Wine Business Solutions

The Wine Paper 12

Wine Marketing Australasia

Day 1

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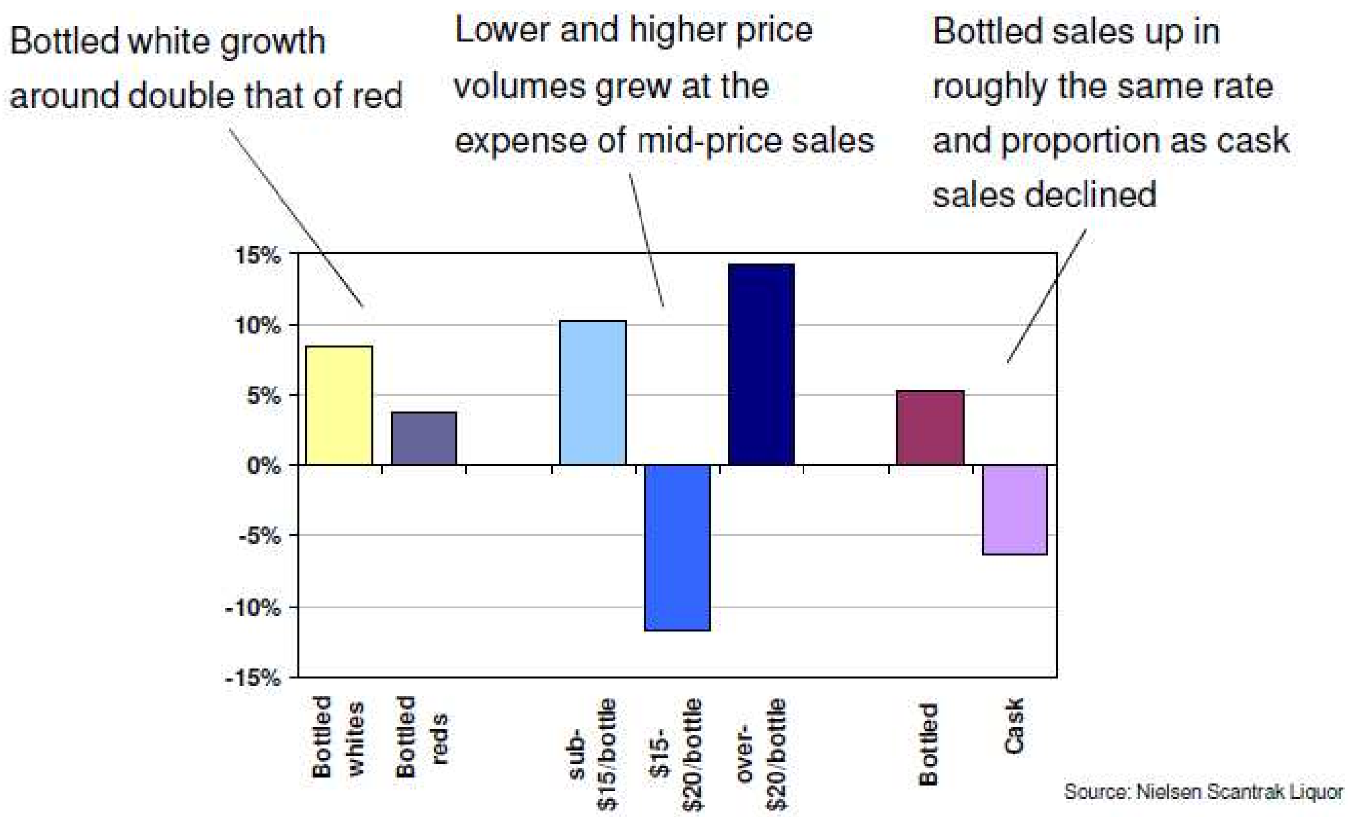
In his inimitable style, Lawrie Stanford kicked of the Wine Marketing Australasia 2010 conference with a reminder that the current crisis facing the Australian wine industry requires a supply solution, not just a demand revolution. It's something I guess we all feel we know but no one crystallises the argument with quite the same clarity as Lawrie does.

Starting out with the domestic scene, consumption of Australian wine by Australians is on the bounce back with a 5% year on year increase between 2008 & 2009, according to Nielsen. Imports actually declined slightly. European wines suffered as a consequence of the global recession. New Zealand, conversely, managed to increase its share of imports to 69% and grow its overall market, albeit at lower price points. WBS's 'Wine On-Premise' research shows us that 21% of all wine listings are now imported meaning that those distributors and restaurant owners who moved heavily into European wine in 2008 must now be sitting on a lot of stock.

