Pathways to Profitability for Small and Medium Wineries

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In this speech I will outline some of the findings of ACIL's recent review of small and medium wineries, which has just been launched by the Minister. In doing so, I will try to avoid the topics of later papers today — especially financial performance and supply issues — although both came across our radar screen in the course of ACIL's work.

The focus of the review, which fulfilled a pre-election commitment by the Government, was to identify ways to enhance the profitability of small and medium wineries, with particular reference to tourism and exports.

I quickly discovered, however, that it is not possible to do this without understanding wider issues affecting smaller wineries, issues affecting the Australian wine industry more broadly, and indeed the global wine industry as well.

A very diverse industry

My second discovery is that it is risky to be too dogmatic about what small wineries should and should not do. This is simply a reflection of the massive diversity that exists within the Australian wine industry — a diversity which, I should emphasise, is one of its great strengths.

Therefore those looking for a succinct blueprint or a crisp 10 point plan, will be disappointed. However, there is, I think, a great deal of valuable information in the report for those who are keen to find it.

For example, there are a number of boxes scattered through the text. These boxes mainly illustrate general principles with specific case studies. They are intended to help winemakers gain from the experience of others so they can decide whether this experience may have relevance for them. Not necessarily to follow exactly what someone else has done, but to think carefully about whether there is some lateral thought that could be applied in a different situation or different way.

My third discovery was to realise just how much favourable publicity there is on the wine industry — on regions, winemakers and individual wines — every day. I have completed many consulting assignments in many industries over the years and I have never encountered the equivalent of the wine industry's publicity before. As an outsider, may I caution you against taking this for granted. In my view it is one of your most valuable assets and I urge you to nurture it carefully.

What is a small and medium sized winery?

I searched in vain for some readily agreed definition of what a small or a medium sized winery is. These terms can be defined quantitatively or they can be defined by market focus. Thus a medium winery might be where the business can no longer depend just on a cellar door, mailing list and a few direct-to-restaurant

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sales and has to enter the retail market. And a large winery would be where the business has to deal with national supermarket chains and is increasingly dependent on export sales.

As with so much in the wine industry, there are exceptions that prove the rule, but I have settled on a four-stage classification as per the Table 1:

Table 1: Four stage classification

Category	Production		Number of wineries	Market focus
	(tonnes)	('000 cases)		
Micro	<20	<1.5	418	cellar door, mailing list, friends
Small	20-250	1.5-17.5	732	as micro, plus direct-to-restaurants, possibly selective exports
Medium	250-1000	17.5-75	149	as small, plus national distributor, systematic exports
Large	>1000	>75	166	as medium; domestic focus national retailers; increasingly export dependent

The role of governments

The review's terms of reference required a consideration of current/proposed initiatives as well as future initiatives that various parties might take to enhance the profitability of small and medium sized wineries. The 'parties' here include individual wineries, groups of wineries acting collectively, industry associations and local, state and commonwealth governments.

As far as governments are concerned, I received widely disparate views. Apart from the issue of tax, to which I will return later, most winemakers seem critical of governments — sometimes for doing too much, sometimes for doing too little, and sometimes for both at the same time!

One quite widely held small winemaker view is that governments do virtually nothing for the wine industry. The truth is quite different. At the commonwealth level, I estimate that $15-20 million is spent annually — such as matching R&D expenditure, export market development grants, various tourism related grants, and grants in the name of regional development or disease control.

At the state level, there is an amazing array of spending measures — funding strategy plans or industry associations, wine or wine tourism conferences, musical events in wineries, website upgrades, wine trail developments, guide books, visits by overseas wine journalists, wine education initiatives, eradicating grapevine rust — the list goes on.

And that's not including the National Wine Centre, a sorry experience that in my view demonstrates that government failure can be an even bigger problem than the market failure it is often trying to overcome.

My estimate of state government wine funding is $30-40 million per year, which may be conservative. Is all of it valuable or fully justified? Probably not. More importantly, the industry should think very carefully before it looks to governments to solve all its problems. This is not how the industry has got to where it is today, and I doubt that it represents the best way forward.

State and local governments have earned the strong displeasure of winemakers about things they are already involved in — the planning process and road signage being prime examples.

Many winemakers are critical that some local governments do not appear to recognise how much value wine businesses have bought to the regions. I hear that, but would suggest that grizzling will not solve the problem — whereas a better documentation of the nature and extent of wine's contribution to local regions might.

