The Present Environment

Currently, in the New Zealand wine industry there is a proliferation of small to (at best) medium wineries. The 2003 vintage has for many been difficult. The cash effects arising from this will be felt over the next few years. These effects will be compounded by the currently higher New Zealand dollar both reducing export margins and making imports cheaper.

These small wineries are typically confronted by:

- **The large corporates** increasing and aggressive dominance of the domestic market.

  The effect: Smaller wineries are left fighting for a diminishing share of shelf space. The real weighted average retail price is also being forced down by these larger players. This is also reflected in the "buying" of wine lists in restaurants and other retail outlets. Real margins are squeezed.

- **The development of "beverage" brands** by the marketing strategies of the corporates.

  The effect: Again the real weighted average retail price is forced down. Again, real margins are reduced. The premium for quality becomes increasingly hard to obtain particularly for lesser varietals and styles. The dedication to, and more importantly, the achievement of, quality and niche marketing becomes essential.

- **A shrinking number** of wholesale and retail options.

  The effect: The supermarket share of the market will continue to grow. Wholesale mail order companies are likely to retain or grow their share. Independent wine retailers and wholesalers will struggle to develop profitable niches and in any case (particularly in volume terms) will be less important. These niche markets will be forced to be more selective as to which local wineries are supported.

- **Export markets** that change and are (relatively) expensive to access. The unique *"New Zealand*" brand niche export market is now being challenged by other producers.

  The effect: The reliance on the UK market and its preferences is inherently dangerous in the "long" term. Niche markets exist for only as long as it takes competitors to see the opportunity. The development of other profitable markets will be slow and expensive. Again, the larger suppliers have inherent advantages in marketing expenditure, distribution chains and the ability to deliver the volumes required. Smaller business will be increasingly forced into cooperative ventures in order to gain traction. That could make individual focus and identity more difficult.

- **The above factors,** together with recent difficult vintages and the stronger dollar, have seen many wineries severely short of cash, overstocked with prior vintage wine and pricing structures out of sync with the market place. The current vintage for many will critically affect the future viability of some wineries.

  The effect: Difficulties are created for many forcing a review of both their operational and investment options. The selling of discounted inventories generates cash but destroys brand value and margins.

- **The possibility of forced sales** is now a reality in the current environment. Many potential buyers have currently suspended their interest perceiving more "realistic" values emerging.

  The effect: If that prognosis is correct there will be disappointed sellers. Some will try to hold on risking a further erosion of their equity. As well, they will materially add to their already stressful personal environment. Any hiccup will be disastrous.

So, Could This Be You?

Typically, these small wineries are characterised by:

- **The romantic illusion** held by some owners (the "*my chardonnay on the patio at sunset overlooking the vineyard*" syndrome!).

  The effect: Often new entrants to the industry have sufficient resources to acquire the operation but not to fully develop its potential. The amount of working capital required to establish a winery (compounded by occasional vintage difficulties and fluctuations of the exchange rate) is often underestimated. Furthermore, the critical importance of the distribution chain and the need for market driven demand is not understood. Unfortunately the "*romantic illusion*" distracts many from the realities.

- **Under capitalisation** manifested by the presence of one (or usually more) of the following factors:
    - High debt,
    - No reserves for the "down" years,
    - The need to continually inject off site income (usually from the spouse or other business earnings),
    - The deferment of vineyard or winery development, and
    - Increasing business risk by cutting quality corners.

The effect: There is not enough investment into real quality resulting in a reluctance to forego income in order to replace varieties and clones. There is also an under investment into marketing and the distribution chain.

- **A poor understanding of the dynamics of the industry** and in particular the close relationship between quality, distribution and marketing. Too much wine is made without a defined market to sell it to. Further, often the responsibility for the development and management of the brand is left to the wholesaler.

  The effect: Frequently we see increased acreage planted with little thought being given to the distribution chain and the marketing effort necessary to sell profitably the additional volumes. New varieties are sometimes planted for their novelty value rather than either their suitability or the existence of a substantial and sustainable market. These factors combined with an undue dependence on single wholesaler (and sometimes a single export customer) leaves those businesses in an exposed and fragile situation.

- **Being too small** to capture any economies of scale. **Note:** Small is fine so long as:
  - A defined niche market is captured,
  - The perceived quality justifies a price premium every year,
  - There is additional real margin to meet the marketing and distribution demands of such a niche market,
  - And the formula is repeatable year after year, and
  - You are really profitable!

