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IS THE NEW ZEALAND WINE INDUSTRY DESTROYING ITS BRAND IN THE GLOBAL WINE MARKET?

By Michael F. Spratt

Many years ago an aspiring young comic named Steve Martin joked about making money by writing a book entitled “How to turn a million in real estate into fifty bucks cash”. This mock “how to” book could have served as the guiding principle behind the New Zealand wine industry’s steady march toward commodity pricing and brand obliteration.

Business Strategy 101A

Succeeding in business can be boiled down to a few simple principles. Compete on the basis of being a low cost producer or succeed as a niche marketer. If the choice is niche marketer, premium brands are critical to earning a profit. The most successful niche brands in the world know this. They lead in their market, they are distinctive, they command a premium, and they trigger a strong emotional reaction that helps people remember their name. Leadership, distinctiveness, premium price and being memorable are four attributes worth remembering.

Not every business has a choice between these two options. Size, assets, competencies, and resources may prohibit pursuing a niche marketing strategy. Likewise, inadequate resources or inability to achieve scale may preclude competing as a low cost producer. Knowing and leveraging your strengths is crucial.

New Zealand Wine as a Case Study

New Zealand wine is a very new entry in the global marketplace. Exports were virtually non-existent twenty years ago and now represent a billion dollars in sales. Despite these impressive growth numbers, New Zealand accounts for a very small percent of global production.

In 2009 over 27 billion litres of wine were produced world-wide. New Zealand contributed 205 million litres, about three quarters of one percent of the world’s annual wine supply. By any practical definition New Zealand wine is scarce.

If New Zealand was a single wine company, it would rank only sixth among US producers, behind Gallo, Constellation, Wine Group, Bronco, and Fosters. The difference is that any one of these companies has a clear cost advantage over “Company New Zealand” because they do not make wine in 643 different businesses with underutilized capital equipment and duplicated overhead. Were “Company New Zealand” to try to compete as a low cost producer, it would be operating with a clear disadvantage. These other companies could undercut “Company New Zealand’s” prices and still make a profit. The only viable option is to be a niche marketer.



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The Emperor's New Clothes

New Zealand wine exports have grown impressively from 19 million litres in 2000 to 113 million litres in 2009. In 2000 exports represented less than one-third of total production. In 2009 exports consumed almost two-thirds of production. For the past five years the New Zealand wine industry has been export dominated. Over the past ten years, the inflation adjusted dollar value of wine exports has increased from \$228 million to \$992 million. How could one argue with such an impressive record of growth in volume and value?

However, closer examination brings a specific problem into sharp relief. The inflation adjusted price per litre is on a steady decline. In 2001 that price was \$13.40. In 2009, it had dropped by 35% to \$8.81, and by July of this year it had further eroded to \$7.25. If this rate continues, by 2025 New Zealand will be shipping over 250 million litres of wine overseas for free.

Even a first year business student would be correct to question the wisdom of an export strategy that produced such alarming erosion in price, especially for a country ill-equipped to compete as a low cost producer.

How does a tiny wine producing country with distinctive and superior products end up a de facto participant in the commodity wine market? Why would producers absent means to compete effectively on price want to mix it up with world class low cost producers?

The Tyranny of Self Interest

The problem with self-interest is that in the long term it seldom is in your self interest.

The erosion of export prices in the New Zealand wine industry due to unmanaged production and questionable marketing choices has not gone unnoticed by New Zealand producers.

Stuart Smith, Chairman of New Zealand Winegrowers stated in the 2009 Annual Report to the members:

“Despite exports and domestic sales volumes benefiting from increased supplies from vintage 2008, those increased supplies also delivered increased competition and downward price pressure... In addition, the fallout from vintage 2008 saw one other significant trend emerge – a surge in bulk wine exports. Historically, bulk wine exports have accounted for less than 5% of total export volume. In the past year this quadrupled to nearly 20%. While bulk exports may relieve pressure on wineries in the



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short term, in the longer term they may significantly impact our market positioning and the reputation of New Zealand wine and our brands.”

Numbers from the month of July paint an even darker picture. Bulk wine sales grew to 40% of exports further reinforcing New Zealand’s reputation as a producer of low priced commodity wine.

The short term self interest of dumping surplus stock has prevailed over the long term self interest of preserving margins for premium branded wines.

Despite alarms clanging throughout the industry, many producers continue to push bulk wine into the export market, effectively “looting” brand New Zealand in a frantic attempt to protect balance sheets before the industry imposes dumping sanctions. What these producers fail to grasp is that the discount slope is steep and slippery. Once balance is restored in the market, neither customer nor fellow producer will help them climb back up.