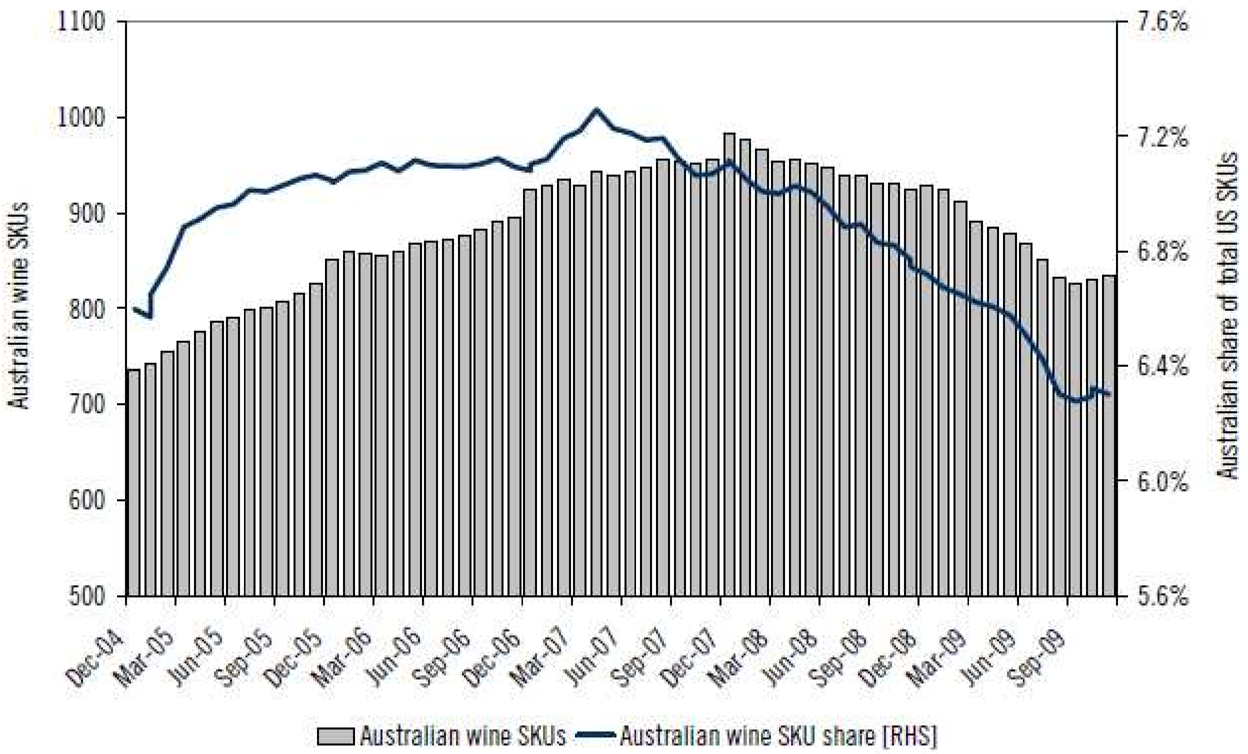
Another interesting phenomenon during the last year is that whilst New Zealand has led sales growth below $15, the over $20 segment is also growing strongly. Cindi Dean of Red and White backs this up stating that their high end wine brands (e.g. Dog Point, Catalina Sounds, Shaw and Smith) have been relatively easy to sell. Clearly those in the worst possible place are those that have been slotted into $16.99 / $17.99 price positions by retailers, especially those reliant on selling red wine at these prices.



The export picture is getting harder to read from a "shipments out" perspective. After adjusting for bulk wine now being bottled in market, it is estimated that total bottled wine export sales are up about 1%.

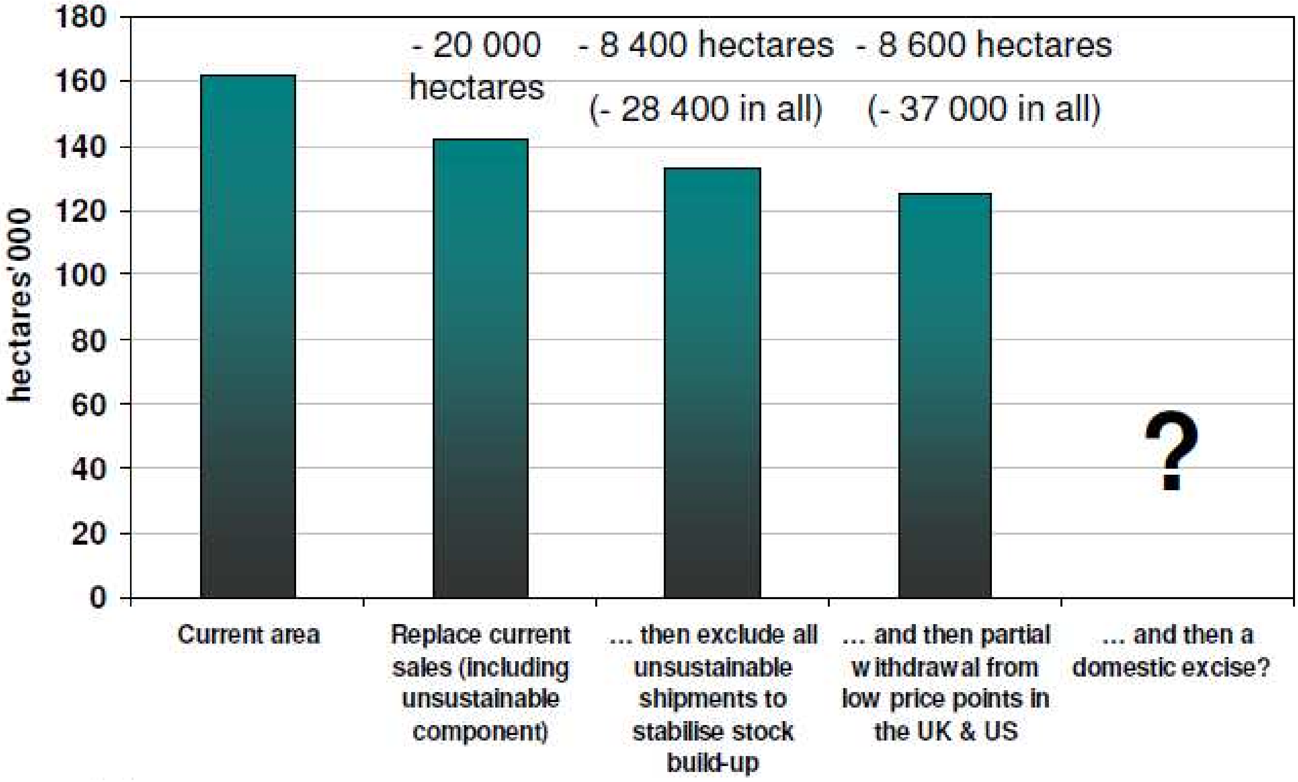
Then there is the effect of poor wholesaler confidence on inventory levels. One Sales and Marketing Director of a top 30 Australian wine company told me that he estimated that distributors managing down inventory has knocked out one month's worth of sales. Whilst it can be argued that inventory will be rebuilt when the economy recovers, it remains a question of when. For this reason, we strongly advise looking at depletions out of store as the main guide to performance rather than getting sidetracked by bottled wine export figures and Gomberg style shipments ex wholesaler data. Both are important but can be misleading if viewed in isolation. According to the latest Nielsen figures out of the US to end of May 2010, Australian, French and South African wine sales were all down around 7% year on year which is about what you might expect given the weakness of the $US relative to each of those currencies.

