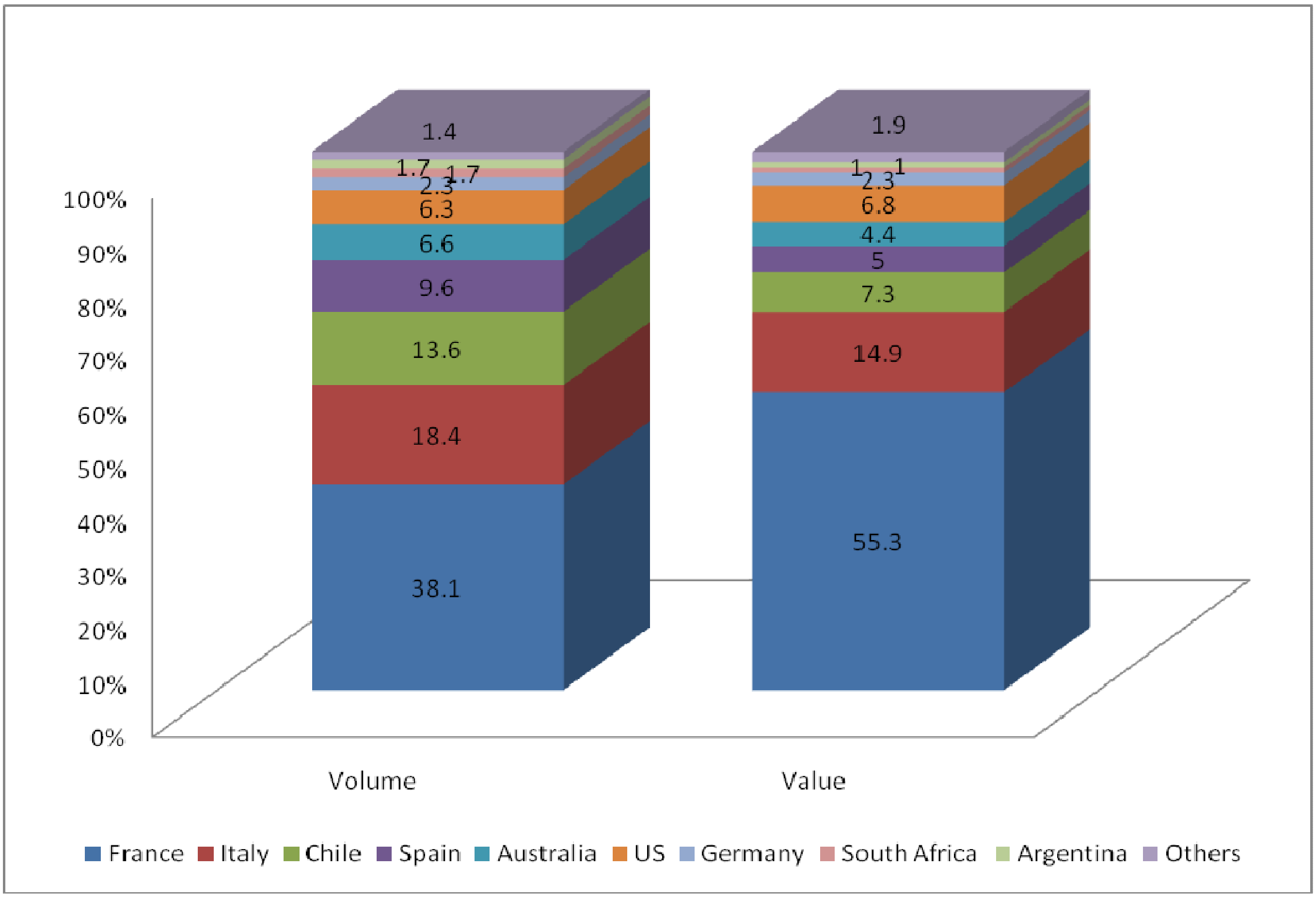
6. Australian imports grew by 14% in the last year but mainly at lower price points reflecting that, as in most markets, marketing activity is lead by the large lower priced brands to the overall detriment of the country brand.

