Wine is business

Shifting demand and distribution: major drivers reshaping the wine industry

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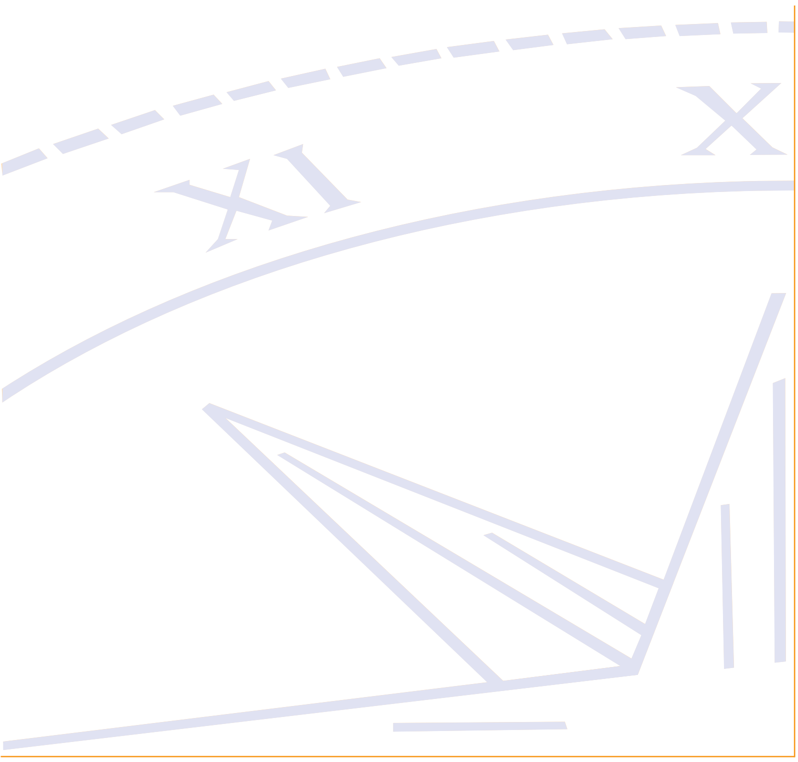


1 Introduction: quality segments

The world wine business is valued at EUR 150 billion for consumer value and EUR 60 billion for wholesale value. The total global production of wine averages round 275 million hl per annum. Of this, some 220 million hl are consumed and the remainder is distilled as cognac, brandy, alcohol or removed from the market through EU subsidies. Exports of table wine account for 27% or 60 million hl, and in 2002 represented a value of EUR 13 billion, making it one of the most traded food products.

Quality increasingly set by prices

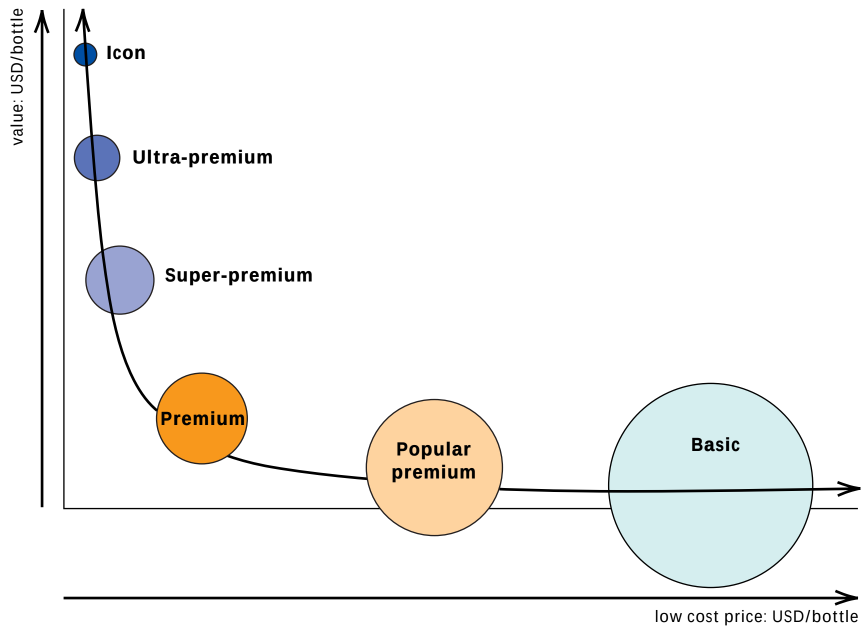
Price/quality segments: key to understanding the wine industry

The wine industry is characterised by a range of quality segments, each with its own trends, market requirements, distribution outlets and so forth. Wine quality is determined by various factors, such as its chemical and organoleptic characteristics. In the European Union a major quality criterion is controlled bottling (AOC), a system that is highly influenced by politicians and legislators, to guarantee and protect the origin of bottled wine. Yet as origin no longer guarantees quality, this system is gradually losing standing. The ultimate and clearest criterion for quality is the value, as perceived by the market, and expressed in the price per bottle, which is where brand value comes into its own. This prompts the price distinctions in the market and so creates different quality segments.

Euro conversion sets new price points

The requirements per price/quality segment are not static but influenced by market dynamics. A clear current example is the euro conversion. New price/quality reference points had to be developed that would apply to all consumers in the euro zone. While this was the case for all products, it seems that the impact on wine was particularly strong. The euro has made the market transparent; it is now clearer to consumers what kind of quality can be expected in the different price segments. Consumers – and wine buyers! – are able to compare prices within the European Union. As they do so, they see that not all price differences can be explained by varying levels of national levies and duties.

Figure 1.1 **Wine quality segments**



Source: Rabobank International, 2002

Figure 1.2 **Wine price/quality segments**

Category	Europe Ex-winery EUR / bottle	Europe Consumer EUR / bottle	Requirement
Icon	>30	> 150	Long-term image, (this takes time!), complexity, cellaring potential, high scores among critics
Ultra premium	3.35 – 30	14 – 150	Typical, varietal or good blend, more complexity, typical character, origin, image, quality brand. In the higher price ranges: image, cellaring potential, complexity, well received by critics
Super premium	2.25 – 3.35	7 – 14	Brand, recognition, origin, full body, more character, rich, typical for single or two-varietal blend
Premium	1.65 – 2.25	5 – 7	Combination of character and accessible, recognisable characteristics of variety, origin, brand
Popular premium	1.10 – 1.65	3 – 5	Varietal, fruit, accessible, brand
Basic	< 1.10	< 3	Low price, traditional (sweet for older consumers)

Source: Rabobank International, 2002

Requirements per price point are more important than names

The price points in *figure 1.2* are indicative of the different segments. Consumer prices are continental European off-trade prices; on-trade prices can be at least twice as high. The 'label' of the category and quality perception may vary from country to country. In France and Spain, for instance, the popular premium segment is considered to start at around EUR 1.5 per bottle, whereas in the USA the premium and popular premium segment generally starts above EUR 3. Since EUR 5 is an important price barrier in many markets – for both retailers and consumers, a distinction has been made between the segments from EUR 3 to EUR 5, and those from EUR 5 and EUR 7. It may be true that a certain premium quality can be expected above EUR 3, but it is only above EUR 5 that quality becomes more important than volume. At the other hand, volumes can drop considerably above the EUR 5 mark. The same holds true for the EUR 10 price barrier, an argument to increase the price level between the premium and super premium segment to EUR 10, as some do. In the beer industry by comparison a brand is only considered a premium beer if it has price points some 20% above the mainstream beers.

Icon wines: more than good quality

The minimum price point of the icon wines has never been well defined. For some wine companies their icon wines are simply their best quality. It is clear that the wines should be rare and combine both superior image and quality. One quotation from Baroness Philippine de Rothschild may be the best description of what icon wines actually represent: 'It is fairly easy to create an icon wine, except for the first 200 years.'

The category under EUR 5 per bottle is believed to represent some 70% of the volume of the continental European market, between EUR 5 and EUR 10 another 20%, with the remaining 10% going to the super premium and beyond. Shares are more or less similar in the USA. In terms of value shares these are estimated at 45%, 25% and 30% respectively.

Retail buyers set price points

The most important issue concerning such categories, however, is that the perception of the requirements per price point is gradually becoming clearer. At present this is particularly true of the increasingly skilled wine buyers employed by the large retail chains. Any supplier can call his wine a premium or even an icon wine, but such buyers understand that a wine worth EUR 4.50 in terms of quality would be very hard to sell at EUR 5.50 in an increasingly competitive market. In the past retailers determined the price barriers; today the consumer increasingly sets the price points and retailers follow.

Requirements can vary per country

Consumer prices vary per country for the same wine because prices are influenced strongly by duties, levies and trade-ups. Consumer prices are comparatively high in the United Kingdom, most Scandinavian countries and the USA, and low in continental Europe. Total mark-ups for luxury wines are also higher than for basic and premium wines sold through the supermarkets.

Popular premium segment very important

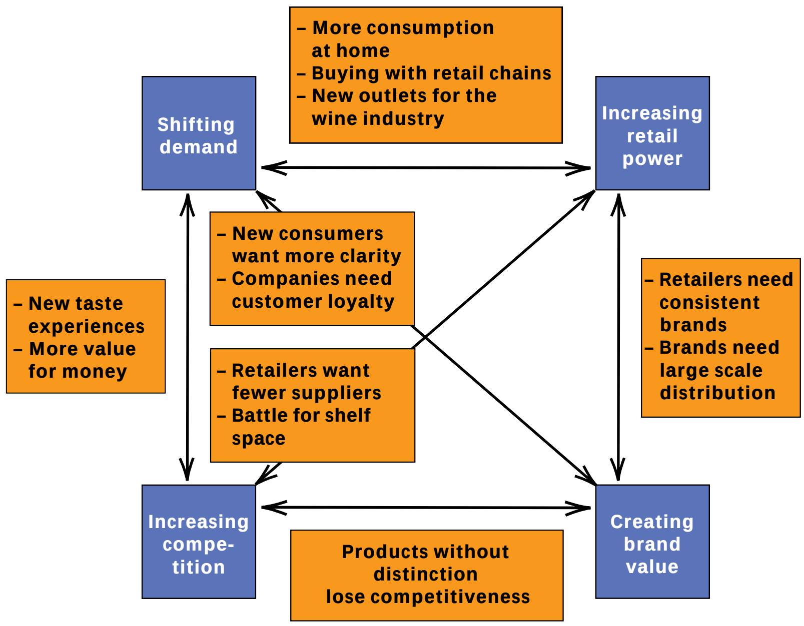
The popular premium segment is very important for the industry and enables wine companies to build a customer franchise for their brands. This segment requires fairly large volumes of 'value-for-money' wines and allows wine companies to create step-up brands.

In the report special attention will be paid to the European market, which represents 60% to 65% of global production and 60% of global demand, being as it is the most important and competitive market in the world. All sums are given in euros (EUR) since the euro zone represents some 50% of the global wine market. At the time of publication USD 1 = EUR 0.99.

2 The industry drivers

The world wine industry is presently undergoing a number of significant changes that will influence the shape of the industry in the coming years. Whilst the industry has been very fragmented, recent developments have turned the industry into a dynamic business, full of challenges and opportunities. Competition will continue to increase.

Figure 2.1 The wine industry drivers



Source: Rabobank International, 2002

Drivers force companies to adjust their strategy

The four key drivers of change for the wine industry – those forces that influence companies to adjust their strategy – are:

1 Shifting demand;

2 Increasing retail power;

3 The increasing impact of brands;

4 Increasing competition between wine countries and companies.

Increasing retail power strongest driver

For all industries, shifting demand is a factor of great importance because consumer choice reflected in spending patterns ultimately determines the value of an industry. Where the consumer spends is as important as whether the consumer spends. This is particularly true in the wine industry. The shift in wine-buying from the traditional and fragmented outlets to the modern retail chains has had a huge impact on the industry. These retail chains, of which there is just a limited number, sell large volumes of wine and increasingly exert their power over their wine suppliers. This trend caused increasing retail power to become the strongest driver for change in the wine industry in the 1990s.

