Wine Business Solutions

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Crunch Time

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From the day two brothers took over the reins of what was once close to Australia's largest wine business, a crash course was set with the earth. Like MH370, the miracle was that it stayed up there for so long.

I am not writing this to heap more pain on a certain family. There are, however, some very important lessons here. The light needs to be shone. I will write, however, in general principle only.

You think you know what your year in front is going to hold. I must admit, however, I wasn't prepared for my phone to be ringing off the hook quite to the extent that it is (I've barely had time to write this paper).

Normally, the new year starts with a big merger or acquisition. That it starts with a very public business collapse has spooked a lot of people. And it should. This really is crunch time for a lot of wine businesses.

And I'm not talking about trade wars, corona virus, global warming, fires, floods and smoke taint. I'm not even going to reference all of the good stuff that Rob McMillan covered so well in his State of the US Wine Industry 2020 report that is wine industry specific.

All of this will put more pressure on struggling wine businesses, but it is, after all, only background noise that solid brands will generally survive.

When I used to run the business turnaround management education program for the TMA of Australia, what struck me most was that all the research and real-world case studies we used pointed to one thing.

Whilst external forces can bring about business failure in extreme cases, it is almost always management. It's the decisions we make. We all make mistakes. Mistakes are humbling and help us learn. Better, I always think, to learn from other people's.

I'll never forget the sales director of one of Australia's largest wine company's response when I asked him, as Chairman of Wine Marlborough, to come and speak to local producers – "No, bugger them". he said. "They can make all the same mistakes and learn the hard way like we did."

This had a profound effect on me. I've always been a big believer in being generous with time and experience.

I'm pretty sure that I have a handle on how a lot of bad decisions get made and would like to share thoughts on how to avoid them.

When you're a kid, you can't grow up fast enough. You're taught to believe that when you're 21, you'll have finished. When talking to an 85-year-old priest recently (not in confession, I hasten to add), in reflecting upon life, his key observation was that, in his long experience, "there are very few grownups".

I was listening to my favourite radio station the other day – Triple J. (For those of you outside Australia, Triple J is unique in the world, as far as I am aware, in that it is a fully government funded, 'youth' radio network and I guess that in owning up to that, I fail the grownup test myself…)

They were interviewing the cast of a new comedy. It follows the central character as he makes decisions 'like a 28-year-old'. In other words, if you only play what is in front of you, if you react to every change in what is around you, if you haven't learnt yet that 'the sun also rises', then a whole lot of 'good decisions, at the time', will surely add up to one very bad one.

This is what research, intuition and observation say about people who are under stress when their business is in trouble. They so often find themselves grasping at whatever looks like it's going to bring about the most immediate cashflow solution. In making a series of those decisions they only hasten their own demise.

As we've said before, the very best of our clients make 40-100 year plans. Now, I'm certain that there will be people thinking - "How pretentious. How ridiculous. How can you tell what the market will be like in even three years' time?"

The point is, it doesn't matter whether its investing, your career, marriage or business, if you don't start with a very clear picture of what you want it to look like at an end point and take steady steps towards that, it's not just "how will you ever get there?" - 'Begin with the end in mind', as Stephen Covey says - it's also that the types of decisions you make, using a short horizon, generally, work against you in the long run.

Yes, people do occasionally build large businesses quickly, acting entirely opportunistically and then reverse engineer their history to make it look like it was all part of a plan. And yes, it is better not to have a plan at all than to remain rigidly stuck to one. Constant improvement, constant evolution and, sometimes, complete revolution are the only way to survive. Think IBM.

A business that seizes opportunities in areas that it does not have sustainable strategic competitive advantage in is a house of cards and these are always the first to go. Michael Porter's principles of Cost and Differentiation determine winners and losers everywhere you look.

I've just read a book entitled 'Profit First' by Mike Michalowicz. When I say "read' I mean skimmed it in order to understand the central idea of which there is normally only one in your average evangelical American business book.

Mike's idea is, that if you want to have a profitable business, you should build profit in at the start. As a starting point, he is absolutely bang on. When working in Mergers and Acquisitions, I reviewed the P & L's of over 200 SME Australian and New Zealand wine businesses. Over 80% of them had not 'built profit in at the start'. Not at all.

I was asked just the other day – "If Marlborough producers can crop at 14 tonnes to the hectare, if the price of grapes is $1800 per tonne and they sell at $18 per bottle, how on earth are some big names there on the verge of collapse? Well, of course, they are not selling for $18, they're selling for $13 but that is only a symptom of the problem not the cause.