Whilst there may be a bigger tale of woe for those trying to get into the US market at the moment, those with established brands that I talk to are still doing quite nicely. Of greatest concern to Australians should be the rapidly dropping number of SKUs as a result of the striking out of unsupported brands. Market and marketing support has dropped off at a much greater rate than sales. Shelf facing are one of the best lead indicators of category health. Perhaps the most telling moment of the conference was when I asked an Australian producer about export. He threw his hands up in despair and the South African standing next to him couldn't help but burst out laughing. It's hard but not that hard…



Source – Citigroup Investments

As to the extent of the oversupply - how much adjustment is enough?

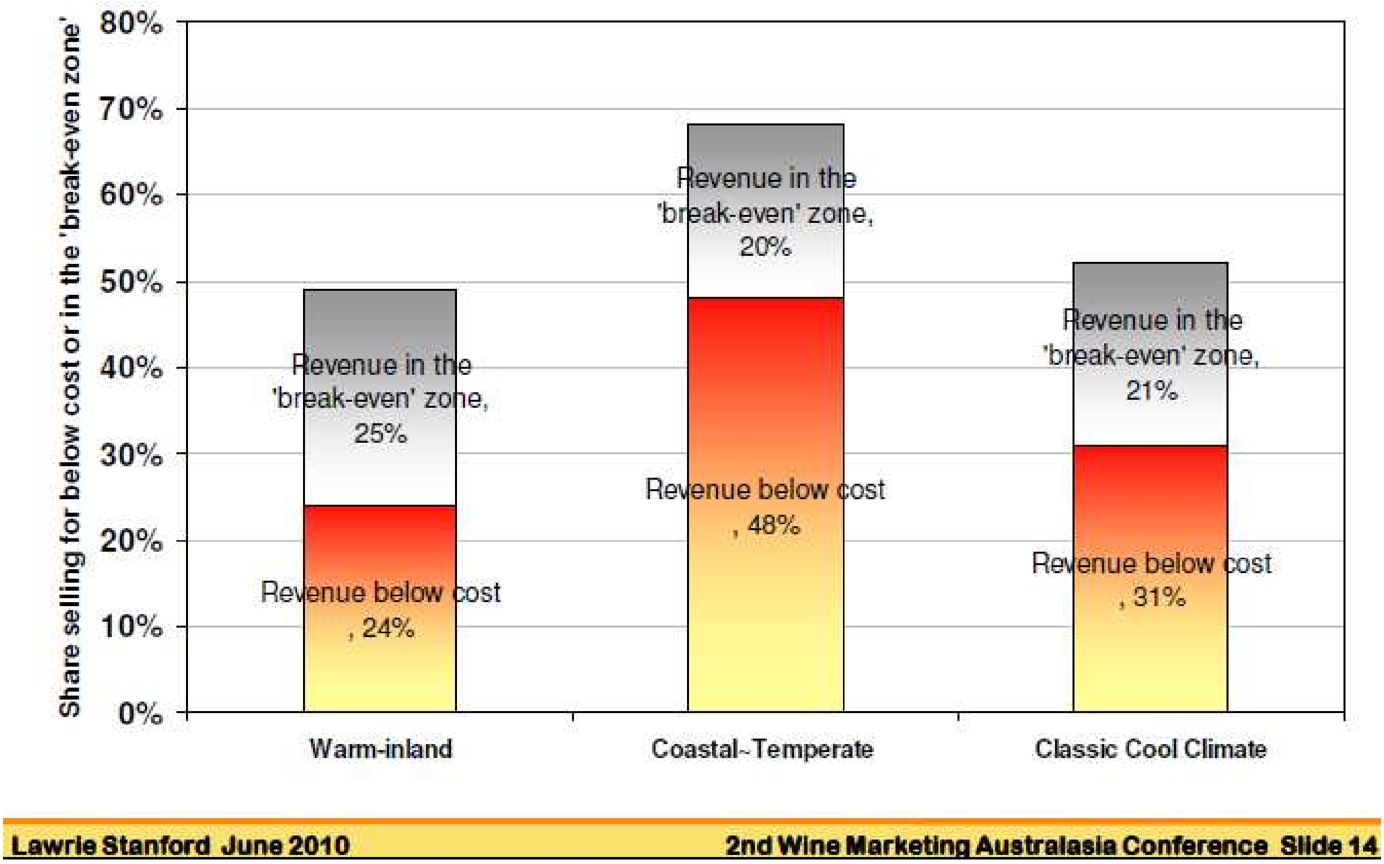


According to Lawrie at least 37,000 hectares and;

- The estimate of 8000 to 12000 hectares of removal/abandonment is anecdotal (principally Warm Inland)
- Tonnes per hectare in 2010 were down – best guess, by 6 to 9%.
- Implies that vines removed or abandoned are 4000 to 9000 hectares (less than the anecdotal evidence).
- Production potential that was not cropped in 2010 may still be out there.
- There is more to understand about vines taken out of production.
- There doesn't seem to be enough gone yet.

There are two or three gears to this, of course. Large companies know where their unprofitable vineyards are and are, by and large, dealing with them. Growers in warm areas who are highly price sensitive and who may have been hit by drought or increased cost of water allocation have also been early casualties.

