Wine Business Solutions

The Wine Paper 42

October 2016

Refreshing your Wine Business

What if you really could start with a blank sheet of paper today? What should your wine business look like?

I can't remember when the last time was that a client said to me that they wanted to plant a vineyard or build a winery. Each year, the people looking to start are fewer and the businesses are getting smaller.

There are two parts to this. Winemakers now realise that even just a few hundred cases sold direct at the right prices, when not owning any assets, is a perfectly decent business model. Secondly, if you go to the bank and ask for an agri-business loan, you may be asked for as much as a 50% deposit in some countries.

Let's suppose you could start from scratch and had the financial backing to build a serious wine business with $10-20 Million turnover, what are the most critical things to focus on?

I've just been through the most intensive training exercise in our history. 115 West Australian wine business owners and senior managers attended six two-day workshops funded by the Federal Government. (Note - we hope to role this out across the rest of Australia early in the new year. We've also got workshops coming up in South Africa at the Business of Wine Tourism Conference and in New Zealand in November).

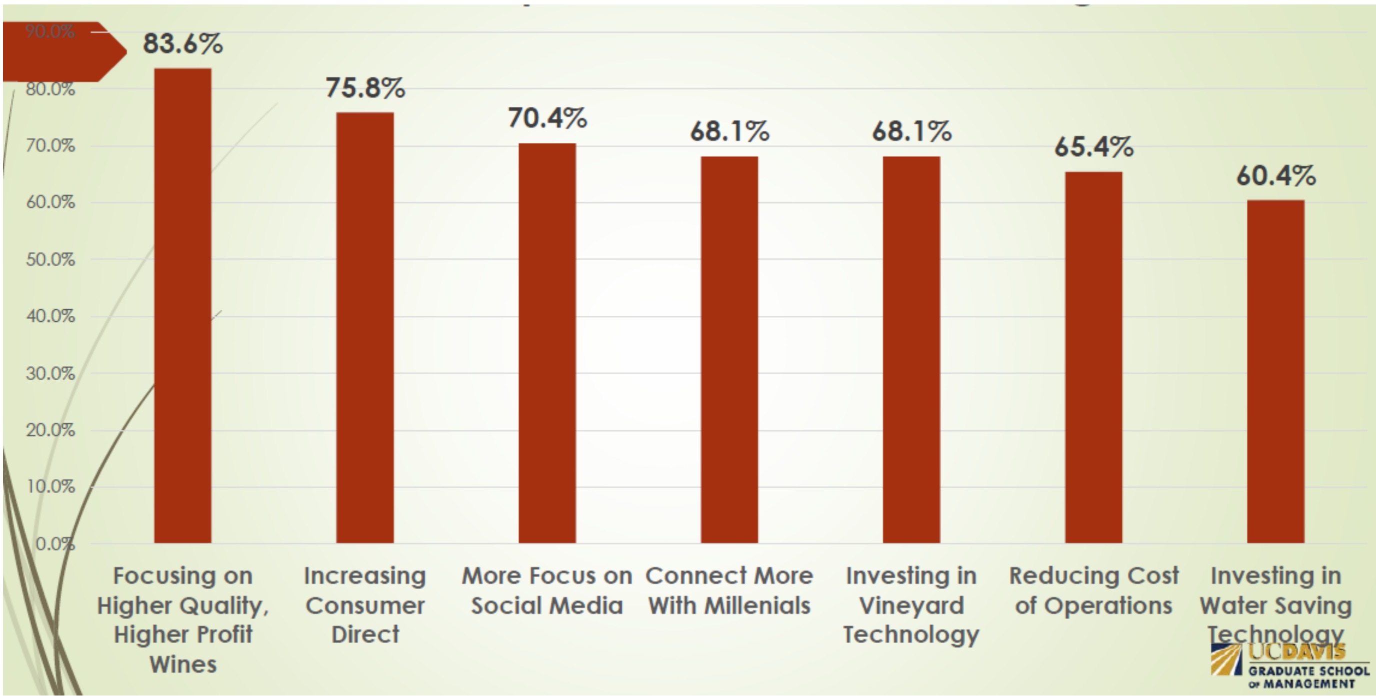
That sort of interaction, with every type of wine business, really focuses the mind. The likely winners clearly stand out. The difference, largely, is those who will, versus most who won't, embrace change. So what are the essential ingredients of a wine business that is likely to be able to thrive going forward?