Brands meet consumer and retail requirements

The emergence and success of brands in the wine industry epitomises how drivers affect and reinforce each other. When wine began to be sold in supermarkets, it brought a new group of consumers into contact with the product. By widening the market in this way, this development has been good for the industry as a whole. Yet this new consumer group felt intimidated by the range, and brands are points of reference by which to identify wines.

Major retailers need brands

Branding also meets the needs of retail chains. They need large volumes of consistent products that are self-explanatory, as their staff is not skilled in selling wine. Stocking the brands of major wine companies meets these needs and enables them to reduce the number of suppliers, which they wish to do in order to reduce their costs.

Increasing competition driver in its own right

The emergence of leading global wine companies fuelled the trend towards branding. These companies made huge investments in order to be able to offer large volumes of branded wine with which they built a strong franchise with customers. The brands were introduced into a highly fragmented industry in which the total volume of wine consumption was flat. Given this, their activity resulted in greater competition among countries and companies. This competition has become a driver in its own right and less distinctive wines are being replaced by the attractive, new supply.

3 Shifting demand

Changes in demand is the most important driver for all industries, and this is particularly true when supply is greater than demand or when market protection is lifted. Today many wine companies – and EU wine companies in particular – have too little understanding of what is driving demand.

Demand continues to change

Changing preferences for wine influence choice of colour, variety, origin, quality and brand, as well as place and moment of consumption. Shifts in choices may occur over the years, over the seasons and even in the course of one evening, and are likely to continue to change. The fact that the wine industry offers choice is one of the attractive features of the industry, but changing preferences can have a strong impact on individual suppliers.

Total consumption stabilises ...

Long-term demand trends in favour of the wine industry

After two decades of decline – 25% since 1975 – the total demand for wine is stable. Today the industry is experiencing both expansion and contraction at the same time. Demand for basic wine, generally sold at under EUR 3 per bottle, continues to decline in most countries. This is mainly because the traditional role of wine as the preferred daily and affordable beverage is declining in old wine countries. According to industry sources, basic wine consumption fell by another 20% in 2001, due almost entirely to falling French and Italian demand.

... with decline in basic and growth in quality wine

The wine market is actually seeing a move from bulk to premium bottled wine, which is balancing the declining demand for basic wine. This poses one of the major challenges for the wine industry today, as the production capacity for the unwanted basic wines remains in place, resulting in huge stocks. In the EU this structural stock excess is distilled, whereas in other markets supply has to be brought in line with demand. As long as the vineyards contain the right varieties, increasing quality by reducing yield is one obvious solution to this problem.

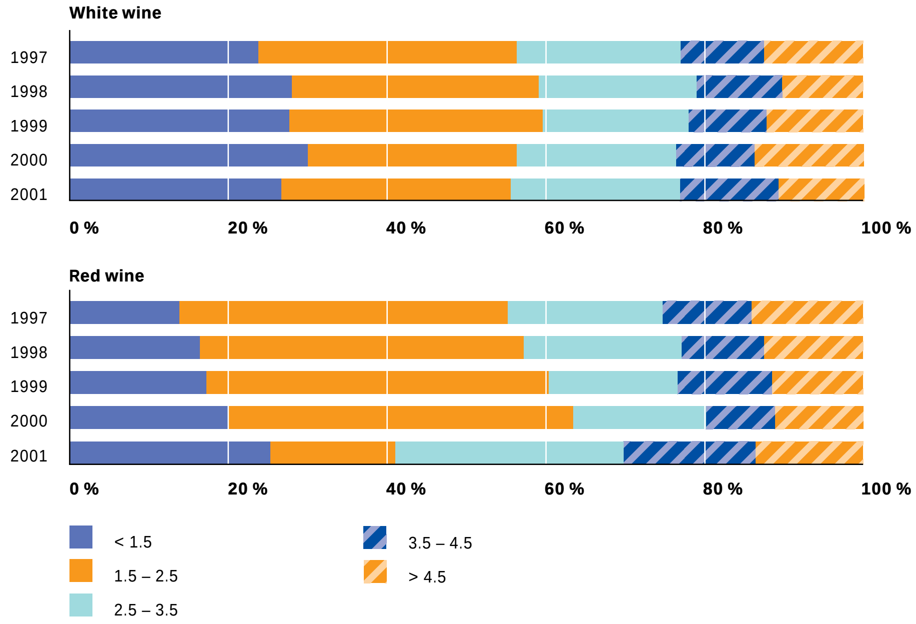
With a preference for premium wines

In wine markets all over the world there is growing consumer preference for premium and popular premium wine. Greater numbers of new consumers are becoming more educated and discerning in their wine tastes and this is being reflected in the demand for more consistent and higher quality wines, while low-quality wine is heavily discounted. The greatest growth is occurring in the premium segments within the price range of EUR 5-10/bottle. The rise of the quality segment offers growth opportunities for suppliers active in this segment.

... though not in all markets

This trend of trading-up is not clearly visible in all markets. In Germany, for example, the segment under EUR 2.5 remains very strong and is even on the increase for red wine. This is largely due to the strong impact of the discount retailers in wine distribution.

Figure 3.1 **Price trends in Germany (EUR/litre)**



Source: Deutsches Weininstitut

Accessible New World wines meet demand

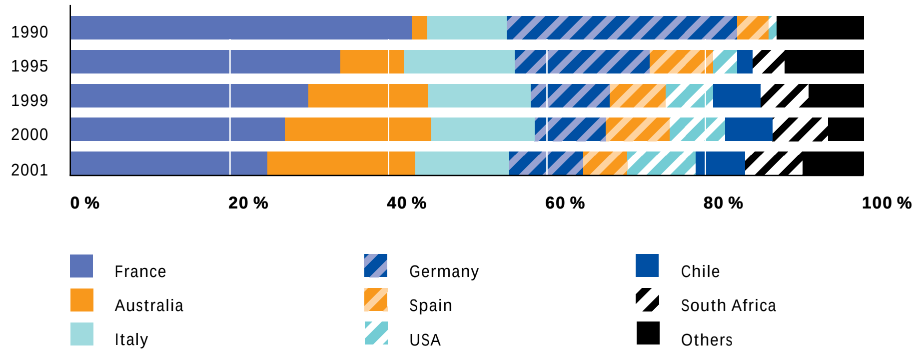
Old versus New World

In line with this trend is the increasing interest in New World wines. These are accessible, single-variety wines with full fruit flavours. Together with consumers desire to try something different and changing gastronomic desires, they are a key factor in the new taste experience. Such wines have the advantage of being easy to drink, making them attractive to new, inexperienced consumers, in particular in the EUR 3 to EUR 5 price range. Once familiar with such brands, consumers find it easier to trade-up.

The Old World faces risk of 'tired' image

The old wine countries have been reluctant to change. This has affected their image among groups of consumers and they have lost a lot of market share. Even in France, Spain and Italy changes are taking place in the youth market, where consumers seem to feel that New World wines are in better keeping with their modern lifestyle. Furthermore, New World wines have attracted the attention of wine connoisseurs. They have discovered the broad range of elegant and refined quality wines on offer at attractive prices in major retail chains.

Figure 3.2 **Changing import shares for the United Kingdom (%)**



Source: Commission for Distilled Spirits, 2002

... resulting in huge shifts in United Kingdom imports

Shifting demand for new wine countries is particularly visible in UK imports, as is shown in *figure 3.2*. During the 1990s the share of imports from Germany dropped from 29% to 10%, and from France from 43% to 27%. Imports from France saw a further fall to 24% in 2001. From 2001 to 2002 the French share in the UK off-trade even declined to 21.4%. The same decade saw the New World countries increase their import share from 3% to 34%, with Australia alone up from 1.6% to 19.5% in 2000, while South Africa's share rose from less than 1% to 6%, and to 8.5% of the UK off-trade in 2002.

Will Old World be re-discovered

One of the questions is whether consumers will rediscover the blends and more refined wines of the traditional, European countries, now that the quality of EU suppliers is also increasing and more attention is being paid to marketing and branding. If so, the revival in demand will be confined mainly to the basic and super premium segments because the fragmented structure of the EU wine industry will continue to be a major barrier to creating strong brands in the premium segment. In order to develop a strong and international premium brand a critical mass of several million cases is required. Few European companies are able to realise such volumes in this segment.

On-trade wine consumption; increasingly trendy

Changing distribution patterns

The trend towards eating out and drinking wine at fashionable bars has favoured on-trade wine consumption, a segment that generally requires higher quality wines. In most import markets some 15% of wines is consumed in the on-trade segment. Since wine is now a socially accepted drink for men and women alike, more venues like night-clubs, bars, grand-cafés and wine-bars are carrying a wider range of wines. Old-fashioned cafes are losing customers, while trendy grand-cafés and wine bars are gaining in popularity. Consumers are moving from ordering just red, white or rosé, to ordering country and grape varieties. In the past the range of wines offered in the on-trade segment was traditional. With the emergence of high-quality wines from the New World, the selection is changing gradually. The traditional male alcoholic beverage drunk with meals – beer – has been replaced to a significant extent by wine, with estimates that 50% of men drink wine nowadays with their meals.

Retail chains have discovered wine

The retail chains have also discovered the advantage of adding wine to their range; they have been the largest growth segment in wine sales. Their increasingly well-balanced wine selection is increasing home consumption. Retail chains present consumers with a broad choice in terms of price points, origins, qualities and so on. This has popularised wine tremendously and allows the consumer to become acquainted with every segment of wine.

More wine consumed during the week

Another important trend is changing consumption patterns through the week. While in continental Europe only 25% of the wine was drunk during the week a few years ago, this has increased to 45% today.

Wine consumption is country-specific

Old wine countries, where wine consumption is a traditional part of daily life, are experiencing a decline in wine consumption. Soft drinks or alternative alcoholic beverages, such as beer, are now being drunk in preference to wine. The United Kingdom, where beer has been the traditional alcoholic beverage, is an exception to this; wine consumption is experiencing strong growth. The driver is consumer desire for a new experience.

Germany: largest importer of cheap wine

National differences can also be clearly seen from the prices and origins of wine imports. Germany imports some 135,000 cases of wine on average, 78% of which comes from Italy, France and Spain, at an average import price of EUR 14 per case. A large share of this wine is used to produce sparking wine – sekt- in Germany. Together, the top four new wine countries hold only a 5.6% import share, at an average import price of EUR 24 per case. German wine imports appear to be traditional and geared largely towards the value-for-money segment.

United Kingdom: large importer of higher quality

In the United Kingdom, by comparison, 35% of all imports came from the new wine countries, at an average import price of EUR 22.7 per case. The New World import share is even anticipated to increase to 44% in the year 2002. The UK market changed tremendously during the 1990s and innovative wines from new wine countries were adopted rapidly. Today Australia is challenging the position of France as the major exporter of wines to the United Kingdom, surpassing France in 2002 with 22.3% off-trade value share against 21.7% share for France. Australia is expectedly to match France in volume share shortly. Germany is still a major supplier of wine to the United Kingdom, but at the lowest prices in the market.