The big change has yet to take place in notionally cooler climate areas. I hear a lot of official denial by spokespeople in these regions but private recognition that oversupply and the need for adjustment are very real.



How do we make that happen? Lawrie's view is that:

- The government is not responsible for saving industries; industry organisations are not responsible for saving wineries.
- The role of industry organisations is to create favourable operating environments for winemakers and grapegrowers – policy, platforms, foundations, services and R&D.
- Wine industry organisations will support viable, business savvy winemakers and grapegrowers and not unviable ones.
- It is the responsibility of every winemaker and grapegrower to plan for viability.

That should have engendered, I would have thought, some lively debate during the panel session. Alas it did not and it seems that most are resigned to it being a slow and lonely demise of many small winemakers. As we will see later, the European government has a very different approach. From my observation of hundreds of small wine businesses in Australia and their growing raft of international competitors, the key question has to be "can we produce outstanding fruit / wine from our existing assets". If the answer to this question is "no" then these businesses need to shift their focus to other ways to generate a profit such as wine and food tourism, something that is still relatively underdeveloped in Australia. If the answer is "yes" then there is still room for more truly world class wine.

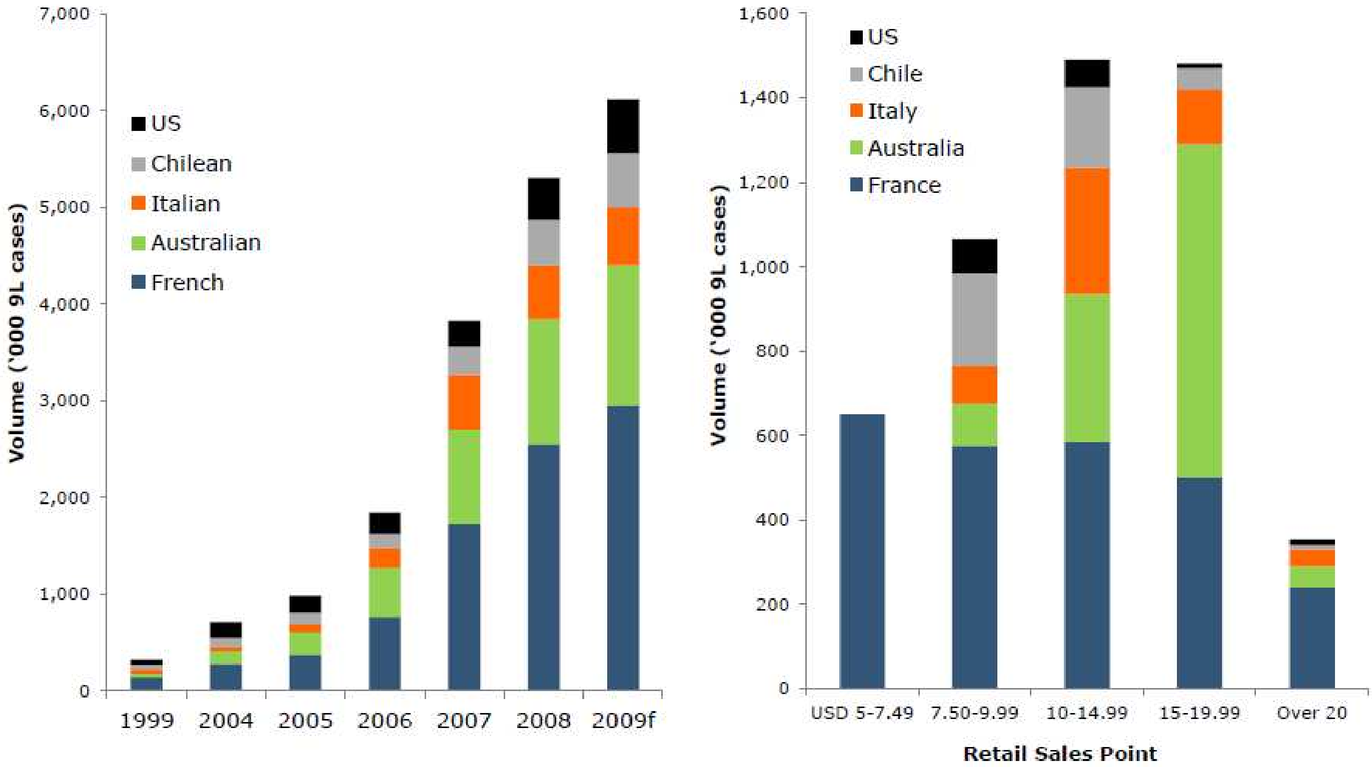
Marc Soccio of Rabobank then gave us an overview of the global challenges winemakers face. Some key points from his presentation included Australia's development of "Dutch Disease", the EU's program to deal with its over supply and Australia's position in the Chinese market.