1. Quality. It has always been the most important thing but never more so than now. Consumers have gotten a lot more demanding, are much more sophisticated, feel ever more empowered and are not afraid to share what they think. They will punish brands that don't deliver.

   An article in the September edition of the Harvard Business Review entitled 'Elements of Value' looked at 30 different 'buttons' marketers could push to sell their goods and services. 'Quality' came out first every single time across 10 highly diverse business sectors.

   I still get asked by clients – "should we invest more in marketing or in the vineyard?" As a marketer, I say "in the vineyard" every time…

   As per the chart on the following page, a recent poll of wine industry CEO's conducted by UC Davis as to their intentions where their next year's business plans were concerned, found the same thing.



What absolutely stagers me is the number of wine businesses I deal with (and this includes entire regions) who have no plan to get to the $45, the $65 and the $100 plus wine. One of those, even in very limited quantities, will generally fix most small businesses. If you haven't got the fruit source to get there, it's well and truly time to think about how you can acquire it.

2. <u>Location, location, location</u>

This one is perhaps not so obvious but equally as important. Even though the market is more capable of understanding complex stories and is actively seeking out more diverse sources of wine, paradoxically it has never been more important to be part of a strong region. With the switch to Direct sales, those regions that have both a strong regional brand reputation and good access to a large population really do have all of the advantages.

Wine tourism partnerships are becoming critical. To be relentlessly bombarded with advertisements for South Australia whilst in West Australia recently was hard for me to watch, let alone the underfunded, under resourced local winemakers. The money is there. To access it, regions need to act as one presenting a clear strategic vision of how their wine, food and hospitality 'tourism offer' will win.

The promise originally was that with technology, you could run a direct business from anywhere. The reality is that unless you have some neat way to get yourself in front of a lot of consumers and tell your story, "*it aint gonna happen*". So if you're sitting on the edge of a regional brand powerhouse, it's time to move closer. If your cellar door leaves you feeling lonely, it's time to think about a more urban version thereof. If you don't have a cellar door, it's time to take your show on the road.

3. <u>Brand Home</u>

Build a stunning one. You've only to visit craft breweries or cideries to realise how hopelessly wrong the wine industry has gotten it. It's fascinating to talk to the owners of such businesses who inherit wine 'cellar doors' and who want to relinquish them because they give such a poor return of capital invested.

How is it that we can't make visiting a winery more fun than beer and fish and chips? We have everything that anyone wants who likes good wine and food and who wants to be seen as sophisticated – why aren't we giving it to them?

Clients like Vasse Felix, Cullen, Hentley Farm, Giant Steps, Crittenden etc. who have taken this step have achieved outstanding results. Why do others stand and watch?

Great brands from Freixenet to Ornellaia know that taking people to your home and entertaining them in a way that they will never forget is the most cost effective way to build a brand.

Visionaries like Domaine Gayda in the Languedoc know that this can all be taken to another level via the 'residence' where guests become fully immersed in wine schools, cooking classes, vineyard tours etc. It doesn't require huge investment. It just needs people to think about how to create an unforgettable experience that is from the heart.