Figure 3.3 **Market volume and average import price per import country in Germany and the United Kingdom** (2001)

	Germany Volume (1,000 cases)	Average import price (EUR / case)	United Kingdom Volume (1,000 cases)	Average import price (EUR / case)	USA Volume (1,000 cases)	US prices (EUR / case)
Total import volume	**125,661**	**14.76**	**121,568**	**25.65**	**52,111**	**45.05**
Italy	50,923	12.15	17,812	15.48	18,889	28.19
France *	28,886	20.34	30,314	31.95	11,444	93.00
Spain	16,504	16.30	10,514	22.14	2,378	40.98
Austria	2,533	9.18	11	52.98	-	-
Hungary	2,011	8.64	943	16.63	-	-
Chile	2,883	13.59	6,045	34.92	5,756	20.14
United States of America	1,062	25.29	9,834	23.67	-	-
Greece	2,202	12.98	108	23.15	-	-
South Africa	1,292	20.61	7,848	25.83	289	34.89
Australia	1,321	25.29	20,388	30.42	8,167	35.59
Germany	-	-	10,435	11.61	1,456	24.82
Portugal	950	20.47	1,985	30.69	944	42.69
Argentina	421	17.13	1,285	29.97	1,367	22.13
New Zealand	66	36.49	1,116	56.07	378	46.03

* The numbers for France include champagne.
Source: ITC/WTO and Rabobank International, 2002

A comparison of Germany and the UK's average import prices offers additional information, such as the difference in price paid to importers into both countries, importers such as Austria, Portugal and the USA. It would appear that different wines are being imported from these sources; the number of cases differs too.

Short-term cycles can be attractive, but are not without risk

Short-term changes

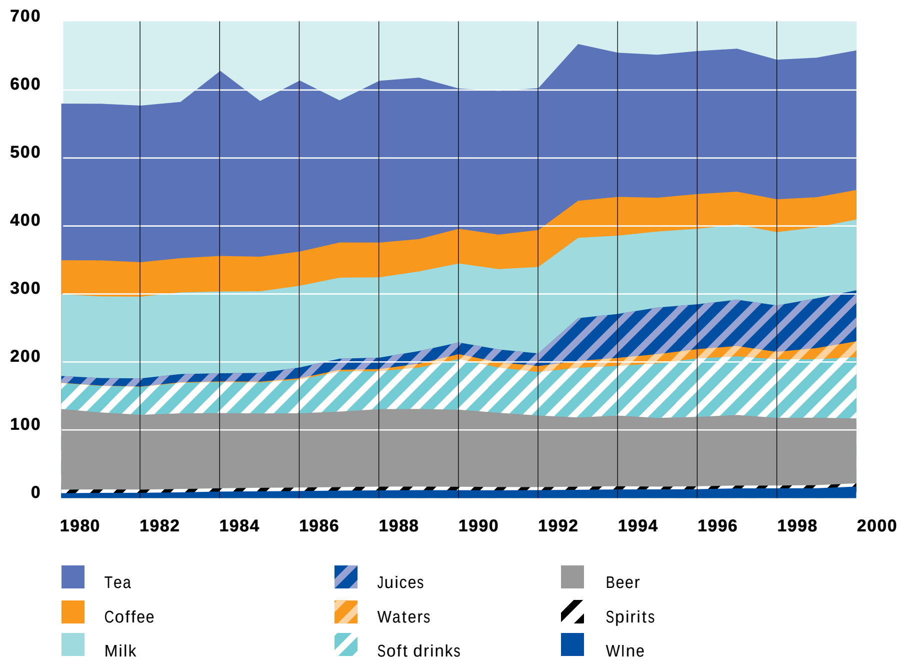
Wine is increasingly becoming a product sensitive to trends. In the 1970s rosé was very popular in several European countries; its consumption declined rapidly in the 1980s. Similar trends were seen with wine coolers in the USA and cheap, sweet, white, German wine and sherry in Europe. The same now seems to be happening to the Beaujolais primeur. Beverages are subject to fashions. Once 'in', a few years later they are 'out'. Today rosé is taking off again in Europe. In 2001 some countries realised more than 30% growth in rosé sales. For those supplying such fashionable products, this may be very attractive, yet any investment is not without risk.

Wine competes with all other beverages

Challenges; innovative beverages and economic growth

Wine competes on the beverage market – a market considered to be saturated in several countries – and has faced increasing competition. Consumption of fruit drinks, soft drinks and bottled water is increasing, while consumption of alcoholic drinks, particularly beer and spirits, is declining. The suppliers of competing beverages are often multinational, brand-oriented beverage companies with large marketing budgets and innovative power.

Figure 3.4 **UK beverage market; wine fights for stomach share** (litres/head/year)



Source: Commission for Distilled Spirits, 2002

Young consumers seem less attracted

Young consumers tend to start drinking wine at a later age than in the past. This is one of the major challenges facing the wine industry and has contributed to the overall decline in wine consumption. These consumers prefer to be associated with something new and exciting, rather than the preferences of previous generations, and so tend to favour trendy ready-to-drink beverages like Bacardi Breezers.

... but are very important in the beverage market

This is both a challenge and an opportunity. There is apparently a huge market for trendy beverages, heavily supported by similarly huge marketing budgets, among young consumers who are drinking at an earlier age than ever before. Today the ready-to-drink market represents some 153 million cases; 34 million of those cases are of the leading brand Smirnoff Ice. In the USA, the segment has gained some 3.5% of the beer market, an issue that US brewers take seriously. In every market where Bacardi Breezer and/or Smirnoff Ice is a hit in the on- and off-trade, retail wine sales take off as well. The off-trade occasions are winning momentum from beer and spirit. However, preferences for these products may change fast.

… and a challenge for the wine industry

It is as yet uncertain whether this fast-changing beverage market is an opportunity or a threat for the wine industry. Few wine companies today would be able to meet the rapidly changing demand for innovative and lifestyle-sensitive market propositions in terms of marketing budgets, volumes, modern packaging and distribution power. Some good examples of this new type of demand are already evident in the market. In terms of wine, these younger consumers prefer white and rosé wines in stylish packaging. A further opportunity for the wine industry as a whole may arise as these consumers develop and their tastes turn to more complex red varieties.

Consumption influenced by state of economy

While wine consumption has various roots, it is also a function of changes in personal income and a direct reflection of national economic growth rates. Economic growth in the major markets such as the USA, the United Kingdom and the euro zone was fairly good up to 2001. In 2001 the economy slowed down and was further depressed by the events of September 11 and the uncertainty they gave rise to. Economic growth rates have since fallen spectacularly, as can be seen in *figure 3.5*. They are expected to pick up again in the near future although at a lower rate.

Figure 3.5 **Annual growth in GDP of major wine-consuming countries** (%)

	1999	2000	2001	2002 F	2003 F
United States of America	4.1	4.1	0.3	2.3	2.1
Euro zone	2.7	3.5	1.5	0.8	1.7
United Kingdom	2.1	3.0	1.9	1.8	2.9

Source: Rabobank International, 2002

Future dynamics: Shifting demand

- Predictions about future demand are less easy to make than a few years ago because the market appears to be more sensitive to trends;
- The shift from white to red wine seems stable, and the share of white may increase again. Basic white wine is expected to continue to decline in contrast to increased preference for better-quality white wine and all segments of red wine;
- The ‘New World’ wines will be more popular among young people in the ‘Old World’ wine countries. The gap in consumer behaviour between ‘Old World’ wine countries and traditional import countries is decreasing. This development is being spurred by competition with other beverages;
- New opportunities for the wine industry will emerge when the post-war baby boomers begin to retire in a few years’ time because this generation will have the time and money for self-indulgence. This will favour demand for high-quality wine. Finally, scientific support for claims of the health benefits of moderate wine consumption (particularly red wine) will also spur demand among this group, particularly in markets where wine consumption has met with some hesitation.

Consumers in all markets are seeking beverages in keeping with their life styles. It is increasingly clear to wine companies that the average consumer does not exist. Targeting a specific group the right way will enable above-average growth at the expense of competitors and competing drinks.

4 Increasing retail power

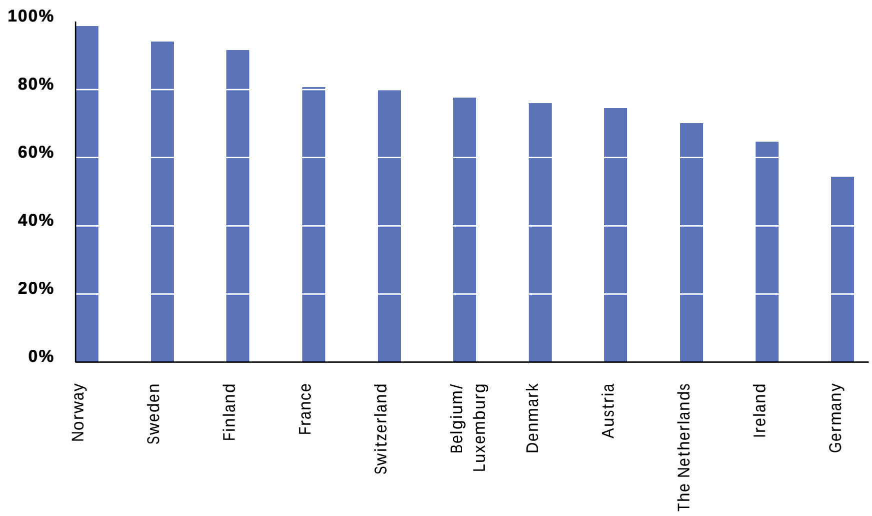
Increasing retail power: no. 1 driver

Originally the fragmented structure of the wine industry matched the fragmented distribution structure fairly well. A large number of smaller bottle shops were kept in business. With consumers – and new consumers in particular – buying more wine from retail chains, increasing retail power was of particular importance in the wine industry during the 1990s. It is expected to remain a key driver for change in the years to come.

Retail consolidation result of increased competition

Following the consolidation of global food and beverage retailing, retailers are wielding greater power and imposing more exacting criteria on supply chains. In most European markets only a few major retailers represent more than 70% of supermarket sales. These supermarkets offer only a limited range of wines. This means that fewer buyers are

Figure 4.1 **Top 5 retailers in European countries** (overall share of distribution)



Source: Rabobank International, 2002

buying larger volumes from a smaller number of wine companies. The emergence of the supermarkets in wine distribution is therefore one of the major drivers of the consolidation process in the wine industry.

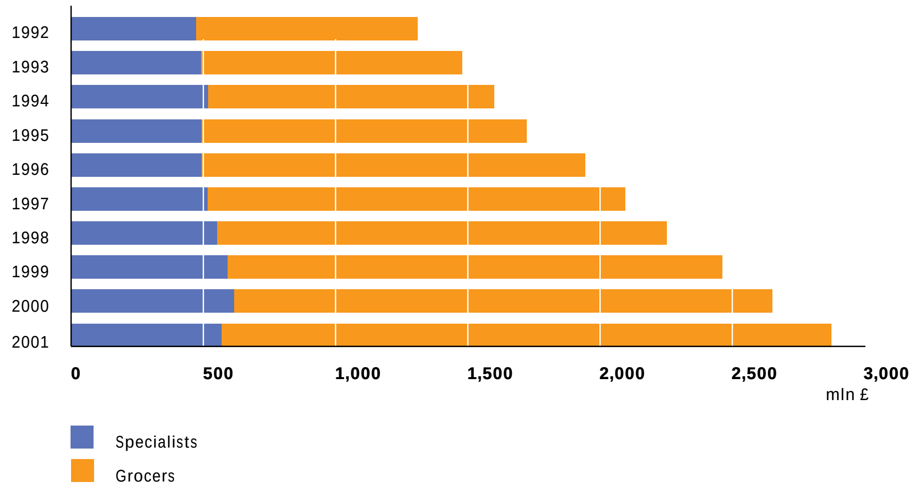
... and requires clear retail formats

A highly competitive retail environment results in consolidation among retailers. In addition service retailers need to create distinction in their formula with respect to discount retailers, whose market share is around 10% in most EU countries. Germany (35%) and non-EU Norway (37%) are two exceptions to this. The presence of discounters makes the market highly price-sensitive because their price points are a benchmark for the other outlets.