How did these businesses end up there? They didn't understand what their value proposition was worth. They didn't charge accordingly. They therefore didn't invest enough in brand building. Or they did. Even more important are skills around price protection. When conducting a strategic review for one of Australia's largest family companies recently, I was asked what I thought they did best. I said that it was clear that they, better than anyone else, managed to defend and continue to raise prices in the face of the massive downward force that is supermarket buyers.

The ability to get to 'the truth' (sometimes confusingly called 'nett gross margin' meaning what is left after all cost of sales are taken out but I prefer 'the truth') is the next most important step. Supermarket business intelligence systems (read rorting money out of suppliers via farcically named, automatically generated claw backs) are getting more sophisticated and sales managers, not necessarily. You need to be sure that your salespeople have the requisite skills. This is the winning and losing of the war for medium sized companies.

Then you need to be certain that you are not spending more on sales, marketing and admin. than you are generating in gross margin dollars. When asked how these businesses were going broke, absurd as this sounds, that 80% plus of those businesses that we reviewed were doing exactly that. It's that simple. Anyone who spent their $37 and bought a certain company's annual accounts would have seen just how far 'out the back door' they were each year for at least the last 5 before the flag was finally raised. You wouldn't believe how many business managers I have dealt with who have been told that all will be fine so long as they break even on the EBITDA line. A wine business run like this will suck out owner cash like a giant vacuum.

Directors of larger businesses have a very public fiduciary duty of care to ensure that margins and profits are protected. That is why when you read the accounts of public traded companies, that bit, at least, always looks rosy despite all that you might understand about what is not so perfect behind the scenes. Any variance usually leads to share sell offs and impacts manager's bonuses. TWE is certainly one to watch, in this regard, currently.

When I was teaching at UTS, I was given the honour of delivering what they call the 'capstone subject' to the undergraduates.

It was clear that some of these students were brighter than those I was seeing in the MBA program. One of them, let's call him Keeran because that was his name, was so excited by the computer simulation we were running as the main exercise that he decided to form a team and join a global competition. All the top schools – Kellogg, MIT etc. – entered. Keeran's team smashed them all.

I asked him - what did you learn? He said – "Well, the model gave us everything to work with that a public traded company has. There was an expectation but not an obligation to pay dividends. So, we didn't. We looked at the business holistically and we weighed up all the data that we had on our competitors. We then invested in what we knew needed to be invested in when it needed to be, always conscious of our goal."

"Great, I said to him. "You've now figured out why private equity companies take public traded ones private." Even with their ruthless short term business value growth imperative, there is still so much potential locked up in these businesses due to the requirement to pay dividends that they know they can win simply by direct money to where it needs to go instead.

'Profit First Mike' had it right but only up to a point. If paying a dividend is the imperative, the sort of investment decisions that a business makes will necessarily be compromised.

When families, proprietors or shareholders simply must be paid then those competitors who invest where it's needed will tears strips of them.

Whether they take it out at the beginning through inflating the cost of goods (and I have seen this happen, preposterous as it sounds) or at the end through a guaranteed owner's or shareholder's dividend, the result is the same. Always those businesses get outplayed by businesses whose primary aim is to maximise both shorter term competitiveness and long-term business value through smart funds allocation.

Too long ago for most readers to remember, New Zealand had a Prime Minister by the name (ultimately) of Sir Robert Muldoon. Rob was ashamedly rude and a bully, a thoroughly despicable individual at times but he had at least one great idea – 'Think Big'.

When New Zealand was even smaller, in terms of population, and more isolated, it sure as hell needed that message.

Most New Zealand businesses that I deal with today fail in the DtC space, for example, not because they are not chock-a-block full of the smartest young people you will meet anywhere but because owners and managers haven't dared to dream big enough in terms of the amount of people they might entertain and sell wine to if they created purpose fit space in which that could happen.

Some aren't in the right location, let's be fair but others are missing out on a potential gold mine.

Impoverished thinking is a blight that effects many family companies. If you always buy the cheapest available assets, you'll be extremely unlikely to be buying the best. This so often flows through by hiring the cheapest people and selling at the cheapest price.

Brent Marris wasn't thinking small when he sold Wither Hills to Lion for $NZ54 Million. What he had worked out was that the more expensive his wine was, up to the $20 mark, the more it would be valued, the more funds he would have to invest in brand building and the more he would sell.