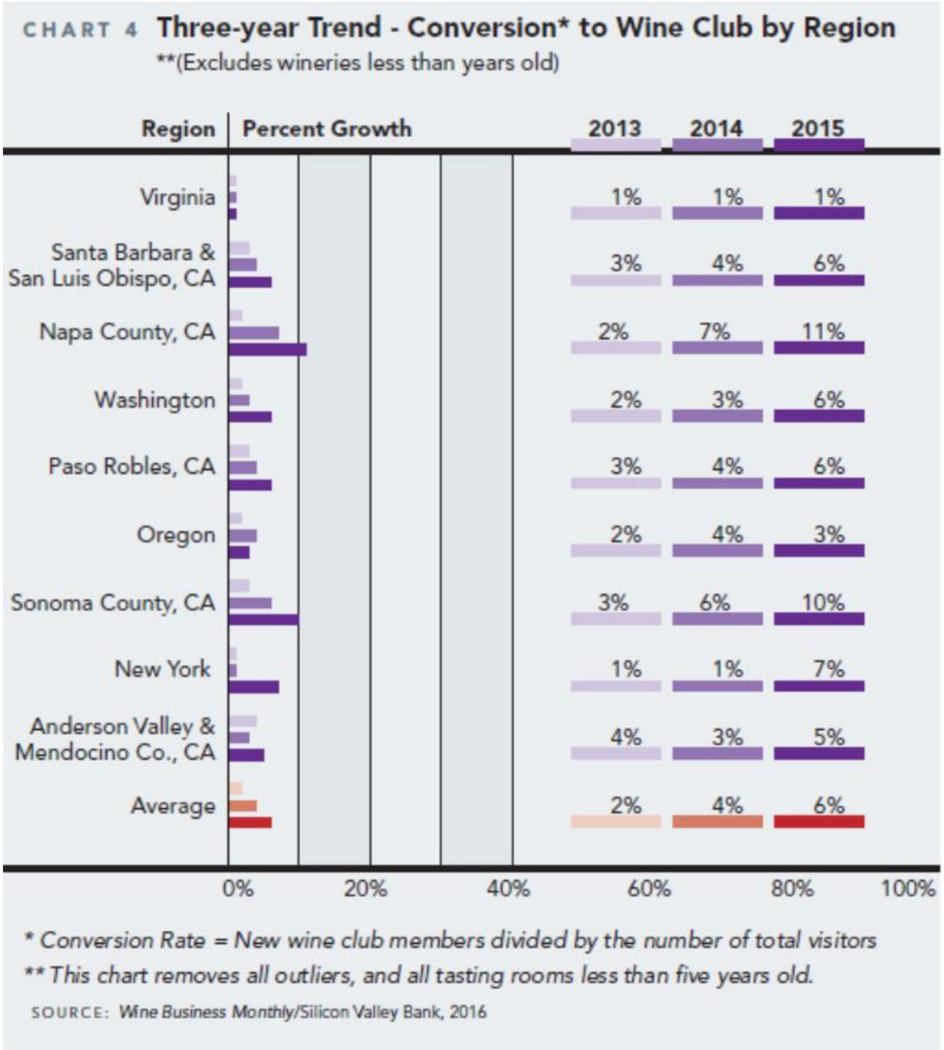
4. <u>Selling</u>

Perhaps most troubling of all were the many people that attended this workshop series who complained how tough things are but when asked did they plan to have a Wine Club or do other easy to implement things like seated structured tastings to lift their sales, said "no".

This is the biggest area of potential upside for Southern Hemisphere wineries (the Americans have this well and truly nailed).

To give you an idea of just what is being left on the table, have a look at what is happening to club sign up rates in the US as per the chart on the following page. Most Southern Hemisphere wineries are yet to get out of first gear with actively selling and making a wine club work.

It shouldn't be surprising therefore that my sales training associate, Gerald Feickert, has been able do double cellar door sales fairly readily for most businesses he has worked with.



5. Branding

I was at a party recently and one of the other guests said to me that they wanted to attend a university program that talked only about 'branding'. He didn't really care for the rest of the sales and marketing 'stuff'. Unfortunately, and rather uncomfortably, I had to give him some bad news.

Branding is a not a component. It is the end product of a process involving all of that 'stuff':

- who will supply my fruit?
- how will it be grown, managed and taken care of?
- what will the characters of the key sites utilised give to the brand?
- who will make the wines and how will this influence the wine's 'personality'?
- what sort of wines will they make using what processes and what enviro. claims can we make?
- what will your finished offer look like?
- what channels will you be looking to sell through?
- in what markets?
- who is your wine for and how will they experience the brand?

All need to be brought into the brand concept and the naming thereof. Great brands capture the essence, the ‘soul’ of all of the above in a truly authentic way. At a time when authenticity has never been more important, getting this right is perhaps the greatest determinant of success. For many small businesses that we deal with, their branding is their biggest impediment. Sometimes, it simply is better to start again but almost no one is brave enough to do that. If Pernod Ricard can successfully change the name of what was New Zealand’s largest wine brand (Montana to Brancott), you probably can too.

6. The Offer

If you are going to build a world class wine brand (and that’s what you’ll need if you’re going to reach a turnover of $10-20 Million) then you are going to have to create an offer that can work well in global distribution.

This is where regional brand strength really comes into its own. There are very few brands that can work without the underpinning of a strong regional brand. Penfolds is in China at the moment. No question there. Gaja, to use an ultra-premium example, is strong enough on its own not to have to rely on the Barolo DO (but it also does). Very few others can.