"Dutch Disease" was the nickname given to the effect on the Dutch economy after the discovery of oil in the North Sea by Royal Dutch Shell. The demand for oil inflated the value of the Guilder leading to unfavourable exchange rates for exporters. Local businesses found it hard to compete against imports and demand for labour in the resource sector sent the cost labour skyrocketing. Sound familiar? The Labour government's inability to sell a solution to the two speed economy hasn't changed the need for one.

Marc answers the question – "Will the GFC force substantial change in Europe?" - in the following way:

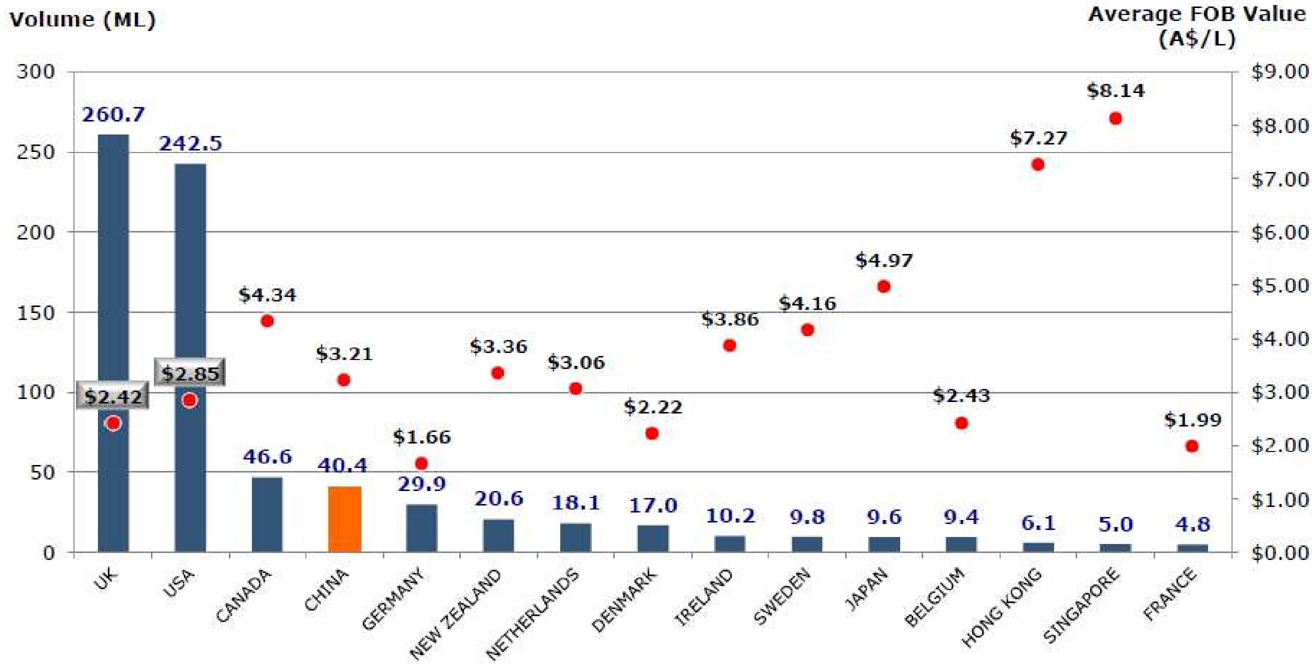
- The EU has budgeted €5.3 billion to support the wine industry between 2009-2013
- All of Europe's major producing countries are under fiscal stress and cannot afford to continually finance agricultural surpluses
- €1.8 billion has been budgeted to grub up 175,000ha of vineyards (5% of total). 128,000ha are forecast to have been removed by end 2010, led by Spain
- Distillation subsidies are set to expire on 31 July 2012
- Alternative measures include Capital investment in enterprise efficiency of €550 million and Market promotion at €800 million
- When the EU-12 NMS are included, the EU forecasts oversupply to still be present in 2015, the equivalent of almost half their current 16 million HL export trade.