Meanwhile a well-known family company is trying to tell me that $15.95 would be a better idea and that it would create 'value' for their customers. It would have shaved about $10 Million off the value of Wither Hills business at that time, is all it would do, even if based upon their current rather than future case sales.

The owners of that family business got to argue about whether they could afford a new car that year whilst Brent waltzed away with the $54 Mill.

We're in the luxury business and all but bottom end of wine has at least some aspiration to it. The only way to win at the bottom is to be biggest. And Gallo know that.

Even Accolade in the UK couldn't make that work. Now smaller businesses have picked up supermarket contracts Accolade didn't want to service. No prizes for guessing who else is in the gun right now.

Most of this poor decision making starts with fear. If family businesses don't understand their opportunity, it's easy to see how they become fearful of change and want to glorify the past. As this paper not so subtly points out, there is a lot worse to be afraid of than change.

I've seen all sorts of tricks people use to deceive themselves into avoiding or to devalue change.

The first and worst, I think, is to confuse, deliberately or otherwise, incrementalism with real change. I get frustrated with people asking me should they put wine in cans or in different bottles or a gimmicky label or make a pink version of it...

If that is what your market wants, and it fits with your brand positioning then, best to just get on with it. But please don't call it 'innovation'.

I once attended a strategy day for a large family company. There were 34 people including agency staff. Not once during the day was anyone given permission to ask - "Is what we are doing fundamentally wrong?" In other words, it wasn't a strategy day at all. It was a day about "doing what we're doing harder". Even while the proverbial plane hurtles towards the earth.

The elephant in the room in their case is the fact that only a couple of people buy their wine. If either of them chose to knock just one dollar out of their price. Doesn't bare thinking about really…

You might know of a business that called their 'innovation initiative' their 'B Side'. I've seen others call the part of the winery that does that their 'jungle gyms'. This sort of language infers that innovation initiatives are necessarily going to be second rate rather than the very thing that will ensure a business's survival. The inference is that what we are doing now is so great that it's only twiddles round the edges that are needed.

When these companies decide to 'go all out and get funky with it, baby', what they miss is;
a) they are not cool,
b) they're following when leading is so important,
c) they often don't have the flexibility that the real innovators have in terms of assets utilised,
d) they haven't the same capacity to withstand failure that larger companies have, and
e) as a result, they get to sell to the same 2-3 people who will tell them what price to sell it at in any case.

This is ultimately what did in one of these earlier referenced companies.

Understanding the market and where it is going, is not difficult. We've written tomes about it. We research markets, distributors, paths to market and price points endlessly.

We all know that any market grows fastest at the front and that that is where the best profits and margins are. We know that, perhaps more profoundly than in any other time in history, the wine market is getting smaller. Not everyone is clear on how and where it is becoming more premium. You can and you must be.

If you have some sort of competitive advantage, scale is almost always the only one applicable in this case, there may be sense in staying where you are or even going down market. Otherwise, the worst thing that you can be right now is a small, big company.

McWilliams' failure was very public, but they ate Evans and Tate, who ate Cranswick Estate all because a bank didn't want to take a haircut. The only reason we didn't hear more about Palandri than Evans and Tate, who were in the papers almost every day for years, was that Palandri were listed on the London Stock Exchange not the ASX. They took their shareholders for even more money. Then we have Beelgara, Cumulus, Peter Lehmann and so on who went quietly. A scan through the top twenty Australian companies ten years ago makes for sobering reading. The same may be about to happen in New Zealand and the US.

The goal for these medium sized companies really should be to be a very large, small company. To be a 'quality estate producer'. This is the idea that the world's leading importers understand and long for. Good wine is the only type the world will never have enough of. To be seen as a quality leader in a region known to be the best at producing an in-demand wine style is the one strategy that never fails.

As we have discussed previously, this is all hard work. There are no short cuts. You must make everything better. Better vineyards, better wine, better processes and efficiencies, better routes to market, better business partners, better people (or people who can get better). And charge for your wine appropriately.

You can, however, start by using new markets as the exemplar of what you would like to be in all markets. We've talked about how Jackson Family Wines Estates and the whole nation of Austria does this.

It's about vision. It's all about discipline. It's about building a premium in order to build a brand. And vice versa. For those that see the way the world is evolving, that see Generation X taking over, flavour profile preferences changing, where the On-Premise / Premium Retail is going and what better DtC can do for even large small businesses, opportunities are endless.

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