... gaining distribution share at the expense of bottle shops

Supermarkets in Western countries are increasing their share of off-licence wine sales at the expense of specialty shops, as can be seen in *figure 4.2*. In the United Kingdom the grocers' distribution share continues to increase, up to 77% of off-trade value, making the retail chains the sole growth market. They benefit from their efficiency in logistics and low trade-ups, the trend of at-home consumption of wines and consumer demand for convenience and one-stop shopping. Up to now the specialty shops have been able to maintain their market value thanks to their specialisation in quality wines. This position is also likely to be challenged. Supermarkets have discovered the benefits of adding quality wines to their range, and even discounters are considering the same route. Although the rotation of such wines is fairly low, selling quality wine – up to a certain price point – can attract other public to the shop. In some markets retail chains sell wines up to EUR 100 a bottle, whereas in other markets exceeding EUR 5 is a challenge.

Figure 4.2 Off-licence wine distribution in the United Kingdom



Source: ACNielsen

Retailers influence consumers and suppliers

The growing power of retailers manifests itself in two directions. Downstream, they try to attract consumer attention through their wine assortment, private labels and promotional activities. Their assortment building, based on branded wines as well as their own private labels, has helped to reduce the consumer's confusion, while at the same time educating and allowing the consumer to trade up, but there is still work to be done. Consumers today are 'in for the education' given by the retailers, who are able to introduce and discuss their wines in their own media. This education, however, could and should be further improved, as the average consumer continues to be baffled by the product. Better use could be made of back labels, information in shops and magazines and retailers' web sites.

BOBs facilitate choice

The Buyers Own Brands (BOB) have played a major role in popularising and increasing consumption – in particular in the value-for-money segment. For the inexperienced consumer the retail brand is the first point of reference. One of the challenges for a private label is to create an attractive range of wines with large volume and consistent quality. In addition to BOBs, retail chains need a range of attractive brands to further differentiate themselves from their competitors.

Retail chains impact their suppliers … and traders

The upstream power is felt mainly in the basic and premium wine segments, where the retail chains have the largest share of wine sales. In these key segments for retailers, further consolidation is anticipated in order to meet retailers' needs for large volumes, distinctive assortment, greater brand variety and more service from fewer suppliers. Increasingly retail chains have their own wine purchasers and buy large volumes of easy-to-understand wines directly from the wine company, thus excluding the traditional wine trader. This is particularly true for the BOBs.

... resulting in large wine companies

The large retail chains are demanding larger volumes of consistent quality and a better quality/price ratio, as well as greater service and a decreasing number of suppliers. The appearance of large-scale wine companies was the perfect response to retailers' needs. In turn these suppliers need broad retail distribution for their brands and large volumes. In this respect there appears to be some balance of power between the major retail chains and the leading wine companies. In practice, however, there are very few wines that cannot easily be replaced by the products of a competitor, which weakens the wine companies' negotiating position. Retailers continue to complain that the wine suppliers – and the Europeans in particular - do not fully meet their requirements in terms of a consistent supply of distinct brands and real innovation. Retailers are therefore a threat for some wine companies yet an opportunity for others.

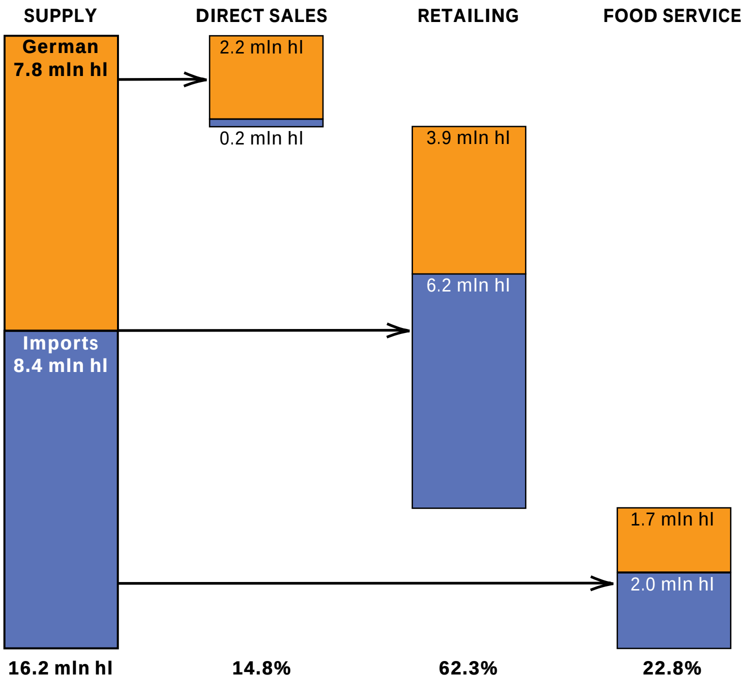
Wine is important to retailers

For retailers wine appears to have been of increasing importance in the overall assortment. Though wine represents only between 1% and 2.5% of total retail sales and is a slow mover, it supports retailers in their positioning. Offering an attractive range of branded wines enables a retail chain to differentiate itself from the competition and may generate store traffic. The fact that the wine market so far has not been transparent – consumers cannot easily compare prices – allows retailers to place above-average margins on the wines.

Retail formats with different requirements

Finally it is important to note that different retail formats exist, each with their own requirements. Discount retailers focus on price and offer a narrow range, which may vary during the season. This may be attractive for disposing of remaining stocks of decent quality but is no option for the leading brands. In Germany the market has an enormous price focus; 35% of the total wine volume is sold through discount stores, mainly at under EUR 3 per bottle.

Figure 4.3 Wine distribution in Germany

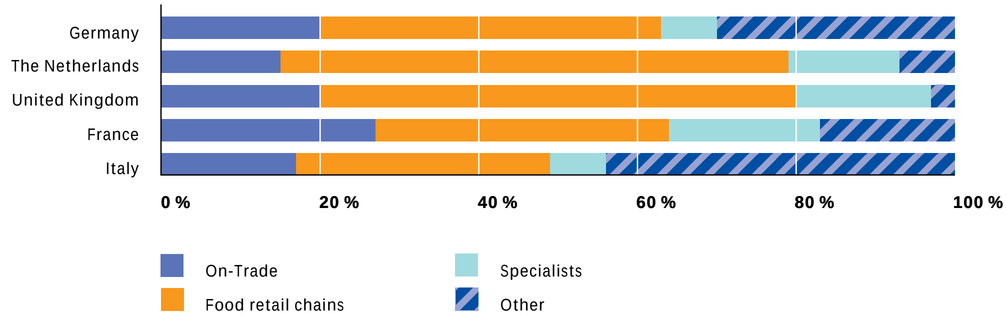


Source: Deutsches Weininstitut

The bottle shop is losing distribution share

In Europe on average 10-20% of volume is sold through specialised retailing (wine/liquor retail shop), the distribution share of which is declining. In the traditional wine-producing countries, particularly Italy, direct sales to the consumer are important. Some 15-20% is sold through the on-trade. This percentage is comparable with the USA, where the on-trade has a 21% volume share and 44% value share.

Figure 4.4 **Wine distribution in Europe**



Source: Rabobank International, 2002

Challenge to pass the gatekeeper

Finally there is the challenge posed by the gatekeepers. For wine companies it is increasingly difficult to pass the few gatekeepers in each market. Important gatekeepers are the buyers for the major retail chains who decide what wines will be placed on the retail shelves.

Figure 4.5 **EU: Gatekeepers' volumes in the supermarkets**

	distribution share all retail chains	market share top 4 retail chains	distribution share top 4	market size (million cases)	average volume per retail chain (million cases)
Germany	42	55	23	204	11.8
France	41	70	28	380	27.1
United Kingdom	70	56	39	140	13.7
Netherlands	72	66	48	34	4.1
Belgium / Luxembourg	53	70	37	32	3.0

Source: Rabobank International, 2002

Figure 4.5 highlights the average volumes bought by the top-4 gatekeepers. Some retail chains are more successful in wine than others. For some, their distribution share in wine is higher than their overall market share, often called: fair share. For Albert Heijn, for instance, the fair share in wine is calculated at nearly 40%, compared with their overall market share of 29%. The volumes sold by the major retailers – and therefore bought by their gatekeepers - in France, Germany and the United Kingdom are huge. The Albert Heijn gatekeeper is responsible for a volume of some 6 million cases.

Other gatekeepers with importers

Other gatekeepers can be found with the leading importers. Once these gatekeepers have passed a major brand from one region or country, it is hard to convince them to add to or replace the range. Failing to pass such gatekeepers is increasingly a major risk for the wine industry. The number of important gatekeepers per market is decreasing.

Future dynamics: Increasing retail power

- Retail chains are expected to continue increasing their distribution share. Consolidation among retail chains in Europe as a whole is, however, less prevalent than in the USA;
- Discount retailers may increase distribution share in the EUR 3 segment. Their competitive advantage in this segment is strong: they can select and sell attractive 'lots' with a trade-up of less than 25% - excluding VAT - thanks to their low-cost structure;
- Service retailers need brands to build a broad and consistent range in their assortment. This requires long-term relationships with suppliers. Service retailers without an attractive range may lose distribution share to discount retailers and other service retailers;
- The wine market is becoming more transparent in Europe because of the effect of the euro, the increasing impact of brands and consolidation in retail. Increasing transparency tends to result in increasing competition among suppliers.

For wine companies it is increasingly important to understand the dynamics of wine distribution in individual markets. Failing to do so may result in not being able to pass the gatekeepers of the most attractive outlets.

5 Creating brand value

Brands: response to retail and consumer demand

With the emergence of supermarket sales in the 1990s, brands gained momentum in the wine industry. But while branding has become a common phenomenon in wine, the sector has yet to establish well-known global consumer brands. The major brands today are mainly in the popular premium and premium segment and include E&J Gallo, Lindemans, and Jacobs Creek. It seems unlikely, however, and given the nature of the

Figure 5.1 The major brands in the wine industry

Brand	Supplier	Country	Million cases
Franzia	Wine Group	United States of America	19.7
Carlo Rossi	Gallo	United States of America	13.5
Twin Valley	Gallo	United States of America	10.5
Almaden	Constellation	United States of America	9.7
Freixenet	Freixenet	Spain	9.3
Livingston Cellars	Gallo	United States of America	7.5
Sutter Home	Trinchero	United States of America	7.0
Woodbridge	Mondavi	United States of America	6.6
Beringer	Fosters	United States of America	6.5
Lindemans	Southcorp	Australia	5.9
Jacobs Creek	Orlando / Pernod Ricard	Australia	5.3
Hardy's stamp	Hardy's	Australia	5.0 (e)
Chenet	Grands Chais de France	France	4.5
Rosemount	Southcorp	Australia	4.9
Inglenook	Constellation	United States of America	4.5
Peter Vella	Gallo	United States of America	4.4
Arbor Mist	Constellation	United States of America	4.2
Rotkäppchen	Rotkäppchen	Germany	4.0
Mumm sekt	Rotkäppchen	Germany	4.0

e = estimate
Source: Adams Wine book, Rabobank International, 2002

product even undesirable, that huge global brands would be established comparable with those of the soft drinks and spirits industry, as this would result in monotone products and consumer attention might drift away to other, more innovative beverages.

First brands in the Old World

Brands in wine are not new and have been created in the Old World before. One of the characteristics of a brand, however, is that it offers consistency, which is why it was easier to develop brands with fortified wines and sparkling wines, including champagne. Former EU wine brands, such as Mathéus Rosé and Blue Nun, have gradually lost momentum because they lacked the premium image, brand ladder and range associated with modern brands.

Modern wine brands meet market criteria

Modern branded wines were first launched by the new wine countries as a strategy to compete with the rich tradition of the old countries. These brands were created with high marketing expenditure, strong customer focus and an appealing range – often based on single-variety wines of a consistent quality from one season to the next.