It then comes down to matching regional brand strength with what your region does best. Our On-Premise research show that, no matter where you are in the world today, trade and consumers are rapidly getting the idea that certain regions are where you go for certain wine styles. No longer can you make any wine style and hope to sell it based solely upon your brand reputation. And this is a very positive thing. It forces everyone to become more focused on getting better at what they do best.

Too many businesses build an offer like it is only they that sell wine to the world. From a production perspective, this makes eminent sense as it presents as a neat way to use up everything that you grow. From a sales perspective, there is always initial excitement as having a ‘complete offer’ means that you, hopefully, never miss a sale. That is, until the Chardonnay, the Merlot, the Riesling etc. are not selling... From a marketing perspective, communicating to different audiences who have different relationships with and expectations of your brand at different price points, it is vastly more challenging.

From, a cost accounting, stock control and inventory management perspective, it can rapidly become a nightmare. Product line proliferation can quickly become the death of medium sized businesses. If you want to build a great business that is sustainable having this type of revenue, it is about focusing on 2-3 core wine ideas maximum, sticking to one brand – ‘avoid tears by avoiding tiers’ - setting your entry price at the right level and using your premium products to leverage that entry price upwards.

7. Pricing

Pricing is the single most important determinant of profitability. The most common consulting assignment we get is helping people out of pricing missteps.

Whilst it is important to have your entry point pitched so that if recession strikes, there is still something people can buy, getting pricing right is a bit like what Wayne Gretzky says about ice hockey – you've got to skate to where the puck is going to.

Understanding what your customer is prepared to pay going forward as opposed to what your neighbours are charging or what has passed for normal, historically, is the life and death of wine businesses. That is where we see our On-Premise research as being most valuable.

Many have been caught out by the change to DtC sales and are still pricing as if for retail. You are never in a better position to add value than when you are talking to a customer. If, like most businesses today, DtC sales are your largest source of profits, then why not let your cellar door pricing lead and then sell what you can through other channels based on that? When you model that out, you'll quickly see how little wine you need to sell to reach profit targets.

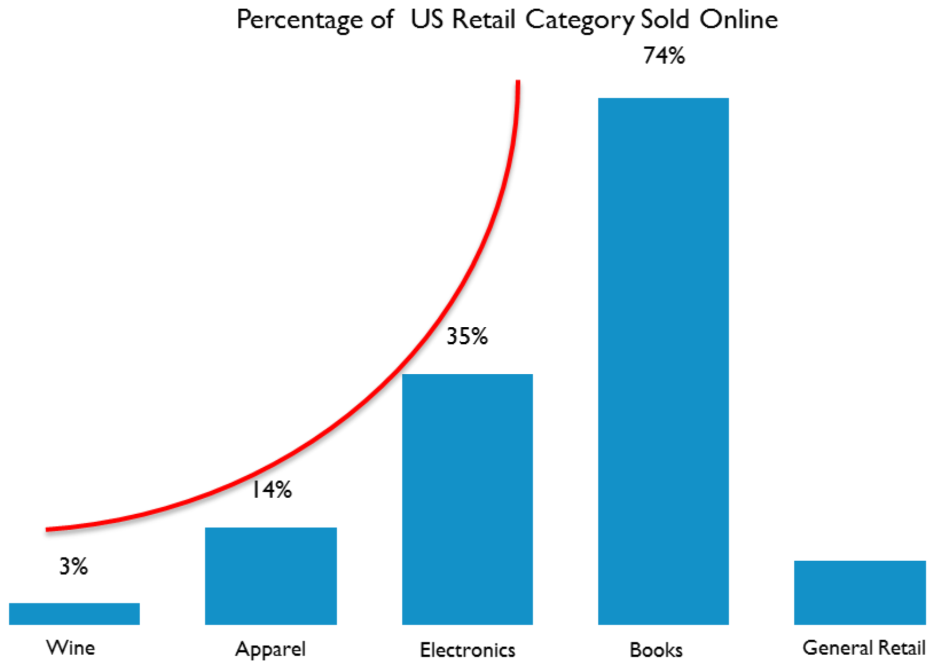
8. Distribution Channels

I was asked recently - will Amazon take over the world of wine? (I think they'd been reading the latest issue of Meininger's). In it, Robert Joseph (Yes) and Felicity Carter (No), face off. They both make very good arguments but if you look at the chart on the following page, you can see that there is a neat half parabola that can be said to represent the inverse relationship between perceived risk and the proportion of online sales for different retail categories.