A more worrying criticism is the suggestion that state governments do not fully appreciate the importance of tourism to the state's economy. This surprised me frankly but it was said so often that there must be some truth to the claim. The criticism is not directed at tourism agencies themselves, but at other departments or officials — that either put lead in the saddlebags unnecessarily or still believe that tourism is a passing fad.

For example, how ridiculous is it that when a winery is staging a musical event in its vineyard, it is prevented by the terms of its cellar door liquor licence to sell its own wines on its own land, but has to sell via a third party — such as the nearby hotel — that may have a less restrictive licence. A review of anachronistic wine licensing provisions would seem a good idea.

The economic context of small wineries

There are widely varying views among respected wine industry leaders about the short to medium-term outlook — from the quite pessimistic to the equally optimistic. I have not conducted a formal outlook assessment but my simple back-of-the-envelope calculations give me cause for some concern. This year's wine grape harvest of 1.65 million tonnes is equivalent to around 130 million cases of wine. The domestic market is currently consuming around 45 million cases, the export market slightly more. The balance seems to represent a large overhang needing to be absorbed either by a slump in next year's vintage — always a possibility — or a further quantum leap in export sales.

The clear message in these figures for smaller wineries is that if your quality is in any way short of the mark or your brands are not well established, you are likely to struggle.

Another vital message from these figures is the necessity to keep banging away at world wine trade liberalisation.

It all adds up to brands

Small wineries lack the scale of larger firms to drive down their unit costs. They need to be different and exploit niches that others have overlooked or do not possess. Examples include direct marketing and use of newsletters, organic wine production, unusual varieties, maximising varietal characteristics with basket pressing, having unique stories associated with a vineyard, or focusing on particular market segments — such as passing ski travellers, 'funky wines' for younger customers, or sweeter wines more attractive to Asian customers.

The central element running through the report is 'brands'. It is a difficult concept for many people, including many winemakers, to grasp. It is not the same as 'label' — and it is somewhat nebulous. It overlaps with marketing and includes the story of the wine or winery or winemaker. It involves understanding what is driving a consumer and making a sufficiently attractive pitch that will lead to sales, followed by repeat orders. It is as much a battle of consumer perceptions as it is a battle of product specifics. It involves quality, consistency, reliability, trust and value for money, as well as the points of difference that make a wine special or unique. As one winemaker said to me: "every glass I have poured at cellar door over the years has been incremental brand building".

Without all these ingredients, a small winemaker will struggle, and may well fail, in the difficult marketing environment of the future. The balance has shifted from that of undersupply with a focus on grapegrowing and winemaking, to actual or potential oversupply and the need for superior performance in marketing and brand performance.

A common comment made to me was "growing grapes and making wine are easy; marketing is the hard part."

Improving profitability

It is easy to state what is required to improve profitability: more revenue (higher average sale prices or volume) or lower costs (productivity improvements, economies of scale or more effective negotiations with suppliers), or both. But from there on, it gets more complex.

The starting point is to have — which many small wineries apparently do not — a clearly focused and honest business and marketing plan. The first question that should be asked of an intending winemaker is: "who will buy your wine?" This area should not involve governments; just as in other industries, the right to go broke is part and parcel of the market economy.

The key success factors, in wine as in any other area of business, are high level business management, marketing and financial skills. Participating in buying pools, seeking joint ventures and alliances, and being part of a benchmarking study, are important activities for smaller wineries.

Where wineries participate in shows, the most valuable feedback can probably be obtained by those who do not win medals, rather than by those who do. The question is whether unsuccessful exhibitors learn the available lessons — by tasting the successful wines or speaking to the judges.

Wine and tourism

Turning to issues of tourism, not all wine regions are equally placed to attract domestic or international visitors. Apart from intrinsic factors such as location relative to major population centres, regions with a broad mix of attractions and good services such as accommodation, restaurants and shopping have the best chances of success. Regions need to provide tourists with a compelling reason to visit or stay longer by aggregating all their tourism strengths. It is important that wine is highlighted as only one of the reasons to travel.

The skills of the cellar door are essentially those of the tourism industry, not the wine industry. Indeed, wine is probably unique in straddling the primary sector (grape growing), secondary sector (wine making) and tertiary sector (wine marketing). It is rare for one person to have high level skills in all three areas.

