Wine Business Solutions

The Wine Paper 61

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Stayin' Alive!

Pauline Vicard is the Executive Director of Fine Minds for Fine Wine, arguably the best network on earth of people devoted to thinking about making the world a better place where wine is concerned.

As any fine mind might, she went straight to that most important question of all. She asked me, when we spoke recently – "How do we make the global wine industry sustainable?"

She was not talking about how we should all use less herbicides, pesticides and other chemicals.

Nor was she talking about climate change and its devastating effects.

She was not even referring to the expanded definition of 'sustainable' so beautifully articulate by Karissa Kruse, President of the Sonoma County Winegrowers, that includes land, water and labour security.

As with wine itself, there are countless people proffering opinions on all of the above.

What she was asking was how do we make the wine industry financially viable, something that very few people want to focus upon, think deeply about and write about.

Without some level of profit, after all, there is no future and no point.

'Making Money in the Wine Industry' has been a pretty compelling subject for our workshops over the years, notwithstanding the angry emails I would sometimes get protesting that seeking to make money was the greatest ill that could befall us all.

At some level, those people are not wrong. Money, as an end in itself, precipitates all manner of evil. If you are not making the gross margin that your competitors are, however, you'll not have the funds to reinvest in the business, to grow better grapes, make better wine, do better marketing, pay better people and win.

That is why whenever a client says to me that they would be happy just to stop losing money, I insist that we aim higher. Profit neutral wine businesses still suck cash in like a rampant black hole.

If we are shooting for better, if we want to improve continually, if we want to have something to leave our children that they should want to have, then that needs to be funded out of the business. Banks and private equity no longer have money for an industry that, historically, hasn't been able to return its cost of capital.

Rather than giving a simplified version of the answer to a hugely complex and challenging question using the sort of banal formula used to sell American style business books, I thought it might be more fun / useful to provide examples of how not to make money in the wine industry.

I was privileged, recently, to spend the day with the former owners of businesses worth hundreds of millions of dollars. Any Australians reading this will know the brands they created and turned into household names. I made the patriarch laugh by framing this question in the negative. Anyone who has come into the wine business expecting it to be as easy as other businesses needs a laugh, after all.

I was referring to the case of a client who I had spent days with (it felt like on ZOOM) extolling the virtues of DtC sales via a primary point of customer acquisition (otherwise known as a cellar door / tasting room / travelling wine popup or whatever you choose that puts you, with a glass, in front of a potential customer).

After all that, they decided that they would not proceed because cellar doors in their region were not ‘profit centres’.

Now, to be fair, it is not often that clients don’t take my advice. I am not one of those so-called consultants who cries in their Cabernet and has that to complain about. If you can’t get people to listen to you, I feel, you should probably choose another life.

These guys were, however, so far from being able to be persuaded otherwise that I didn’t even bother confronting them with what has so amused my other very wealthy and serially successful clients.

I said to them that when you have a combination of:

1. weak local wine tourism strategy,
2. low expectations of direct sales by wineries,
3. low utilisation of wine club, online and other direct channels beyond cellar door,
4. not charging for tastings
5. and low sales per visitor,

you will be unprofitable.

Saying that a cellar door is not a ‘profit centre’ under those circumstances is like saying that “this aeroplane is a really crap car. Those wings and that propellor thingy are a bloody nuisance”. Consequently, the smaller producers of that country’s largest wine producing province are missing their biggest growth opportunity.

I was lucky enough to be invited to have coffee with David Fesq recently. David's family and that of Rob Hirst's (who I collaborate with on our China On-Premise research) were selling 'grog' to sailors on the Sydney docks in the 1830s.

With that kind of multigenerational perspective on the wine distribution business, you can imagine that there has been time to think about and challenge the status quo, the real secret to making money.

David, like me, had always been perplexed by people not wanting to spend good money on good people.