EU brands mainly in sparking wines … New brands coming up

The modern brands posed a threat for the old wine countries in several ways. The brands appeared to be appealing successfully to the market and gaining market share. The response, however, was not easy. Firstly, the industry culture was not in favour of brands. Secondly, the industry structure was too fragmented to create consistent brands of the appropriate volumes. Consistent quality is also problematic because of the instability of the climate. Interestingly, the leading European brands, as shown in *figure 5.1*, are to be found in the cava/sekt segment. As is the case with champagne, these industries have a strong focus on branding, being less vulnerable to seasonable influences on the crop. Nonetheless, some of the leading EU wine companies are now turning to branding, treating it more seriously than merely a fancy label on the bottle.

Wine brands have advocates and opponents

There appears to be some misunderstanding about branding. As explained below this issue is much more complex in the wine industry than in any other food or beverage industry. The industry has strong advocates both for and against branding.

Economics support brand stance

Brand advocates

From an economic perspective the brand advocates seem to be right. In the United Kingdom off-trade market the top 5 brands have a combined market share of over 13%, which continues to grow. In 2001 the off-trade market grew 7% in volume; only the top 20 brands benefited from this growth (+34%), leaving just 0.6% growth for the rest. The Rosemount brand from Southcorp outperformed even amongst the brands; up 44% in volume and 31% in value, thus gaining further market share. In the United Kingdom on-trade the top 5 brands represent over 12% of the market. It is interesting to note that seven out of the top eleven UK wine brands come from Australia, two from the USA and one each from the United Kingdom and France.

In the USA similar high market shares can be observed. Interestingly enough, the market share of the top 4 brands has stabilised whereas the top 20 brands have increased market share. This trend is in line with the stabilising demand in basic wines and growth in the quality segments, where the brands are smaller. In most other countries, however, wine brands have a much weaker position, partly because there is as yet no consumer brand awareness.

Figure 5.2 United States of America: combined market shares in the wine industry

	1995	2001
Top 4 brands	22.6%	22.8%
Top 20 brands	50.6%	52.0%

Source: Adams wine book

Brand sceptics only defensive

Brand sceptics

Brand sceptics have a range of arguments why brands would not work in the wine industry. Such arguments may partly be traditional and defensive, as most traditional wine companies simply lack the critical mass to create brands. Others claim that wine should not be marketed like a soft drink and that the diversity does not allow for real brands with more homogeneous quality. This may be true for the small volumes of the super premium segment and beyond, but with premium and popular premium wines consumers prefer the consistency that brands can offer, and branding is therefore a main feature of these segments. In addition, the largest popular premium brands sell some 6 million cases and each represents a segment share of less than 2%. Gallo, the world's largest wine company, has less than 3% market share in the total wine market. Such numbers are very low compared with most other beverages. For the time being there appears to be enough choice.

AOC or region is not a brand ….

In a highly fragmented market, company brands, regions, controlled bottling (Appellation D´Origine Controlé; AOC), variety and even countries can all be a point of reference for the consumer. It appears indeed that consumers are gradually shifting from ordering just a white wine at a bar to ordering a Chardonnay. More sophisticated consumers may order a Burgundy or a Margaret river wine at a smart restaurant. So while building the brand of a country – Australia – or a region – Rioja – may help to create image and distinction in the market, it is not enough. A region or even AOC represents a style of wine and is at best a certain guarantee for quality, but is not a real brand. When for instance AOC Bordeaux is being sold for about EUR 2 per bottle, this certainly impairs the region's image for quality. At best a region or AOC can be one of the carriers of a brand, in particular if the quality of the region can be secured and increased. A brand can only be created and safeguarded by individual companies and not by a body representing the interests of a whole region.

.... but an important carrier of corporate brands

Brands, regions and factors like AOC cannot, however, be regarded as completely separate issues. A wine company may make a very good brand, meeting all the market requirements, but if the image of the country or region is poor or has been damaged by scandal, the brand value can be impacted strongly. For consumers, wine is directly related to pleasure and lifestyle and in the event of doubt about brand values, they will shift easily to other wines. So for branded wine companies looking to guarantee the quality of their own wines, contributing to regional and national quality guarantee systems is just a matter of risk management.

Brands: a point of reference for consumers

Brands and consumers

The range of wines available today is so broad that it is often confusing and even intimidating for the consumer, new consumers in particular. Brands - a recognisable point of reference for the consumer - serve to counteract this problem.

Wine brands may become tired

One issue is whether present wine brands may lose their attraction as happened to the old EU brands. Some wine critics have predicted this on the grounds that many brands are too industrial and generic. This may well be the fate of some brands, especially if they become tired and do not follow the general trend to further improve quality and brand profile.

... and brand loyalty is still low

Wine is indeed different from other branded beverages. Even in the United Kingdom and the USA, brand loyalty in wine seems not to be very strong. Brand loyalty may be somewhat easier to realise in the large popular premium segment, as most consumers there lack any kind of wine knowledge, and well-known brands give them some security. In the premium segment, however, consumers want more choice, want to be surprised – in a positive way – and continue to experiment – without too much risk. For the time being, the range here is huge, which offers growth opportunities for attractive brands.

Brands should stand out in the crowd

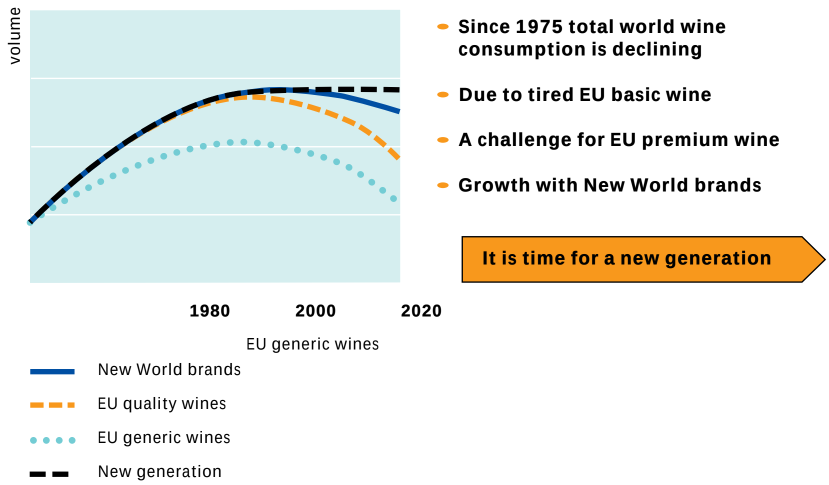
Today's wine consumers don't buy a brand; they join it. This means that a brand really should stand out from the crowd, should not be complicated but fit into a relaxed lifestyle. The brand that understands branding as opposed to labelling will have above average-growth opportunities.

US brand awareness and wine advertising

Brand awareness is increasing among consumers, particularly in the United Kingdom and the USA. Nevertheless, even in the USA there is still ground to gain. Wine advertising in the USA grew to an estimated EUR 145 million in 2001, from EUR 135.2 million in 2000; on average some 2% of sales value. By contrast, the beer advertising spend was EUR 953.4 million while spirits companies spent USD 406.7 million; between 10% and 20% of sales. A major challenge for the fragmented wine industry is to reach the right consumers with a limited budget. Smaller companies focus on magazines, such as the

Wine Spectator, or just stick to trade magazines. Notwithstanding large US wine industry budgets – relative to the average budgets of EU wine companies – brand awareness for US wines is still limited. According to recent research, Gallo and Beringer are known by 70% of US wine consumers, but even Robert Mondavi is unknown to about one third of US wine drinkers. For the time being, such brand awareness is unheard of in the EU, maybe with the exception of the United Kingdom, where Australian and US brands have gained a strong position.

Figure 5.3 **Life cycle of wine brands**



Source: Rabobank International, 2002

Wine brands need to be build

... to gain a premium

Wine branding

Brands need to be deliberately built to create consumer loyalty. In so doing they generate a price premium or at least a buying preference over wines without a clear brand. A brand without a clear premium in the market is merely a trademark, which may be useful for contacts with the gatekeepers, but is not enough to build customer loyalty in an increasingly competitive market. Successful brands are based on a thorough understanding of the market and are sold mainly through the major supermarket outlets, where the volumes required for a brand can be realised. Requirements for brands include reliability – consistency in quality and volume and simplicity. The latter offers clarity to both the retailer and the consumer alike.

Innovation and brand are more than fancy label

Innovation in wine branding has mainly been limited to updating labels and in some cases the bottle. There appears to be demand for really innovative consumer-oriented brands, such as brands particularly developed for consumer groups or drinking occasions. Brands today need to clearly distinguish themselves because some 25% of the retail wine assortment is already branded.

Brand is not everything to everybody

The segmentation of the wine industry, however, means that a given brand is unlikely to achieve success in all segments, from basic to ultra premium. Each brand must therefore target the specific market segment in which it can build recognition and increase market share. Many wine companies, however, have good experiences with brand ladders, which encourage consumers to trade up within their existing brands. A brand ladder may trade up from the generic brand to a special selection (bin or reserve) or single vineyard/estate. The Southcorp brand Lindemans is a clear example. Other brands are trading down; leveraging the brand name of a ultra premium wine to be able to produce the larger volumes possible in the premium segment, such as Mouton Cadet and Penfolds Rawson Retreat.

Time for a new generation of wine brands

When brands fail to innovate they may become tired and fail to hold consumer attention. It is time to consider a new generation of brands that are less generic and targeted more specifically towards various consumer groups, lifestyles or consumption moments. The first of such brands are now visible in the market, developed for the youth or female market, often in single-portion bottles.

The middle market is battle field

Wine brands will reshape the industry

The growth opportunities anticipated in the middle segment, mainly popular premium and premium, will make this the main battlefield for wine companies investing in their brands. This is also the segment in which the major retail chains have a dominant position in wine distribution. The major companies have the best position in this segment. Competition between wines from new and old wine countries is fiercest here and branding will be a key weapon in the battle to survive. Wines from smaller suppliers may all too easily be excluded.

Future Dynamics:

- All wine companies – not only the giants – need to monitor market trends, consumers, distribution and branding in order to adjust their strategy in time;
- A further increase in the major brands can be expected, in particular in those markets where consumers have not yet discovered brands, where they are able to gain market distinction and customer loyalty, and may even attain as much as 40% of retail sales;
- The leading global brands form the heart of the retail assortment;
- There is also room for smaller and single-product brands with clearly distinct products, such as a brand from a smaller country, Freixenet cava or Blue Nun;
- Suppliers without clearly distinct products can be replaced too easily on retail shelves. Additional strategies may be required to strengthen their position;
- It is time for a new generation of wine brands aimed at consumer groups or drinking occasions.

6 Increasing competition

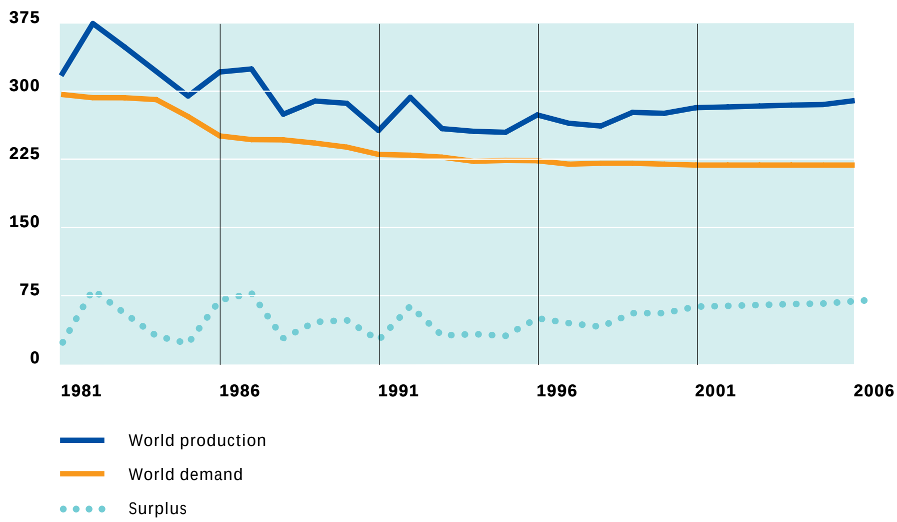
Significant changes are occurring in the competitive relationships between the wine companies and the old and new wine countries, with old wine countries gradually losing market share to new wine countries.