The Elephants in the Room

There are 643 member wineries and 1128 member grape growers in the New Zealand Wine Society. The member wineries are divided into small producers (Category 1), medium producers (Category 2), and large producers (Category 3). There are 577 Category 1 members, 60 Category 2 members, and 6 Category 3 members. Almost everybody in the wine business knows the names of the big six: Constellation, Delegats, Giesen, Matua Valley, Pernod Ricard, and Villa Maria.

The sheer volume and distribution reach of these large producers dwarfs the market impact of all the other brands combined, even with such notable names as Cloudy Bay, Craggy Range, Dry River, Pegasus Bay, Neudorf, Felton Road, and Ata Rangi.

From a global branding perspective, New Zealand wine is known by what is most available in the marketplace - premium quality, inexpensive Sauvignon Blanc that has the distinctive character of tasting grassy.

There is nothing wrong with making wine like this, or making it in large volume and selling it at inexpensive prices, so long as your aim is to succeed as a low cost producer. However, making wine and selling it for commodity prices is not in the best long term interests of any New Zealand producer if the only viable strategy is niche marketing. Once residency is established on the low price shelves, even ruthless management of supply is not a ticket to a better place.



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Lost in Translation

If you were a premium branded, distinctive, superior product in scarce supply, who would buy you? It would not be the average punter looking for a cheap wine to lubricate guests at a backyard barbecue. Where would you be found? Most definitely you would not reside in the supermarket between the frozen peas and the paper towel aisle. With what other products and brands would you be associated? Certainly not discontinued and unknown labels on a “special discount” table hoping to be picked up by an unsuspecting shopper on a lazy Sunday afternoon. And, how much would you cost? Certainly you would not be competing on price with “Two Buck Chuck”.

Somewhere along the way, the link between premium product and premium pricing was severed. Also lost in the translation was awareness of a simple concept that you cannot manage price without managing production. A concept well understood by OPEC, diamond miners, toy manufacturers and French wine producers. If you do not manage your supply, the market will manage your price for you.

Pure Discovery

The 2009 New Zealand Wine Institute’s Generic Marketing Programme marches under the banner: “New Zealand is a world of pure discovery”. The stated vision for the industry is “To be internationally recognised as the leading producer and marketer of highly distinctive premium quality wines.”

There is nothing in this statement inconsistent with being the number one producer of premium quality, cheap wine.

A subtle change in that vision statement would have a profound impact on the marketing strategy. If the vision were “To be internationally recognised as the leading producer and marketer of highly distinctive, high quality, **premium branded wines**”, a steadily eroding litre price would be a clear indication that marketing tactics were failing.

Premium branded products sell for a premium or they are not considered premium. Among other things, that is what differentiates premium brands from generic products. Claiming to sell premium quality for a low price is a sales gimmick that discount merchants use to push volume out the door. Most of the public is wise to this trick and do not accept this proposition for anything other than undifferentiated commodities. If it is cheap, people have a hard time accepting that it is different or better than the rest.

From a marketing perspective, there is nothing inherently wrong with “Pure Discovery” as a slogan. It is an intriguing proposition that might be quite effective in persuading a person to spend money on a holiday to New Zealand. However, it is not clear how this proposition will help induce customers to pay \$50 or more for a bottle



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of New Zealand wine. Nor is it clear how the clean, green implication of “Pure” is reinforced by exporting wine in closures that are decidedly eco unfriendly and often associated with low priced products.

Voices in the Wilderness

There are a growing number of small producers in New Zealand who understand and accept the reality of the world wine market and the strategic choices available to New Zealand. They know that unparalleled quality is a pre-requisite to charging a premium. They know that price is not a barrier to purchase when the product is good and sought after. They know that they are judged by the company they keep and therefore must be mindful about where they are seen. And, they know that cutting price does not make it easier to sell but rather makes it harder.

Like other niche focused New Zealand wineries, at Destiny Bay we limit production. Each year we drop more than 70% of our potential fruit. Not because we want to charge more, but because one of the pre-requisites for making a premium, distinctive, and expressive cabernet blend is to force vines to work hard to grow fewer, better berries. If all we cared about was volume, we could produce four times as much wine and sell it for a third of the price. The problem is that the wine would not be distinctive and would fall into that marketing void of average product at an average price.

Since we cannot make the most we strive to make one of the best. But the best is expensive to make and expensive to buy. Our customers and loyal patrons know and respect this. Although we have wine that retails below NZ\$75 a bottle, we also produce and export some of the most expensive wine to come out of this country.

Lest anyone think that we and others like us are rolling in profits consider this. A producer seldom gets more than half of the retail price and even less of the restaurant wine list price. And, the costs of production and distribution are substantial. In the case of Destiny Bay, those costs have to be amortized over a tiny production volume. Profits in the wine business are elusive and long in coming, but serious wine making and marketing is not a short-term venture.