When you consider the leverage that an extra $10-20,000 has in terms of the difference in the quality of person you can secure the services of, why wouldn't you? Top salespeople can sell several times the value of wine that the worst performers do. David now considers that to be the key to their competitive advantage.

Now I get that large businesses must control payroll. And small ones too. In the large services firms, for example, what they pay in salaries is often all that separates them from competitors in terms of their ability to fund client acquisition (and partner bonuses). There aren't a lot of other levers to pull.

And paying someone more won't make them a better person. Please don't fall into that trap as I did once.

Like a lot of the other examples I'll use in this paper, I'm not recommending that any simple rule or formula be applied unilaterally. It's a matter of fully understanding a question (and this applies to wine itself) in all its complexity including the novel circumstances that surround it and using all of that to make decisions.

The other decision that David has made that impressed me was that he has figured out that they do not need to take on low value brand principals (those who always want more and can't tell you why), low value brands, and low value accounts.

Flipping that to the positive – his preference is to sell high value brands in high value outlets (who pay their bills) leveraging the services of high value salespeople, meaning that you develop a model where you get maximum reward for effort, avoiding exhausting yourself growing a business profitlessly.

As we are always saying to our clients and in our workshops, there is a strategy that you can use to sell wine to <u>any</u> sort of customer. There is, however, nothing to say that you must.

There are very few Masters of Wine who make wine. Of those who do, a number of whom are our clients, I am not aware of anyone making anything other than spectacularly good wine.

This is because of their application of intellect. Through understanding fine wine, in the deepest and broadest sense possible, they are using global benchmarks as the lens through which they set their parameters rather than what their neighbours are doing.

It amuses me and my MW clients, both, that their neighbours continue to tell them that they cannot, almost like they are not allowed to, sell wine at 'those prices'. But they already have.

You don't have to be a Master of Wine to do this. I've seen floor managers of fine wine stores take that level of understanding, work out where a leading wine region was going wrong stylistically and then lead that region in terms of innovating their way out of trouble, via the example of their winemaking.

So how do you develop that expanded understanding? You can participate in the show judging process. Probably the best thing I did in my life was to participate as a Panel Chair of the International Wine Challenge. As a learning experience at a particular juncture in my life, it was the most cost-effective way to see and taste the entire world of wine.

Those that then seek to get involved more heavily, to the point where they can pick their own wines and thereby manipulate the system, end up not doing anyone any good. That is why you see that companies who put huge amounts of effort into winning awards can still make wine that no one who loves wine wants to drink. You could follow someone else's lead. You've only to see what happened to disciples of Robert Parker to conclude that this may not be such a good idea.

No – this is something that you should do for yourself. And why not? It's fun. I'm a member of a tasting group that formed over many years, almost by accident, that includes a top wine writer, the leading importer of French wine, a natural winemaker, a lawyer who collects wine, a merchant banker who trades it, one of the best up and coming conventional winemakers, a sommelier, a bargain bin online retailer and a guy who at one point was the 2nd largest trader of Grange. The theme is that there is no theme. The only rules are that we must bring 'good' wine. We enjoy that with basic Italian food. It is only now that I pause to think about it that I realise what a great model this is. Anybody who says anything gets shot down by someone.

Diversity. Disruption. Discourse. When putting your own 'group' together, that is what to be aiming at.

There is a boom taking place in Tasmania right now. And I'm not talking about the boom in wine tourism that is happening across all parts of the world that are lucky enough not to be in lockdown.

I'm talking about that scary start of the cycle thing where people rush out and plant madly. I remember, like it was yesterday, Sir George Fistonich's (Villa Maria) comment to me when Peter Yellands and the Todd Family (Ara) went out and planted hundreds of hectares of Marlborough like it was wheat. I remember, even more clearly, what Peter Yellands said to me when he worked out where that had landed him…

Some of this is based on a perceived US market opportunity. Last time I scanned the 37,000 plus listings we use for our US On-Premise research for Tasmanian wine, the answer was the same as what Melbournians were eating last week to celebrate the end of lockdown – doughnut (aka zero).