The performance of cellar doors, while excellent in places, is not uniformly consistent. Design, staff training and continuity, relations with tour groups and overseas visitors, and the relativity of cellar door prices to retail bottle shop prices, are among the areas where improvements are possible.

There is a wide range of initiatives that need to be pursued if the full potential of wine, food and tourism is to be realised. Many of them are outlined in the report, and some are the subject of specific recommendations. Sometimes the onus will be on individual wineries to take action, sometimes on regional groups of wineries, and sometimes the matters are more in the domain of wine industry associations or governments.

Hopefully, many of the suggestions in the report will be able to be picked up by the Winemakers Federation, and its recently appointed wine tourism officer, in the context of implementing its wine tourism strategy.

Other recommendations are relevant for the Tourism White Paper and ten year national tourism strategy, now being finalised by the Commonwealth Government.

Wine exports

Wine exporting does not always make sense for small wineries. It is hard work and costly. Considerable persistence is required and not all firms have the financial resources to make a significant long-term commitment.

Even if success is achieved, credibility can be short-lived if sufficient stocks are not available to service the market.

Export success factors include:

- combining with overall ‘brand Australia’ messages;
- having a reliable distributor/agent experienced with the particular type of wines;
- making regular visits to key markets and customers;
- having a story to tell and supplementing it with promotional literature;
- over delivery in quality at the price point;
- having appropriate administrative capacity to negotiate export protocols and liaise with distributors and shipping agents; and
- having continuity of supply

The experience of the Queensland Government in leveraging sister city and sister state relationships for the benefit of its wine exports should be closely studied by other state governments and wine associations.

Institutional support

The report contains some brief commentary on the role of the Australian Wine and Brandy Corporation and the performance of wine industry associations.

Generally, small winemakers strongly support AWBC’s activities but there are concerns about the quality of some data, some would like to see AWEC more active, and there are several export certification issues at the margin.

I also think there is merit in considering a merger between AWBC and the Grape and Wine R&D Corporation.

There is a plethora of wine industry associations — national, state and regional — plus regional/local tourism associations that winemakers can join. There are, for example, 15 regional associations in NSW and three in the Hunter alone. During the review, and without pointing the finger in any direction, my antennae were twitching on occasions at issues of overall effectiveness, duplication, poor communication and insufficient activity.

For what it is worth, my advice is to address these issues while broader economic conditions are favourable, rather than wait until the pips are squeaking.

Wine taxation

The review was not an examination of the Wine Equalisation Tax — a point made clear from the outset. Nevertheless, wine tax issues arose so strongly and so often that I took the view that for the report to remain silent on the subject was not sustainable.

There are no tax-related conclusions or recommendations in the report, but rather the history is distilled, the current operation of the WET is described, views of small winemakers — or at least the printable ones — are summarised, and there is commentary about wine taxation against generally accepted tax policy principles.

My hope is that this discussion will clear away some misconceptions and enable future dialogue between winemakers and the Government to proceed on a more informed and constructive basis.

Conclusion

In mid August I was fortunate to attend an industry dinner at Leeuwin Estate for a group of visiting American wine representatives. During the dinner, Robert Whiteley, a wine writer from California, made an observation which I have used as the theme for the report:

- "Small wineries are the roadmap for Australian wine. They are much more important than the good quality inter-regional blends that exist".

To me, this and the necessity for brand development, are the two enduring messages I have taken away from four months of intensive work.

Many of the lessons in the report are for individual winemakers to absorb. As another report on another industry said three years ago:

- "there is nobody out there to save you, but there are ways you can save yourself — if you are sufficiently resourceful, flexible and innovative. There is no single solution that suits everyone, but there are four threshold requirements:
- businesses need to take individual responsibility for their future; the mind-set must shift from "they or them" to "I/me" or "we/us";
- diversity should be celebrated not lamented;
- success depends on continual innovation and its quick implementation; and
- government intervention should only be in response to a demonstrated market failure".

Changes to the WET, even if your wildest dreams could be realised, will not alter the importance of these observations.

Where governments do perhaps need to listen more carefully and be more responsive is in regard to the regional development implications of smaller wineries and their potential to be the catalyst for further economic growth.

At a time when regional development problems have never been more prominent on the policy agenda, the wine industry, and smaller wineries in particular, can claim to be part of the solution.