If you're going to buy a book online, you know the author (probably) and you get the gist of the book from the title (almost certainly). There is very little uncertainty involved and it's not a big outlay either.

When it comes to electronic goods, people will buy online but they also want to see the item demonstrated, they want a live physical comparison of features made with other similar products and they want features explained that they perhaps didn't know existed (or that they wanted).

There is a reason why Apple has the highest sales per square meter of floor space of any retailer on earth…



Source: Wine Institute, SVB Tasting Room Survey, and ShipCompliant

When it comes to clothing, the average number of times a woman will try before buying clothes bought online is now more than 3 in Australia, for example, meaning that that entire sector is unprofitable. It's another good example of some tech. person thinking "wouldn't it be good if" without fully comprehending the commercial ramifications.

If we go to wine, the risk involved is enormous. The mathematical probability that you've tried that wine from that producer from that year is extremely low. You can't see the wine properly, you can't smell it and you definitely can't taste it. Whether you're buying a case of wine or a rare bottle or two online, it's also significant capital purchase. Hence the low uptake in terms of online sales of wine.

People like Naked Wine's Rowan Gormley deliberately mislead the press and the public by claiming to 'disintermediate' wine. That only works for software and other physical products that can be turned into data.

You can't disintermediate a heavy physical product like wine. It still has to be picked, packed, shipped and warehoused. You can cut participants out of the distribution chain and look to save cost that way but shipping one case or less at a time is extremely inefficient and expensive. That is why the entire online wine retail sector in the UK is unprofitable. That, of course, includes Naked Wines operations.

Contrast that with wineries making half of their revenue from DtC sales and at great margins and you have an altogether different business proposition. So how will channels change and evolve going forward?

Certainly 'flash deal' sites like Vinomofo and Wines Till Sold Out help wineries to deal with excess inventory. Early results from our DtC benchmarking show a significant decrease in sales through 3rd part online retailers as inventories tighten. Some of the longer established online resellers are also not on a sure footing as they fail to evolve and their audience ages. They may not all last.

Vivino was one of 600 wine apps cluttering Apple's App Store, but it has prevailed to become the biggest with 17 million registered users and 47 million ratings. Vivino's hope is to evolve into a fully-fledged 'digital marketplace for wine'. Vivino's strategy going forward involves supplying ratings to supermarkets and chain retail, something they hope to be able to exchange for information as to what those retailers have available to buy from their stores. That way, they can create a 'recommendation algorithm' so that if you want to buy a highly rated Shiraz for under $20 at a store close by, it will give you that information.

What is perhaps most interesting about Vivino's approach is that they recognise that selling wine online doesn't work for 95% of sales situations. Most people would rather buy bottles conveniently rather than commit to cases. Vivino also wants to skip taking responsibility, either directly or indirectly, for deliveries, something Amazon via the US Postal Service is struggling with, where wine is concerned.

That hasn't stopped US wineries turning their direct shipments into a $US2.3 Billon business. The issue is, that most of their customers don't really want to buy wine by the case either and are dropping out of wine clubs after just 27 months on average.

So what's the answer? I believe that we are going to see online recommendation platforms driven by a number of players including Vivino, Amazon, Apple etc. where you will simply go to a site / app, see all of the relevant reviews, weigh up the offers, chose who you want to buy from and how you want it delivered. Google is perhaps best positioned of all to provide a better shopping experience than it currently does and, as the first port of call, to grab the lion's share of the online shopping market. There is a significant conflict of interest there, of course, and some major legal hurdles to get over first.

Wineries have a huge opportunity regardless of how all of this plays out. You are the authentic owner of your brand so any search function of any 'market' platform should still give you priority. Your events (cellar door, club, diners, off site events) are increasingly the only way that people will get to experience your brand first hand. Your online shopping experience can be massively more than it is now. Rather than dead shots of bottles – what about the perfect wine and food match played out in video?

Selling direct internationally, especially within the US is going to become a lot more important. South African wineries are well advance with this but Australia and New Zealand have yet to make a real start.