A little while back, I was asked to present to the Tasmanian wine industry. The focus was wine tourism, but I also felt I had to talk about that ugly thing that you can't do much without - Money.

I showed attendees the table below which features brands' share of listings of the Tasmanian Pinot Noir category in the Australian On-Trade and those brand's average listed price.

Brand	Share	Price
Dalrymple	9.2%	$ 81
Devil's Corner	6.1%	$ 44
Tolpuddle Vineyard	5.5%	$ 135
Holm Oak	4.9%	$ 50
Josef Chromy	4.3%	$ 60
Spring Vale	4.3%	$ 61
Glaetzer-Dixon	3.1%	$ 176
Stefano Lubiana	2.5%	$ 107

I also highlighted the brands that had used 'outside thinking' to set price. Dalrymple (Yalumba), Tolpuddle (Shaw and Smith) and Glaetzer-Dixon are all South Australian businesses. (Note that in the case of Shaw and Smith there are not one, but two Masters of Wine involved). Victorian based Brown Brothers own Devils Corner but that, of course, is a completely different sort of outside thinking. The Lubianas are as much Tasmanian natives as anyone. They just didn't allow local thinking to cloud theirs. The three other longer-established local businesses had use each other and the local market to set their pricing.

Upper North Island			Auckland		
Plus GST	$ 60.00	15%	Plus GST	$ 78.00	15%
Mark Up 250%	$ 52.18		Mark Up 250%	$ 67.83	
Wholeslae Margin	$ 20.87	30%	Wholeslae Margin	$ 27.13	30%
Price per Bottle	$ 14.63		Price per Bottle	$ 18.96	
Price per Case	$ 175.56		Price per Case	$ 227.56	
Plus Excise	$ 27.56		Plus Excise	$ 27.56	
Revenue per Case	$ 148.00		Revenue per Case	$ 200.00	
COGS	$ 74.00	50%	COGS	$ 74.00	50%
Admin	$ 29.60	20%	Admin	$ 29.60	20%
Sales & Marketing	$ 22.20	15%	Sales & Marketing	$ 22.20	15%
EBITDA	$ 22.20	15%	EBITDA	$ 74.20	37%

This week, we released our first ever insight into the New Zealand On-Premise.

As we always do, we looked at the difference in pricing between the regions and the principal city. Whether it is Sydney, London, Shanghai or New York, the answer is always the same. Money always pools there.

The New Zealand project was really a response to regionally based businesses' description of the possibility of the whole market, once again, based on what they were seeing in their local area.

You can see above that using local prices, as opposed to Auckland prices, produces three times less profit. Expressed conversely, a wine business could produce three times less wine and still make the same profit. Their overhead per case would, of course, increase next season if sales volume reduced. But not by nearly the extent to which profits increase. This is the case in a situation of equilibrium. When the whole wine world is getting smaller and more premium, it becomes inarguable after a point.

Jumping back across the ditch to our friends in Tasmania, one of the business owners then confronted me afterwards and said - "if our business model works for us, if we can produce at such scale that $60 on a wine lists and a lot of DtC sales at the retail equivalent thereof means that we can get by, that our people yet paid, the owners get feed and they get to feel 'successful' owning this beautiful asset, isn't that enough?"

That is a heck of a question. How do you answer that honestly without sounding insufferably arrogant? If we wind back to the start. If we again focus on that single most important question, then the answer has to be "no." You can't sit there. All markets everywhere become more premium. Even now and in the worst of it, you want to see the year on year increase in Dom Perignon listings in Florida, just as one example. You can, of course, grow your way out of trouble. You can look at businesses like Delicato in the US that have done that. In the race to lowest cost, however, there is only one winner. In fine wine there are many.

Any of you that regularly read this will know that I have been on a bit of a crusade in relation to the way in which the Marlborough wine brand has been sold and marketed internationally.