7. While volumes are still small, Japanese imports of South African wine increased nearly 40 percent in CY 2009. Much of the increase is attributed to interest in South African products due to the soccer World Cup.

The wine trade has indicated a belief that growth in inventories of South African wine will lead to a decline in import volumes in the near future. The same thing happened in Australia and New Zealand in 1995 during the Rugby World Cup. South Africa had a unique chance to establish its brand but due to there being zero co-ordinated management of the South African wine offer, what Australasians expected (relying on their memories of South African wine pre sanctions) and what they got were entirely different things. Let's hope for South African's sake, history does not repeat itself.

Sixty per cent – 60% of wine is imported. 60% of wine is sold on the Tokyo region. 60% is sold in the Off-Premise leaving a comparatively large 40% sold in the On-trade. More than 60% of wine consumed is red and at least 60% of drinkers are women.

Organic Wine - Japanese consumers are among the most health conscious in the world and have shown an interest in organic wine. The first organic wine shop opened in Tokyo in 1998 and other outlets selling organic wine have opened since. Approximately three-quarters of imported organic wine is supplied by France with most of the remainder from other European producers. Organic wine is priced at a premium like many organic foods with 750ml bottles starting at 1500 yen ($16.85). It is important to note that often standards need to be met in both importer country and country of origin before approval to export as certified organic can be given.



Source: World Trade Atlas, based on Japan Customs data (CY Jan – Dec 2009)

We recently ran the first of our workshop series for 2010 in Stellenbosch and received rapturous response. It was sell-out with 16 companies registering, which is the maximum we will permit. I was a little concerned initially that we were pushing the limits but the quality of the individual participants meant that the group session yielded some highly valued discussion on the key issues facing the SA industry.

Dana Buys of Vrede en Lust gave an 'impassioned' presentation on the use and value of new technologies for wine business owners. http://www.vnl.co.za *(Note - Dana has a lot of amazing stuff on his site. One thing he did not talk about in his presentation was his photo gallery which is truly something to see as much for the technology as the pictures).*

In discussing those factors which made the critical difference for wine business success, 'positively directed energy and forward momentum' emerged as the most important as they did in a recent Harvard Business Review study. Dana and his team have buckets of that. Interestingly, I was informed that one of the largest SA companies is conducting a comprehensive review on this basis. It is certainly a key factor we monitor in any business strategic review carried out by WBS.

The other big themes of this workshop series are developing an integrated understanding of how wine businesses make money based on your target customer and getting control of the front end of your business. Our Distributor Benchmarking Study - "Winning by a Margin' is now up on line and available for purchase. http://www.winebusinesssolutions.com.au/_catalog_50625/Papers

Our NSW Workshop is also nearly full. This one is a little different as NSW Industry and Investment pay for 10 hours of one on one business mentoring which workshop participants receive free of charge. I think this is an excellent model of service providers and government working together to help businesses. Support for this program came as a direct response by Paul Judge of NSW Industry and Investment to comments I made in Wine Paper 9. We are always happy to hear that people are listening.

If you would like to know about a workshop in your region, please send us an email: peter@winebusinesssolutions.co.au