On a brighter note, Australia does seem to be doing a few things right in China.



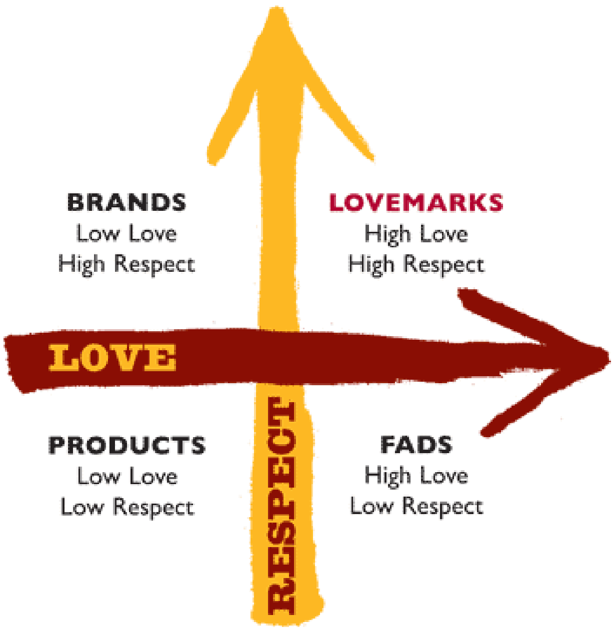
Source IWSR

Australia is currently the strongest player in the $US15-20 price category and barely features at the lower end. Clearly this is the profile that Australia would like to / should have in all markets. The Ultra-Premium category is still there for the taking but France is doing much to ensure long term dominance of this territory. Australia remains under-represented at key trade fairs in Hong Kong and Shanghai.

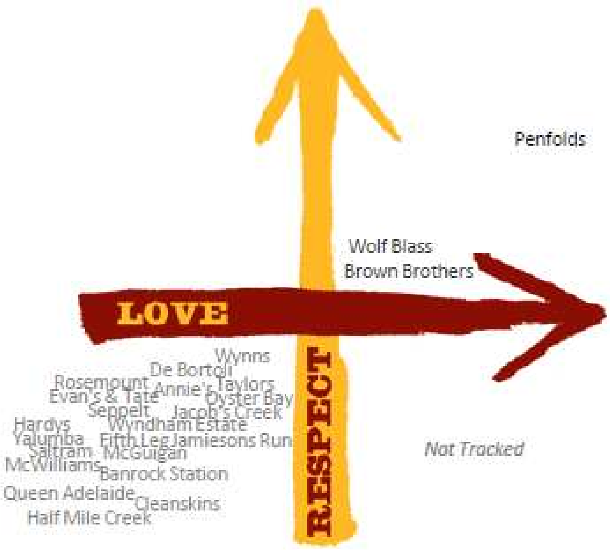


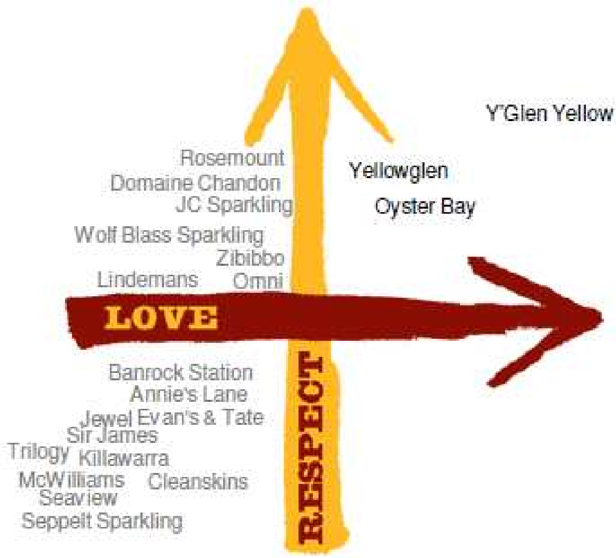
Source AWBC wine facts

Fosters' Marketing Director, Simon Marton, then asked the question – "Can Lovemarks exist in the wine category?", Lovemarks being brands that inspire loyalty beyond reason.



Simon suggested that in a market that has thousands of alternatives, that is oversupplied globally and constantly on sale, developing such a following is extremely difficult. A few do exist, however...