I've been at pains to point out how our research and that of some of the world's largest wine businesses shows the way in which the palates of wine drinkers are evolving and the basic Marlborough product is not. New Zealand now has half the listings in the Australian On-Premise that it had 6 years ago. OIV data released yesterday, however, shows that New Zealand is the only major producing country to be significantly increasing exports – up 11% year on year. Not only that, total sales are up in most markets.

How can this be? Ever other category that we have seen go 'over the hump' in the On-Premise goes into long term decline in the broader market fairly quickly thereafter. Part of the answer lies in some very clever marketing and PR by Charlotte Reid, the new Marketing Manager of New Zealand Winegrowers, someone in whom the people I respect most in New Zealand expected no less of.

But marketing alone can only be 'fingers in the dyke' unless there is genuine change at the product level.

Perhaps the key insight from our NZ On-Premise research is that this change may already have its beginnings in the NZ Market itself.

When we looked at the Sauvignon Blanc category, the single most listed brand was Dog Point which is also close to the most expensive. Ivan Sutherland (who I referenced in our last newsletter) and James Healy were viticulturalist and winemaker at Cloudy Bay for nearly 18 years. They clearly learnt a lot from that.

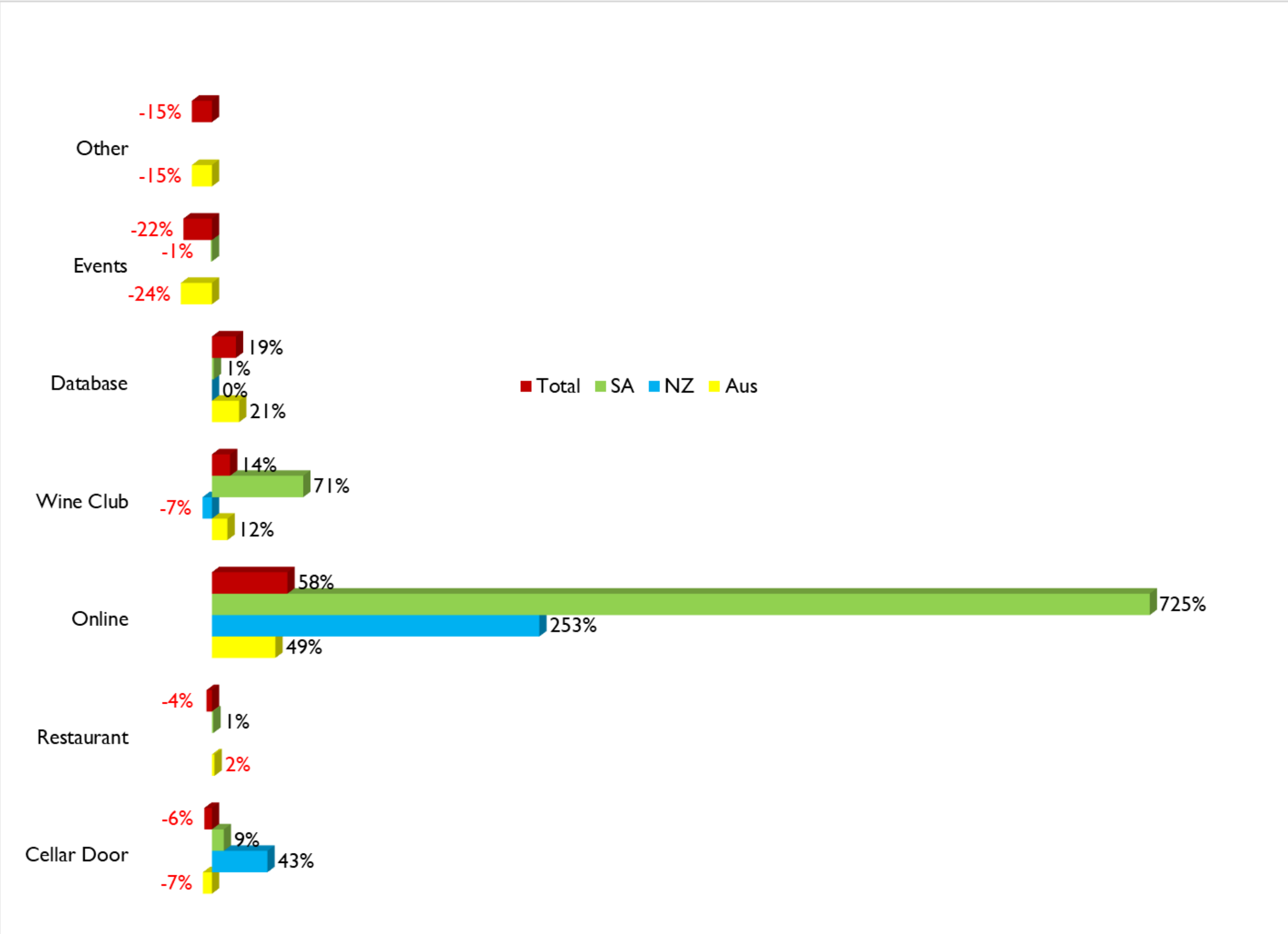
When I was Chairman of Wine Marlborough, almost 20 years ago now, I said to Ivan – "If and when it all goes to hell, if the savalanche really were to hit, you will be the last man standing", meaning that taking the quality leadership position, walking that hardest road, is the strategy that survives all.