  The effect: This creates pressure on (usually) the owner to be jack-of-all-trades – the viticulturist, the winemaker, the cellar-hand, the salesman, the marketer and the accounts clerk. Something usually gives!! Usually product quality followed by cash flow and a stressful family life. Furthermore, most participants do not realise the depth of commitment required and the extended time it takes to achieve that goal.

- **Having on going staffing problems.** Small wineries often are unable to afford the investment necessary to recruit, retain and incentivise good winery and viticulture staff from one year to the next.

  The effect: This creates stress and uncertainty from year to year. Further, it is difficult to maintain an integrated and continuous quality development plan. That leads to uneven, inconsistent quality, difficulty in establishing an identifiable "brand" style, etc. In turn those factors impact into the marketing and distribution change. Obtaining a "brand" premium is nearly impossible.

- **A reluctance to cooperatively share** capital facilities and investment into the distribution chain and marketing.

- **The effect:** This results in relative over investment in expensive fixed assets meaning capital, effort and expertise are all wasted. This must be a New Zealand thing!

A. We Can Help You By:

- **Preparing Your Business for Eventual Sale. Fact:** Every business will eventually be sold. This is "ground" preparation including such things as ensuring:

  - The adoption of appropriate reporting standards (as distinct from compliance accounting and FRS rules) to ensure the real result of the business is known and year on year trends recorded. **This ensures the real value of the business and the brand is apparent.**

  - The gathering and collation of appropriate vineyard, winery and sales statistics.

  - Appropriate legal structures of ownership are in place together with a review of supporting current deeds (eg: Inter-entity Leases, Wills, Powers Of Attorney's, succession plans, etc).

  - Quality opportunities of the vineyard, winery and marketing are understood, determined and achieved over agreed timeframes.

  - Marketing strategies and distribution chains (including export) are established and developed.

  The degree we can be successful in preparing a winery for eventual sale will be dependant on the following:

  + What is the probable future timing of the proposed sale? Is it imminent or have we some time? If imminent, is the pressure to sell caused by security holders, creditors, health or other factors?

  + What resources of cash, time, energy, expertise, etc are available?

  + Is there a willingness by the owners and other interested parties to "*buy the vision*"?

- **Bringing Like-minded Parties Together.** To what extent can we facilitate such things (in no particular order or appropriateness to your circumstances) as:

  – Sharing capital assets

  – Sharing expertise (viticulture, winemaking, marketing, etc.)

  – Sharing marketing and distribution initiatives

  – Developing export strategies on a cooperative basis

  – Developing quality standards and future objectives

  – A further option in the short-term could be the development of "Peer Groups" within clusters of wineries – "*a problem shared ….. etc*".

- **Developing Business Plans.** Working with the owners to develop (and later monitor and refine) a comprehensive business plan clearly detailing:

  - The objectives sought (and including the means of measurement),

  - The resources available now and ongoing, and

  - The expected time frames for completion of each step.

  - All of these would be overlaid by recording the measurement points to reflect the success (or otherwise) of the plan's implementation.

- **Developing Quality Standards.** This is aimed not only at the technical aspects of viticulture and winemaking but at the business, marketing and distribution components. Whilst we are neither experts in viticulture or winemaking, we understand the importance of the overall interrelationship.

- **Developing Sustainable Pricing Policies.** This is working with owners to generate an understanding of the key drivers affecting the pricing of their products.

  Pricing means much, much more than the numbers on the price list. It requires an understanding of each market the business sells to (or wishes to sell to) and each product. It incorporates the tactical use of incentives, discounts and promotions, and any value given away (such as free freight or extended credit terms). The relationship with the comparative quality of the wine (by product), any premium the region(s) may carry and the respect of the brand(s) need to also be taken into factored into a comprehensive pricing policy.

Note: From experience most pricing is scientifically determined by looking at competitors and neighbours. The resulting pricing is either slightly above his (“*My label looks better*”) or slightly lower (“*His is overpriced*”). Alternatively, your wholesaler will base the pricing on how your product fits into his portfolio. If that is the case you are effectively a price taker!!

- **Assisting Potential Overseas Winery Buyers.** Currently there are a number of overseas interests pursuing acquisition strategies in the New Zealand wine industry. So long as internationally the Brand “*New Zealand*” retains its (relative) premium position local wineries will appeal to off shore buyers. The current pressure on liquidity means there are a number of “willing” sellers.

  However, informed buyers are likely to wait until some of the price expectations currently prevalent are replaced by “reality”.