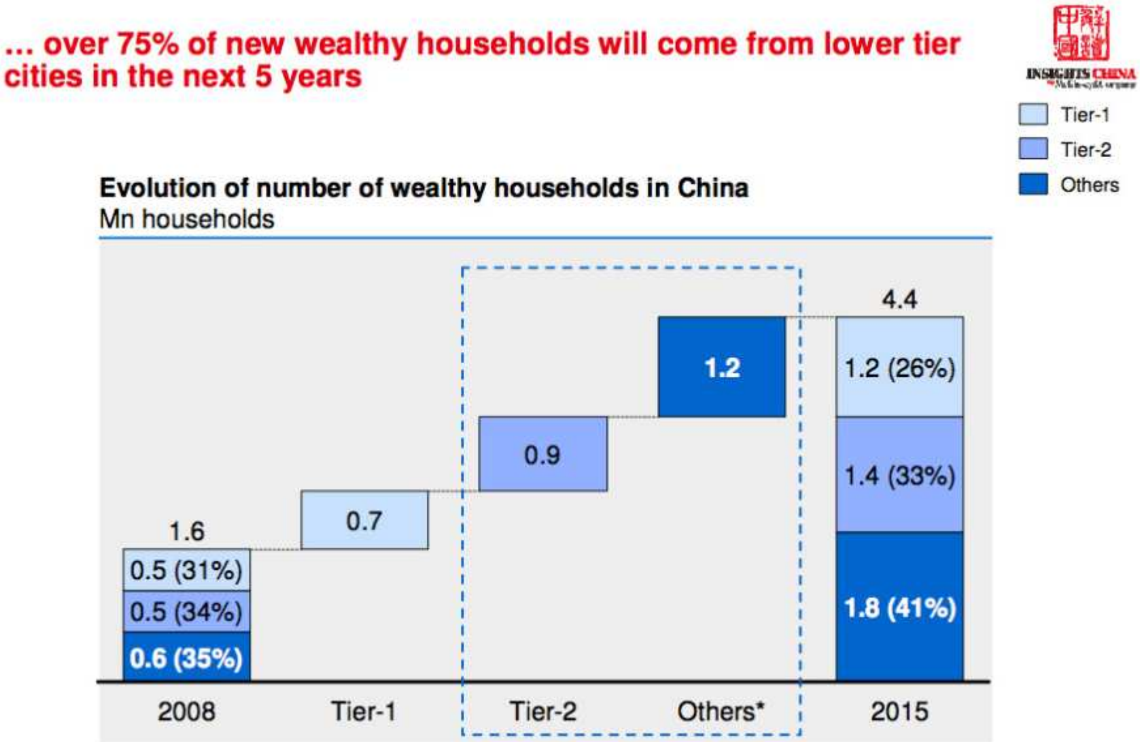




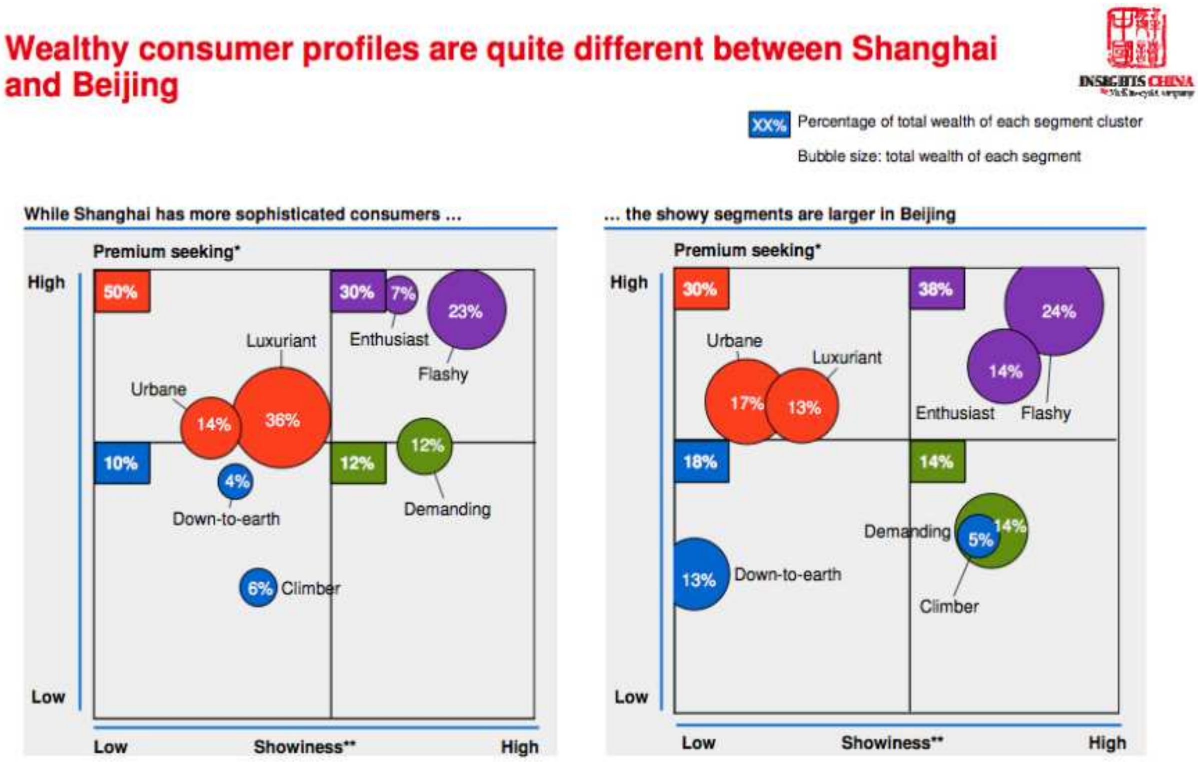
Source – Fosters Roy Morgon Tracker - High Involved Males *- Low/Med Involved females*

The big question is, how do I get there? Simon's message is pretty much identical to that which I presented in the last Wine Marketing conference. Position your brand as the most likely source of the experience desired by your target audience. For sparkling wine, the experience anticipated is an exciting one where romance might perhaps feature. "Sex in the City" becomes a very obvious sponsorship opportunity as does Spring Carnival. No surprise that Yellowglen is a major sponsor in both cases.