And of course there are some countries in which the traditional paths to market simply don't function meaning that in China, for example, selling on TMall / Alibaba and supplying direct to customer ex a bonded facility effectively supplants the entire wine distribution channel. Those traditional distribution channels will evolve however and we may see them becoming more important in those markets.

9. Communications

As the wine industry becomes clearer about the role of Social Media as part of an integrated communications strategy, we can look forward to everyone using it more effectively.

Social Media works poorly in terms of direct sales conversion. We've all seen that. It works well in terms of creating an online brand image, telling your story and giving people access to an idealised lifestyle particularly through platforms like Instagram.

It perhaps works best of all for driving interest in attending events. I define events to mean any occasion when someone representing your brand can be standing in front of a customer with a glass of wine. This includes cellar door visitation. Wineries with restaurants are having the greatest success in terms of driving social media interaction. You don't need a restaurant, however, to actively participate in the conversation around enjoying wine, food and associated lifestyle and to encourage people to 'events'.

Going forward, it's taking forever to get there but we can expect better integration so that people will be able to use one screen / one portal to see everything they want to more or less instantly. More dynamic representations of your brand, brand home and brand experience are going to be needed in order to maintain people's attention. You don't have to be Einstein to predict a boom in drone video photography. The same three dimensional principals need to applied to visual representations of people enjoying your wine as part of your online sales funnel.

10. Sustainability

Australia, in particular, has been dealing with environmental sustainability for a very long time and has invented a number of the water conservation technologies now being deployed in the US.

The bigger question is business sustainability. That is what we are here to help with.

One great way to help us help you is to participate in our winery Direct to Customer Benchmarking exercise. Simply follow this link.

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

One - Start by understanding your customer value proposition. Only part of this stems from your company's unique heritage and / or personality. To be successful, this needs to be strongly linked to what your customers ultimately want from the experience of your brands. There is some excellent research on this that is publicly available. Getting it right is therefore not out of the reach of small companies.

Two - Once you understand what customers value most, you can then remove what they don't want (thereby reducing costs and freeing up cash), focus your communication on what they do want (often at no additional cost), differentiate your company on the basis of fulfilling customer needs more accurately than any competitor (again, often at no extra cost) and raise prices (because your offering is more highly valued)

Three - Always be asking the question – "If I could start with a blank canvas today – what would our wine business look like?" It's all too easy to let existing assets, existing product lines and existing ways of doing things blind us to what it is that our consumers value most. Often, it's simplicity. Complexity usually adds to costs and often only serves to confuse customers. Retaining unnecessary or irrelevant product lines, assets or business processes is the worst contributor.

Four - Make everyone in the company accountable for securing customer preference. This is not just the job of marketing but of everyone in the company, the owner most particularly. Make this the focus of the way every employee innovates their job processes on a daily basis.

Five - Invest in relationships. This is particularly so with major distribution partners. Make sure sufficient time and money is invested before demanding results. Be prepared to invest up front in bringing them to your home base and entertaining them in order to build enduring friendships.

Six - Make all employees champions for profit. Develop a culture of honesty around net revenue. Make sure everyone knows the actual price achieved net of all discounts, rebates, bonus stock and anything else that might otherwise cloud the true profit picture. Keep them focused on reducing costs but let them know that a percentage increase in wine company revenue is, on average, twice as effective as the same percentage decrease in the cost of goods sold and 3-4 times as effective as the same percentage saving in operating expenses.

Seven - Optimise your pricing mix. Focus first on selling more, higher margin product in high value markets to high value customers. Beware of people in love with "big volume". Big numbers make for big stories but often mean a lot of running around for no additional profit.

Eight - Build better business intelligence gathering systems – most companies are good at monitoring their own press. Very few have effective systems in place to monitor competitors, track changes in consumer preferences and turn customer feedback into customer value added.

Nine - Build 5-10 year Strategic Plans, forecast rolling 12-month budgets, link them to the most relevant KPIs and tie remuneration to these, wherever possible. Everybody knows they should do this. Few do. The difference in the performance of companies that do is enormous.

Ten - Watch your cashflow – building a cashflow forecast is a relatively easy exercise with the right software and some quality assistance. Some people survive years of losses but you can only run out of cash once. In a cash hungry business like wine – Cashflow is not just King but Oxygen.

Wine Business Solutions

Phone +612 9744 8332

info@winebusinesssolutions.com.au

http://winebusinesssolutions.com.au