6.1 Competition between wine countries

Increasing wine surplus is challenge

The world wine market has been characterised by declining production and consumption over the last 25 years, a decline that has affected mainly France, Italy and Spain. The EU in particular has a structural overproduction varying from 12 to 25 million hl. Some of the surplus is used for the production of alcohol – brandy, cognac, etc. – whereas the remainder is largely distilled as industrial alcohol. In the 1990s

Figure 6.1 World supply and demand equation (million hl)

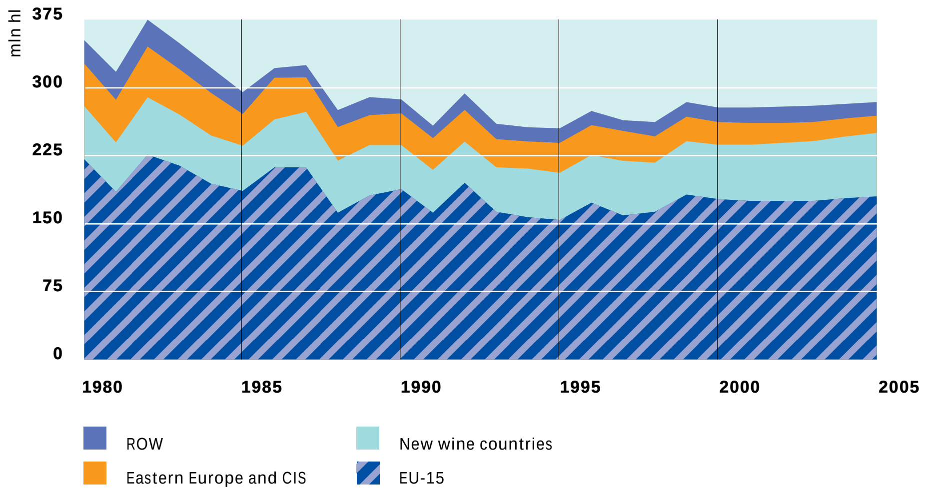


Source: Food and Agriculture Organization of the United Nations, Rabobank International, 2002 overproduction averaged about 16% of world production, but this may become as high as 23% if the current supply and demand trends continue. The question is whether the alcohol markets, which are often subsidised, can absorb such supply. Pressure on the industry seems to be mounting, and competition will follow suit.

Increased production comes from the New World … whose quality wine will flood export markets

The variation in world production is mainly due to the annual changes within the EU where the weather is less predictable than in other wine producing regions. Production in Eastern Europe has declined considerably while New World wine production today is, rather remarkably, nearly the same as 20 years ago. This can be attributed largely to declining production in Argentina, which more or less balanced the increasing production in the other countries. For the year 2006, however, we anticipate that production in the New World will increase by about 14%, from 66 to some 75 million hl, based on the recent plantings in many of these countries. Since domestic demand in these markets is more or less stable, nearly all of this additional wine will enter the world market, which alone will increase world trade volumes by 15%.

Figure 6.2 **World production and outlook**



Source: Food and Agriculture Organization of the United Nations, Rabobank International, 2002

Figure 6.3 **World wine production** (million hl)

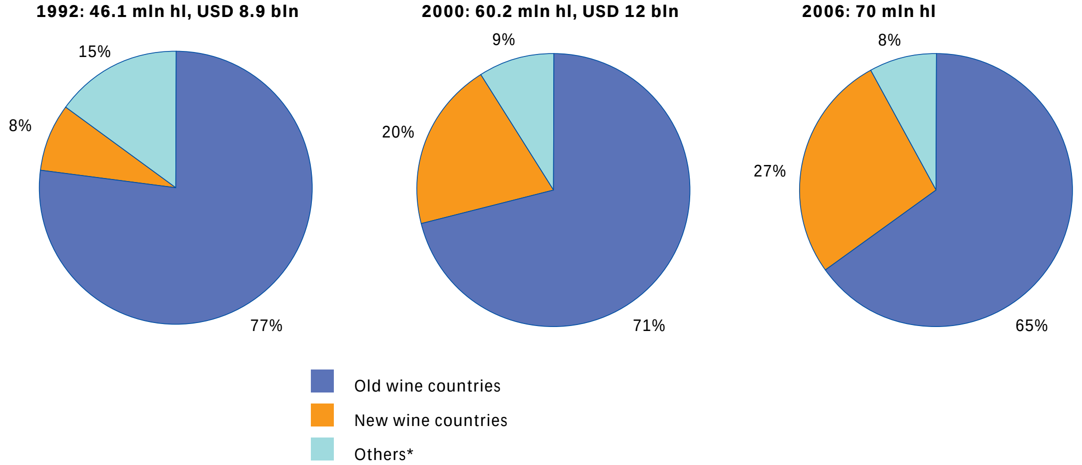
	1981 – 1983 average	1998 – 2000 average	2001	2006E
EU	210	175	164	170
New World wine	59	59	66	75
Others	79	44	52	35
World	348	278	282	280

Source: Food and Agriculture Organization of the United Nations

Shifts in competitiveness visible in trade numbers

The shift in competitiveness is clearly highlighted by the export shares of the New Wine countries, which increased from 7.8% in 1992 to 20% in 2000, and is expected to increase further to 27% in the year 2006. Figures in the UK market are quite revealing; Australia has surpassed France as the number one supplier in the off-trade segment, with a volume share of 22.3% for the twelfth month ending July/August 2002.

Figure 6.4 Wine export shares



* Others are mainly Eastern European countries
Source: Rabobank International, 2002

Competition takes place in different quality segments

The countries and companies compete not only in terms of volume in the international market, but more importantly in terms of quality, expressed in the price points, typified by the average exports price in *figure 6.5*. Price points are a clear reflection of the quality of the wine, as perceived by the market. New Zealand, for instance, while being a small

Figure 6.5 Export volumes and prices of major wine export countries

	Average annual export volumes (million cases 1990-1995)	Average export price in EUR/case 1990-1995	Average annual export volumes (million cases 1995-2000)	Average export price in EUR/case 1995-2000
France	128.1	32.24	166.8	32.37
Italy	148.9	10.19	164.8	13.70
Spain	76.3	10.25	92.8	12.82
Chile	9.6	12.37	36.2	12.87
Germany	30.0	15.18	25.9	16.40
United States of America	12.7	13.22	25.7	17.59
Portugal	20.9	21.23	23.2	22.26
Australia	10.0	19.50	22.3	29.38
South Africa	4.9	13.23	12.9	14.37
Argentina	7.5	4.70	12.7	10.07
New Zealand	0.8	26.57	2.1	29.42

One case = 12 bottles of 0.75 litres
Source: Food and Agriculture Organization of the United Nations

supplier in the international market, has wines that enjoy a good image and are regarded as high value and high quality.

Despite the increased competition, a few countries were able to increase average export prices in the course of the 1990s. A clear example is Australia, which saw average export prices increase by some 50% due to the shift in focus from basic to quality wine. Argentina also saw a strong increase in average price because it was exporting larger volumes of quality wine in addition to its bulk wine shipments. Referring to the ex-winery price points mentioned in *figure 1.2*, export prices of some EUR 12 per case indicates that large volumes of basic wines are being exported. This segment is particularly vulnerable in times of overproduction.

The challenge will be in which quality segment

It is, therefore, important to understand where, and in particular in what quality segment, the increasing competition will occur. Other than the traditional overproduction of cheap basic wine in the EU, most of the increased supply in the years to come will be quality wine, given the substantial investments New World countries have made in that segment. The question is whether the market can absorb the additional volumes that will result from the more intense competition from these quality wines.

Different factors will influence the outcome

This issue, however, is more complicated than just volumes. An additional 10 million hl from New World wine countries – 4% of the present total market volume, or some 10% of the quality market, in the next 5 years – should not be a major hurdle, since the quality markets continue to offer good growth opportunities. The response of the consumers and the wine industry can, however, have a major impact. Experience has taught that individual wine companies can grow fast in a shrinking market if they move away from the traditional approach. In addition, markets can change very fast. In the second half of the 1990s the wine industry in Australia anticipated an oversupply of Chardonnay; today there appears to be a shortage of quality Chardonnay in that market. If companies decide to reduce yields and increase quality in a massive way, this factor alone could have a major impact on the supply/demand equation in the different quality segments. Furthermore, premium wine may be sold at lower price points, which will have its own impact on the market. As a whole, it appears that the near future will reveal stronger supply pressure than in the past, which may further alter the competitive scenario.

Australia

Each wine country has its own challenges

Australia seems to benefit from a near ideal industry structure, with several suppliers of very strong brands, and many smaller suppliers, which add to the range. In addition, the country image fits well with the modern and laid-back life style related to modern wines. Nearly all the vineyards are planted with classical varieties. Finally, the industry has a unique industry culture, together building the brand of Australia, and facing challenges ahead.

The country certainly has a strong competitive position, in particular in the United Kingdom, and is now gaining foothold in the attractive US market. Nevertheless some challenges are emerging as the success has partly created its own problems. Due to heavy planting, some wines are faced with oversupply, and prices for lower quality grapes and wines have dropped considerably. Analysts, however, believe that the current oversupply is only a temporary problem and that the industry may shortly experience shortages again, based on projections for near future supply and export opportunities.

For smaller and medium sized companies it is increasingly difficult to maintain the best distribution channels abroad, when these channels are already filled with the brands of the giants. Many wine companies have anticipated these challenges and have adjusted their strategy accordingly. Others may have less room to manoeuvre. Finally, an export market that maily comprises two countries has its own risks. The next step for Australia is to increase the distinctiveness of its wines, making better use of the different characteristics of the regions, including 'terroir', now that a strong basis has been laid. A report on the challenge for the future has been called 'The Marketing Decade', an appropriate title.

United States of America

Similar opportunities and challenges exist for the USA, though with the additional challenge prompted by the industry's lack of export orientation in the light of a profitable domestic market. The USA is one of the few wine producing countries with massive imports. The cost price in the USA seems to be higher than that of some competitors for similar qualities, which is a challenge both in the domestic and export market. Nevertheless, several leading US wine companies are now successfully entering export markets.

Chile

Chile has been very successful in the international markets, with decent New World wines at reasonable prices and a few strong international brands. However, its limitations are starting to catch up. Known in particular as a reliable supplier of basic and premium wines, Chile is finding it hard to break away from this image. If competitors become more innovative in content and branding, many brands form Chile run the risk of becoming 'tired', in particular when there is too little distinction amongst the wines. The industry is now responding, by moving in the direction of more elegant wines of higher quality.

Argentina

Argentina has some challenges of its own, due to the national economic and political situation, which makes it more difficult for the wine industry to continue to invest, in among other areas its own brands and distribution in the export markets. One of the assets of the industry is the broad range of wines produced, although most of this volume is not yet of export quality. Nevertheless, both Chile and Argentina have several foreign investors and joint ventures with leading international wine companies, which no doubt will further stimulate the industry.

South Africa South Africa has the characteristics of both the Old and the New World, in terms of industry structure and types of wines produced. Gradually some international brands are emerging. The image of the country is largely that of an increasingly reliable supplier of popular premium wines, and the more premium estate wines. The country has the potential to distinguish itself more from others, in terms of image, brands and wines.

New Zealand New Zealand has been in a unique position up to now, as the only wine country lacking enough supply. The strategy to focus on quality and the best suitable varieties in the climate, Sauvignon Blanc in particular, combined with a generally good image has proved very successful, as proven by the high average export prices. The portfolio has now been extended with other varieties. The challenge is to maintain the image and price points, now that volumes are moving up.