I can't tell you how please I am to see this played out. Mind you, no one should be surprised. Being the most expensive and the largest seller is exactly Shaw and Smith's strategy for their Sauvignon Blanc in the Australian market. That they have the same distributor (Red + White) in each market shouldn't go unmentioned. It takes everyone in the supply chain to build and protect a brand.

Now of course there are 101 different other things to have to manage in order to have a financially sustainable wine business. But pricing correctly is a good start.

Australia and New Zealand really have been the 'lucky countries' when it comes to how they have managed through the pandemic. The virus has been contained, the respective governments have tipped in hundreds of billions into sustaining businesses and with no one travelling internationally, local wineries are experiencing a boom in wine tourism such as may never be seen again.

But what about South Africa? What if your government, rather than being supportive was, at times, antipathic? What if your wine tourism was internationally driven and there isn't enough local demand to soak up current inventory?



The slide above is one of the more interesting ones taken from this year's Direct to Customer Benchmarking research which compares DtC sales year on year to June 2020.

It highlights just how fast people and businesses can change when they must. With no other way to sell (and let's be fair, buy) wine, online got some incredible focus and results for wineries during SA lockdown.

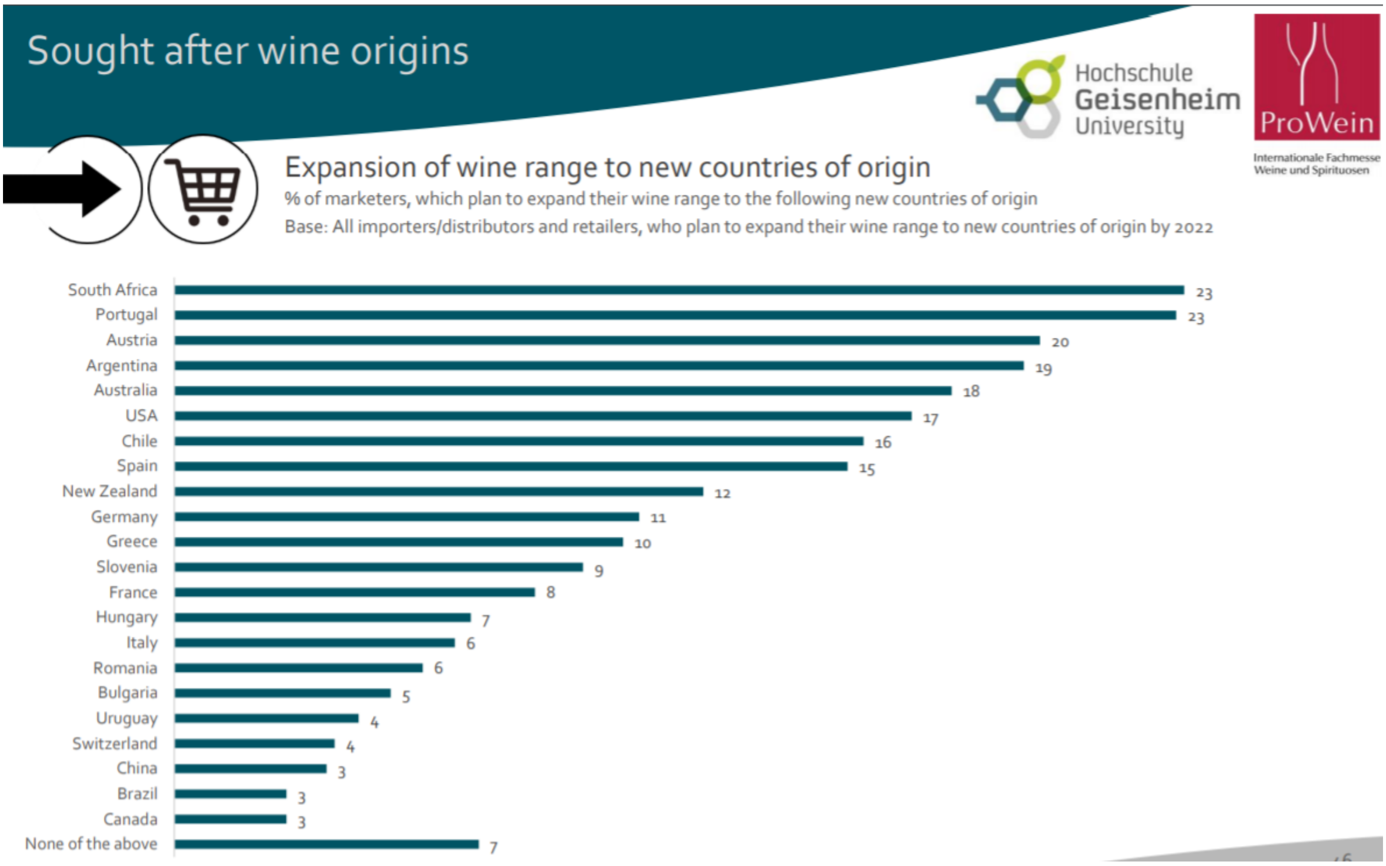
	Ave Database	Ave DB Sales	Ave Web Sales	Total Digital	Per Customer
Aus	8726	$ 146,448	$ 181,564	$ 301,777	$ 35
NZ	2300	$ 11,574	$ 6,019	$ 17,593	$ 8
SA	6968	$ 69,577	$ 18,091	$ 87,668	$ 13

The table above looks at what sales to database (excluding wine club) and via web sites are now worth (converted to $A) to wineries, on average, in the three countries. With a cross industry average of $120 per engaged email recipient per year in Australia, you can see that there is a way to go yet.

Those direct sales may have helped South African businesses through the depth of the crisis but, for the medium sized businesses and up, that is not going to solve their situation.

The country is sitting on a mountain of stock collectively with many producers either threatening or enacting discounts. Those international retailers that are 'chipping in to help' are doing so by also offering discounts which, again, may assist in the short term but does nothing for the country's brand image.

At Prowein 2019, I saw firsthand that South Africa had the most commercially effective stand there but don't take my word for it. 1700 participants nominated South Africa as the source country they were most interested in expanding their selection from.



Perhaps a good place to start is to dig down into who these trade players are and why they felt this way…

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.

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