Click this link to download a brochure showing the program in outline

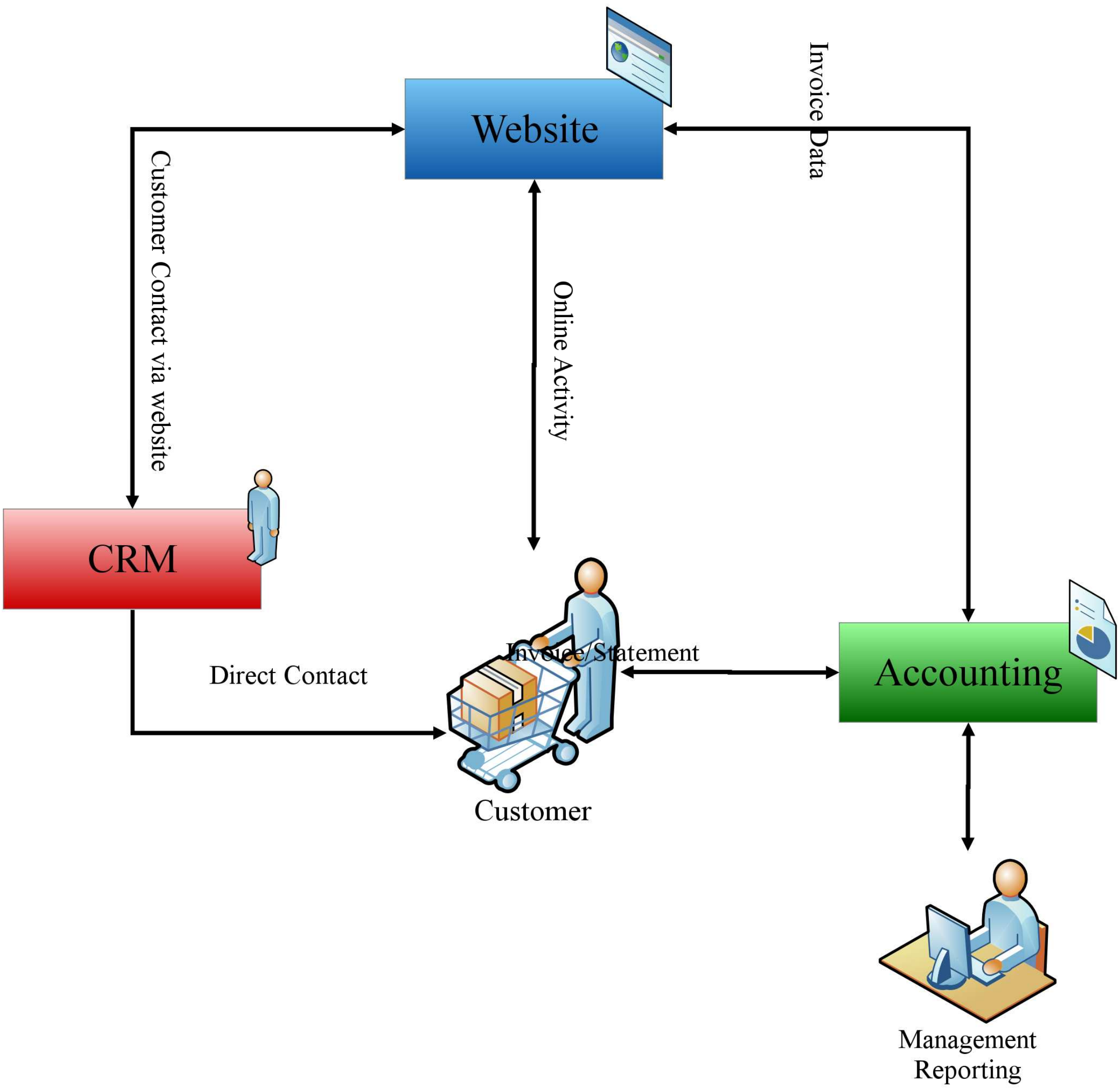
http://www.winebusinesssolutions.com.au/brochures/2010.pdf

All Previous issues of the Wine Paper are now on-line. Just click the link blow.

http://www.winebusinesssolutions.com.au/Resources

On that page, you will also find an article that will appear in the Australian Grape Grower and Winemaker February edition. It highlights the way in which website backend technology has changed to the point where it is now possible at virtually no cost to know who is coming to your site, what they buy, how much they spend, even what search words they used to find you.

You can then use this information to more easily manage communications and build sales. Sounds simple enough but as many of you will know through hard experience, to date, it just hasn't been. Now at last there are some easy to implement, cost effective solutions.



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.