Spain Spain is often seen as the most innovative wine country in the EU. This is certainly true for several of the leading companies, of cava and Rioja in particular, who are international players. The country has the advantage of the clearly distinct Tempranillo variety. Unfortunately, Spain still produces huge volumes of basic wines, which are hard to sell, and do not add to the wine image of the country as a whole.

Italy Italy, the second largest wine producer in the world, is also the most fragmented. Only very few companies have the scale to be able to compete successfully in the international premium market. A few companies are successful in the ultra premium segment. It exports large volumes of very cheap wine to Germany for the production of sekt, the market for which is saturated. Nevertheless, signs of change are visible. The country has a unique range of wines, which could be attractive to add to the range of 'classical' varieties, now much in demand.

France France is the world's largest wine producer, with a traditionally strong image. The country now appears to be faced with the dialectics of progress and is losing market share in the international market. The country continues to offer a unique range of wines of all qualities, but lacks the industry structure and spirit of innovation to effectively meet the modern challenges in its export markets. Several companies seem to understand these challenges, but it appears to be difficult to implement a new and successful strategy. Unfortunately, the Languedoc/Roussillon region, where most innovation has taken place, is faced with many challenges today, including a 15% decline in exports. The major risk for France is a loss of market share in the attractive premium segment, due to a lack of strong brands.

Germany

Germany seems to be at the crossroads of different trends. The lion's share of supply comprises cheap, sweet white wine, popular with older consumers and some retail formats. In terms of innovation and image, this appears to be a dead-end street, as can be seen in the export volumes and prices. The country has largely lost the premium segment, which today requires other styles of wine and other branding strategies. Some companies, however, have met with the challenge and have successfully re-invented their brands.

Old wine countries have less freedom to respond

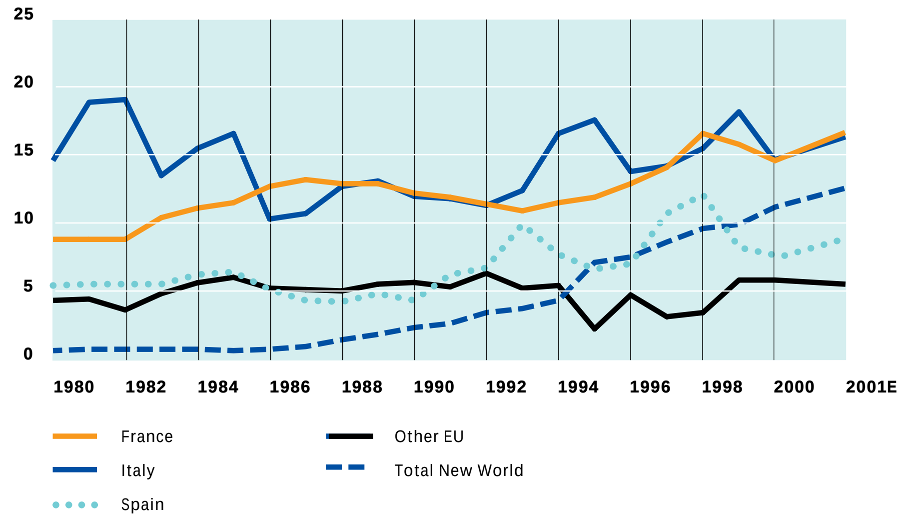
Old versus new wine countries

Traditional suppliers, in the EU in particular, which used to be supply rather than demand oriented, and have tended to neglect or ignore new approaches, will remain the most vulnerable. The fragmented structure in the old wine countries makes it difficult to react to current trends. Most of the innovators are too small to be able to create strong brands and benefit from growth opportunities in the premium market. The best opportunities for such companies can therefore be found in the high-quality and top-basic segments of the market, where they can benefit from the traditional image and the proximity of the market.

New World success is more than the brands ...

New wine countries were originally at a disadvantage given their distance from the major markets and, as a result, focused mainly on domestic markets. However, with improvement in international transport techniques and the decline in shipping rates, distance is much less of a barrier. Costs to transport wine from South Africa to London by boat, for instance, are now lower than trucking it from Southern France to London. In addition, the 'new' countries had the freedom to innovate in quality and branding and

Figure 6.6 **Long term export volumes of Old and New World exporters**



Source: Rabobank International, 2002 based on FAO* statistics

* Food and Agriculture Organization of the United Nations

create critical mass. More importantly, however, is their focus on the market, both customers and consumers, which allows the companies to adjust strategy in time.

Figure 6.6 shows the long-term export volumes of the major suppliers in the Old World and the combined exports of the New World countries. It is interesting to note that France, Italy and Spain have been able to increase export volumes considerably – particularly in the 1990s, counterbalancing declining domestic consumption. Only during the last few years have their exports been declining, whereas New World exports continue to grow. Combined, the New World countries still export less than France or Italy, but with 10 million hl from these new countries estimated to be on the market around the year 2006, this situation will certainly change.

A challenge for all wine countries is to develop their own style and image in the fast changing wine market to support the position of the individual companies. But, as the stock market knows, past results are no guarantee for the future.

6.2 Competition between wine companies

In the past, the market was highly fragmented but with increasing consolidation in the industry, competition among companies is mounting, not only in terms of volumes and price points but in particular in terms of shelf space in the most attractive outlets.

Leading wine companies: a few categories

Most of the leading wine companies in the world can be found in the new wine countries, which are much more pro-active in the changing market. Continuous product innovation, largely geared towards a specific market segment, brand building and broad product portfolios are all hallmarks of this market orientation. The leading spirits companies seem to have discovered the wine industry as well, due to the growth opportunities of branded wines. Their wine interests can therefore largely be found in the new wine countries.

The largest EU wine companies operate in the sparkling wine (champagne, sekt and cava) segment, which is much more brand oriented and therefore requires critical mass, as well as in the French négociants, most of whom invest little in vineyards but are active in blending and branding.

In addition to these wine companies, several large wine traders and retailers are active in the wine industry, including:

- Southern Wine & Spirits; US trader, EUR 4 billion sales, including spirits
- First Quench: UK retailer, EUR 1.5 billion sales
- Wein International WIV Germany: direct sales to consumers, EUR 0.5 billion sales.

Figure 6.7 **The top 20 wine companies in the world** (based on most recent figures available)

		Wine sales Million cases	Million EUR	Remarks
1	**E&J Gallo**	63.4	1,428	Largest wine company, incl. Spirits
2	**Allied Domecq**	21	1,200	After acquisition Mumm Perrier, Montana, BYB, Buena Vista, Argentina (2x
3	**LVMH**	7	1,140	Mainly champagne
4	**Southcorp**	22.2	1,050	After merger with Rosemount
5	**Foster/ Beringer Blass**	14.2	1,050	After acquisition Beringer
6	**Constellation/ Canandaigua**	42	863	Includes trade, Turner Road and Franciscan, excluding Mathew Clark USD 695 m
7	**Diageo**	12E	700E	After acquisition of Seagram wines
8	**Castel Frères**	48	666	Négociant, also in beer and water
9	**Henkell & Co**	12.7	619	Mainly sekt
10	**Freixenet**	16.6	528	After acquisition of Yvon Mau and Wingara
11	**The Wine Group**	n.a.	n.a.	
12	**R. Mondavi**	9.4	441	
13	**Pernod Ricard**	17	440	Includes Jacobs Creek and third party trade
14	**BRL Hardy**	17	420	
15	**Schloss Wachenheim**	15	420	German sekt
16	**Grands Chais de France**	3.0	386	Négociant
17	**Val d'Orbieu**	4.7	350	Co-op
18	**Kendall Jackson**	n.a.	n.a.	
19	**Rotkäppchen**	8	300	German sekt
20	**Brown Forman**	5.4	257	Including Fetzer

Source: Rabobank International, estimates, based on industry sources, 2002

investments increased costs

Investments and innovations have intensified the competition and the need to offer competitive products. These large investments, mainly made in the new wine countries, however, have resulted in a new challenge: high fixed costs. Several companies have decided to get listed to be able to attract the capital required to expand their business. Such listed companies have to take the return on capital employed into account more than other companies.

Further consolidation expected

Consolidation is expected with branded wine companies in particular, as the value of the brands and increasing distribution power of these companies will allow for the premium price points required to cope with the costs of acquisition. Consolidation in vineyard production, other than with the integrated branded, super and ultra-premium wine companies, is not expected to the same degree, due to the low return on investments for vineyards, anticipated in times of overproduction.

Competition: fight for the best distributors ...

One of the most visible places where the increased competition will take place is the battle for distributors and shelf space. Both in Europe and the US most wine companies sell their wines through specialised distributors/wine traders. Several of the larger wine companies are now optimising their distribution in the major markets. The new approach of Diego and LVMH in the USA, appointing single joint distributors per region, with a dedicated customer sales force, is a challenge for small and medium sized wine companies, as the distributors are likely to give less attention to the brands of these companies. In Europe the largest wine companies have direct access to the retail chains.

... as well as shelf space

As the size of the retail shelves is limited, the wine companies also compete for shelf space. If a gatekeeper of a retailer considers placing a new brand on the shelves – they get new offers on a daily basis – this will adversely affect another brand. As the volumes per brand increase, the risk of being replaced can cause considerable damage for a wine company, which is a prime reason to surpass the expectations of customers, consumers and retailers alike.

Wine itself has to fight for shelf space

The battle for shelf space does not only involve wine; with several retailers the shelf space for the RTD beverages has increased at the expense of the wine listings. So far the wine industry has not been able to find an answer for this fight for stomach share – and therefore shelf space.

Future dynamics: Increased competition

- ’Old‘ wine countries are expected to continue to lose market share, and in the premium market in particular;
- Wine companies are becoming professional beverage companies. Most have invested in premium and super premium brands;
- Competition between wine countries and companies in particular is mounting. This will result in pressure on prices and margins, and increased risks;
- Wine companies are therefore looking for formulas to outsource the vineyards in the lower segment wine, while maintaining their own vineyards in the quality wine segment;
- Increasing competition will result in increased quality at competitive prices, which makes wines more attractive and encourages consumption.

7 Drivers' impact on wine strategies

The 1990s have shown attractive growth opportunities for many wine companies, but competition is mounting and wine companies need to prepare for a more competitive market. Clarifying and fine-tuning strategies is now more important than ever. The whole strategic process should be based on a good understanding of the market, and it is here where some ground can be gained. Knowing the industry drivers, as well as their own position in the industry, wine companies can analyse their key success factors (KSF). These depend on the market segment in which the company operates, and can be quite different for a leading global premium wine company and, say, a leading producer of Burgundy wines. If a company has analysed the market in which it intends to compete, amongst others in terms of quality, country/region of supply and sales, it can list KSFs and produce the profile of an ideal competitor in the selected segment. The discrepancy between the present situation of the company with the KSFs is a good basis for the development of the strategy, expressed in the business plan, and should be as specific as possible.

The KSFs are company specific and relate to the following issues:

- Clear positioning;
- Branding power;
- Range;
- Scale;
- Distribution power;
- Strong margins and financial strength.

A good example can be found in Southcorp, as a leading global premium wine company.

Box 7.1 KSFs for Southcorp

Key attributes to attain premium wine company status
- **Strong global brands;**
- **Premium price positioning;**
- **Strong relationships with distributors and customers;**
- **Scale matched with ability to meet market demands;**
- **Achieving margin, profit and return criteria;**
- **Efficient, sleek operations.**

Source: Southcorp

Positioning: where to compete

Clear positioning: a major strategic statement of where the company wishes to compete, in terms of quality, range, size, origin, etc. A major issue is to make a choice between volume or quality, as most wine companies cannot build competitive advantage with both these aspects at the same time. In general, a relationship exists between the quality segment chosen and the critical mass required in that segment. The large wine companies in the New World have been first to clearly position themselves in this respect. Cost leadership is the generic strategy for basic wine companies, since competition in this segment is largely based on price and, therefore, costs. For quality wine companies the generic strategy involves quality and brand leadership in the segment chosen.