George Zaal of Longfellows Wine Exports then gave us a presentation on the Chinese market which contained a couple of interesting insights. Whilst "tier one" cities would be most exporters' first port of call, most of the growth in newly wealthy households will take place in tier 2 and tier 3 cities during the coming 5 years.



Note - 1st tier: Key cities - Shanghai, Beijing, Guangzhou and Chengdu. 2nd tier: Secondary provincial capitals (consisting of 23 cities).3rd tier: Prefecture or county level city capitals



This was the topic of my presentation and is the theme of our workshop series this year. So far, over 40 wine business owners and senior mangers have attended workshops in Stellenbosch and Sydney. South Aus. workshops will run in July. https://winebusinesssolutions.worldsecuresystems.com/Workshops.htm Feedback has been the best for any program we have run to date. The mentoring component that forms part of the NSW Industry and Investment backed Stepping Up program allows us to work hand in hand with 16 wine businesses, which is both humbling and highly instructive.

The presentation and the workshop highlight the critical difference between the key consumer groups and how to realign your business model so as to better deliver your value proposition to your chosen audience. I talked through the practical skills necessary for achieving breakthrough performance dependant upon which market you are looking to address. In terms of the oversupply situation, messages were incorporated in the presentation as follows:

All mature wine nations produce basic grade wine, branded wine, wine for Aspirational wine consumers as well as wine for wine lovers and connoisseurs. A great "country brand offer" includes all of these levels. Italy and France do this exceptionally well. Muddling the segments, argue one segment against another, portraying wines as two dimensional (big bad company wines verses good little family wine) or worst of all - one segment blaming their failure on someone else's success, makes us look…well…not so smart. What can we do to improve Australia's offer and save our business?

1. Know where your 'centre of gravity' is. That is, which segment will provide your business with its growth engine? Where do you have genuine strategic competitive advantage? Your sales volume by price category relative to your production should provide a guide. It may not be what you are best known for by the wine literate (e.g. Brown Brothers use the goodwill generated by a lot of product innovation and show success as the 'halo effect' over an ocean of Crouchen Riesling). Too many businesses have too many layers to their offer relative to their size which both makes them less understandable to consumers and impedes the business's understanding of what it should be focusing on. Generally this is production driven but now, if each layer is not world class with a clearly defined reason for being, someone who specialises in selling to that audience will shut you out.

2. For companies targeting wine appreciators as their core market, the single most important activity is talking to people. New Media provides an important conduit but it is not the primary source of information used by established drinkers…yet…. Watch this space…

For them and the people that sell to them, there is no substitute for market visitation and nothing that is more cost effective in terms of promotion than talking to people in your vineyard. Whilst exchange rates might have taken the gloss of exports, airfares and accommodation are cheaper in real dollar terms than they were in 1992.

3. Large wine companies perhaps need to re-evaluate their decision to withdraw from regions as it is the strength of regional brands that determines the saleability of branded wine product. Where would the French be in supermarkets globally without the image that Champagne and First Growth Bordeaux create for them? Certainly Pernod Ricard sees all of their growth opportunity at $US10-20 per bottle and that simply won't happen without underpinning by regional brands.

4. Medium sized companies and larger family owned ones simply need to get better at understanding and marketing to the Aspirational wine drinker. The weakness of $15-20 part of the Australian offer is both the main reason for Australia's flagging fortunes in the US / UK and why the door was left open for New Zealand in Australia. The branding, packaging and promotion of brands by many of these companies had been tolerated by Australians who grew up with them but makes no sense at all to people in far off lands. This remains the biggest opportunity for Australian companies to develop large, profitable businesses in Asia and North America. The offer needs to be engineered backwards from the market if it is to succeed. The owners of these businesses need to understand what the urbane, sophisticated, educated person (woman mainly in most markets) is looking for.

5. If small producers are to survive and thrive then identifying the very best tracts of land, producing vastly better wine in much smaller quantities and selling for two or three times current prices is one strategy that can work. Making some wine of average to good quality from whatever you have planted in your paddock and selling it at the same price as your neighbour is no longer the recipe but the road to ruination in most cases.

6. More people need to work together as the Australian First Families of Wine have to raise awareness and access funding. Like-minded companies looking to target the Aspirational wine consumer with innovative products have a big opportunity here. Regional "Quality Marks" need to be developed no matter how politically challenging that may be. The Government needs to be pushed harder on free trade agreements. New Zealand and South America run rings around us there. Above all else, we need to harden up, pick ourselves up and get back to having a go. It is not all parochial to say that there are more good wines produced in Australia than anywhere else. If Australia has been parochial, it is in not seeing and acting upon what needs to change. The market has now forced that upon us. There will never be better time to access cheap assets and act upon opportunity.

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

(From Wine Business Solutions article published in Wine Business Magazine)

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.