Only the largest wine companies can try both generic strategies at the same time. This appears to be the case with both Gallo and Constellation/Canandaigua in the USA, who have a history as large producers of basic wine. The three main suppliers of basic wine in the US together have 55% basic segment share, which offers limited growth opportunities. Both companies are now building brands in the quality segment, with Canandaigua in a separate division. A similar trend is visible in Australia, where the leading companies are gradually shifting focus from volume brands to quality brands. For smaller wine companies the focus may be to move away from the battle of the giants and specialise.

Brands: more than a label on the bottle

Branding power: The brand strategy should clarify issues, such as the emotional and instrumental values of the brand, the brand ladder or architecture, as well as the communication supporting the brand. Companies that offer a range of brands with different price points should position their brands in such as way that they interrelate coherently and do not confuse the market. Building branding power in the popular premium segment for instance, has different requirements than in the super premium segment, with a different target group and message.

Brands and distribution strategy interrelated

Brand positioning is directly related to the distribution strategy. Most brands are only sold through one type of outlet, or one retail chain per market, to avoid price competition. This also meets the requirements of retailers who prefer to sell unique products. In addition, for smaller suppliers it is more attractive to be a strong single retail brand in a few selected markets rather than try to spread resources over too many outlets and markets.

Only a few wine companies sell their brands through different, competing outlets, such as Gallo and the Chenet brand of Grands Chais de France. This approach to building consumer brands, meeting consumers wherever they shop, is likely to work in the popular premium segment. It does, however, make the market more transparent and prompt the risk of price erosion.

Concept of brand power varies throughout the different quality segments

Branding power in the premium segment and beyond, however, is based less on volumes and market share than on content and image. Market driven quality brands require a constant and, if possible, increasing high quality. Style seems to be shifting to somewhat more elegant wines, although not in all markets. Maintaining image is crucial, as is a good rating. Innovation is required to continue to attract customer attention in this battleground of the industry. Also here the wine companies in the new wine countries have an advantage, as they have more freedom to re-negotiate the terms of the contracts with their grape growers, and increase quality. Wine brands are, therefore, not static but need to continue to surpass customer expectations.

Promotions

Sales discounts in particular – from 10% off, to 2 bottles for the price of 1 – can increase volumes tremendously. If the brand is not strong enough, however, follow-up purchases are unlikely, and discounting prices will represent more than 2/3 of total volumes sold. This is particularly the risk for tired brands; consumers will consider the discount price as the real price and will not be inclined to pay more. This is another reason to continue to increase quality and create a brand ladder to avoid too much erosion of the generic brand. For the time being promotions will continue to be important in the wine industry, in particular in case of overstocking.

Range boosts distribution power

Range: All wine brands in the market – with only very few exceptions – represent a single producer from a single country and, in most cases, even a single region. Only the large wine companies can offer a broad range of wines still of native origin. Retailers and distributors, however, want to reduce the number of suppliers and those able to offer a broad range of wines from different origins are more attractive. An attractive range, if possible with at least one need-to-have brand, reduces the risk of being excluded and, therefore, increases distribution power.

US and Australian wine companies are teaming up

Many of the acquisitions and joint ventures of the last two years can be seen in the light of this trend. Australian and US wine companies in particular have found each other, and each major wine company in these markets today has at least a joint venture in the other market. For the time being this is mainly geared to be able to produce premium wines together for the attractive US market, and benefit from each other's distribution power. The next destination in this process may be Europe.

Spirits companies are moving in

The investments of the spirits companies in the wine industry can partly be seen in this light as well – adding an attractive range of wines to leverage and strengthen distribution power. Now that the major spirits companies have bought most of the leading spirits brands, and total sprits consumption has levelled off, investing in quality wine can be an attractive diversification for spirits companies. Quality wine is still a growth market, and the companies can leverage their distribution power selling wines as well. Allied Domecq, for instance, invested some USD 1.3 billion in 2000 and 2001 to acquire leading wine and champagne brands, adding in total 14 million cases of wine. Wine, however, is not a spirit, and requires completely different skills to be able to sell it in an effective way. Industry analysts are, therefore, not certain whether investing in wine would really increase shareholder value. A clear and positive example here is Pernod Ricard, with its highly successful Jacobs Creek brand. The company may have been somewhat late to recognise the value of the brand, but now that its growth and profit contribution has become clear, large investments are being made.

Range and focus

There is a clear relationship between range and focus. If wine companies lack focus and have a very broad range, they may dilute resources. Some companies became very strong with a single product first and then built on that position. A good example here is Freixenet, the Spanish market leader in cava, which has now decided to leverage its strength and broaden its range to still wines through the acquisition of the Australian wine company Wingara, and further strengthen distribution through the acquisition of the French négociant Yvon Mau.

Range increasingly includes brands from several countries

Another issue for many wine companies now is whether the range to be offered to the customers should only come from their domestic origin, or should include a range of international brands. It appears that the major global wine companies have already answered this question, gradually broadening their range of brands to other origins. Though the brands themselves will remain attached to a single producing country, being able to offer a range of attractive brands from several wine countries certainly adds value for the customers.

Distribution; strong relationship with retail chains

Distribution power: Distribution power means to be able to gain more secure access to the most desirable retailers, speciality shops and foodservice outlets. This can be strongly enhanced through a strong customer focus and an attractive range of wines. This is particularly true now that many retailers have indicated that they intend to reduce the number of wine suppliers. Key to success for the larger wine companies is that they have reached the scale to be able to have their own sales organisation in the major export markets, to be able to build direct contacts and enhance sales.

... next step; optimise on-trade and independents distribution

There is still a lot to be learned and improved. So far the leading wine companies have given particular attention to building a strong relationship with the major retail chains, as a major outlets for their volume brands. Now the time has come to further optimise distribution with speciality shops and on-trade outlets. It appears that both outlets in general still have a very traditional assortment and have little means to invest in further optimisation of their wine sales. In this respect the initiative with the Federation of Wholesale Distribution in the United Kingdom is a good example of the road ahead.

Box 7.2 UK distribution initiative

In the United Kingdom the Federation of Wholesale Distribution is supporting independent retailers to stock and merchandise their New World wines, based on market data. The organisation is backed by leading New World suppliers, such as BRL Hardy, Pernod Ricard/Caxton, E&J Gallo, Constellation/Canandaigua/Matthew Clark, Diageo/Percy Fox and Southcorp. The free scheme uses ACNielsen data to give objective advice to independents on what wines consumers want.

Similar programmes are being launched for this target group, to optimise their range of spirits and fortified wines. It is clear that such initiatives, though objective, benefit the attractive brands. Optimising the range offered by the independent retailers is important, since they represent about 40% of total UK off-trade value, with independent grocers (EUR 357 million turnover), multiple specialists (EUR 917 million), independent specialists (EUR 185 million).

Scale has to match market segment requirements

Scale: A certain scale is required, not only to reduce costs but also to adequately supply the customers. Critical scale is directly related to the quality segment in which the company operates. The top three US basic wine companies, for instance, produce between 40 and 60 million cases of wine to gain cost leadership and benefit from scale advantages. The leading US suppliers of popular premium and premium wines supply around 6 million cases. In Australia such companies have volumes of between 10 and 22 million cases and a strong focus on the export markets. These are numbers unheard of in the much larger EU market, with the exception of some of the Négociants and sparkling wine companies.

Strong margins and financial strength: Both margins and financial strength are required to be able to further invest in innovation and the power of the brands. Some of the wine companies have reduced their balance sheet and disposed of part of their vineyards as a way of increasing Returns On Capital Employed and achieving financial flexibility. It leaves the growers with the risks of primary production. It may even be an option to step out of the production of basic wines, which is much more price sensitive, and concentrate on the premium wines and beyond. Such trends are visible at Southcorp as well as some quality wine companies in the USA, who have disposed of their vineyards, while maintaining their brands. In other markets, however, the trend seems to be towards further investment in vineyards. In Chile the major wine companies are tending to reduce dependency on individual grape growers, which are then left in a very vulnerable position. In Argentina various initiatives, including Foreign Direct Investments, have linked up land ownership to the vineyards, thus securitising origination at a 60% to 70% level.

Outlook

In line with the current trend in the spirits industry we foresee the emergence of leading global wine companies, with an attractive range of international brands of the right scope and size. In addition, these companies are now optimising their distribution structure. These are key strategies for the wine industry in the near future if it is to meet the challenges in the consumer market and the retail sector.

The simple fact that these companies are optimising their scale, range and services will have its own impact on the entire wine industry. Most wine companies will not be able to meet the KSFs of the leading global wine companies in the world, as discussed above. This does not mean that they cannot have a bright future ahead. It means that they too need to monitor the market, adjust strategy – within the limitations of the company – and, if possible, outsmart the competition; just a decent wine is not enough. The market has become too dynamic to allow a wait-and-see approach.

8 Conclusions

The influence of industry drivers

The wine industry is changing fast from a highly fragmented supply-driven agribusiness to a competitive professional beverage industry. Changing consumer demand, increasing retail power and the impact of branding are the major drivers for change. This has resulted in a consolidation process whereby companies require a certain critical mass to be able to create brands in order to be reliable suppliers for the retail chains.

The impact of the consolidation process will become a driver in its own right and competition is mounting. This does not means that there is no future for medium sized and smaller wine companies as the market will continue to require a broad range of wines from all over the world. It does mean, however, that they to need to understand the market environment in which they operate and change their strategy in time.

The increased competition is very visible and finds tangible expression on retail shelves. Consumers are offered a more attractive and consistent range than in the past. The number of buyers/gatekeepers is declining, while the volumes they buy is increasing. Passing these gatekeepers is becoming an uphill battle, increasing opportunities for the major wine companies and risks for others. Wine companies experience that it is increasingly difficult to get shelf space, which will only be allocated if their offer is more attractive – to the retailer and consumers alike – than the offer of the competitor, which will then be pushed off the shelves.

The 'new' wine countries have been first to see the growth opportunities in the wine industry, innovating in taste, style and brands. The first signs of a revival of the 'old' wine countries are visible. Meeting the market requirements would require, however, a drastic restructuring in Europe. Failure to do so would not only make the EU wine industry more vulnerable but it may also push more basic wine – up to now a strong EU stronghold – out of the market and enable increased volumes of New World premium wines to enter at competitive prices.

Key strategies

In line with the current trend in the spirits industry, we foresee that building an attractive range of international brands is a key strategy for the wine industry today. In the near a future a strengthening of the distribution structure can be expected, leveraging the power of the established range. This includes a stronger focus on customer requirements.

These strategies optimise those of the major wine companies in the 1990s. A further strategic move will be towards new innovations.

Need for innovation

Compared with other beverages, the wine industry lags behind in real innovations. Gradual innovation in packaging is visible, though it is still very traditional. Wine marketing remains fairly traditional as well, with limited budgets. Adding new varieties and blends may raise some additional attention, but does not break through the fairly traditional marketing approach of the industry.

The market environment requires innovative marketing initiatives, which will further make a difference in that market. Too few brands are challenging consumers to trade up. Failure to innovate may even result in a decline in beverage share, as consumers want clarity, convenience and new tastes experiences. Gaining the young consumer market (now already typified as the Breezer generation) would be an attractive challenge; the present 'gap' with such trendy beverages is now too large to cross. Such innovations can create completely new market segments, a move away from the present volume game to the value game.

The 'new' consumers have little experience in wine and need to be educated. Growth opportunities are to be found in branded quality wine in general, in brands aimed at supermarkets and on-trade consumption, and brands which particularly target the requirements of specific consumer groups or drinking occasions, lower the 'confusion barrier' and support consumers in expressing their life style.