Creating a premium wine brand takes time, patience, focus, and more than a little stubbornness. It is not for the weak of spirit or the thin of wallet, and it most definitely is not for the naïve speculator or casual amateur seeking to create a vanity label.

As the matriarch of the Rothschild banking and wine family once said to a questioner who asked if it was possible to make a profit out of making wine: “Of course you can. It is just the first 200 years that are the problem.”



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Niche Marketing as a Subversive Activity

Borrowing from a small Minneapolis based Advertising Agency, “You don’t need a bigger lure. You need a sharper hook.”

So what is New Zealand’s sharper hook? Might it reside in the soil, site, climate, and spirit of a fiercely independent and proud country with a reputation for environmentally sensitive practices, an abundance of interesting and personal stories, and hundreds of distinctive and expressive artisan wines? Certainly it does not reside in bulk production of wine, plentiful in supply, sold by discount specialists.

Two major challenges facing the New Zealand wine industry are brand de-familiarisation and thoughtfully managed production to ensure that the inherent distinctiveness and quality of flagship wines and emerging brands is not cannibalised by corporate indifference and short-term financial objectives.

New Zealand wine producers need to acquire skills in subversive marketing and lead the charge to overthrow the outmoded and inefficient global wine distribution system. The creative and strong willed Kiwi spirit that produced brands like The All Blacks, Icebreaker and 42 Below needs to be rekindled in this industry.

Effective niche marketers are laser focused on attractive, distinct segments. They are obsessed with positioning their product in front of the right people in the right places. They build passionate and loyal customer bases, use non traditional distribution channels and employ clever promotional tactics. They leverage their marketing investment, are ruthless in picking their partners, and do not tolerate mediocrity. If a business does not have distinctive products, superior quality, a compelling story and a serious commitment to succeed, it cannot be an effective niche marketer.

Perhaps most importantly, effective niche marketers do not travel with the herd. That is why presenting wine in huge cattle call tasting events is the province of lumbering low cost producers who execute marketing strategies with blunt instruments.

What is the point of spending time competing for mindshare with 10,000 other wine labels in a convention centre format, where mid level trade people stagger around a taste-a-thon, sipping wine in an alcohol induced mental fog, struggling to remember where they parked their car let alone which wines they tasted?

This is not the setting where premium branded wines belong or where discerning purchasers expect to find them.



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The Future is Already Here

The New Zealand wine industry is facing its greatest challenge to date. Unfortunately the most likely response is for nothing to change. Repeated calls for control of production and repositioning New Zealand wines in different markets have gone unheeded. Absent a precipitating event or a bold move, the New Zealand wine industry will keep doing the same things over and over again, hoping for a different result.

Real change begins with understanding and accepting reality. The erosion in New Zealand export prices is not the result of temporary imbalances in supply and demand, successive bumper crops, fickle wine writers, merciless distributors, obstructive biosecurity procedures, or swarming locusts. As a producer of less than 1% of the world's wine supply, it is bewildering how too much production could be considered the major problem. The inconvenient truth is that the New Zealand wine industry is not over producing, it is under marketing. It is pursuing a fundamentally flawed strategy of aiming at the wrong end of the market and missing low.

The likelihood that in fifteen years New Zealand will be exporting 250 million litres of wine for next to nothing is remote. Years before such an economic Armageddon takes place the industry will downsize and restructure. All but a few of the small and medium producers will collapse. Vineyards will be torn out or top grafted with other varieties of fruit. Distressed sales of wine stocks and land will cause property values to tumble, attracting foreign investors who will snap up valuable land and wine making assets for clearance prices. New Zealand wine will be sold unbranded in bulk or become a fractional blending component for other shrewd marketers who know what they are doing. Those premium brand producers who manage to survive will be marketing themselves not as New Zealand wine, but as Gimblett Gravels, Waiheke Island, Hawkes Bay, or other appellation specific regions. And the once proud, vibrant and growing New Zealand wine industry will be a mere shadow of its former self.

Those who consider this scenario excessively pessimistic should consider the recent article posted on Wine Spectator dated September 2, 2009 by Daniel Pilkington. It is entitled "Foreign Investors Target New Zealand Wine - Looser regulations and lower vineyard prices are attracting potential buyers"

"The New Zealand government's recent moves to soften rules on foreign investment have opened up the country's wine industry to overseas buyers. The biggest acquisition so far, the purchase of the New Zealand Wine Fund by California firm Foley Family Wines, pushed the level of foreign ownership in the industry to more than 45 percent, according to figures from New Zealand Winegrowers."

The article goes on to say that "investment in what was a small industry just a few decades ago could bring both opportunities and potential problems...more foreign



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investment is sure to follow...and prices are cheaper than at any time in the past decade."

Despite New Zealand Wine Institute CEO Philip Gregan's effort to put positive spin on the acquisition, "Foreign investment is a signal that people see value in the New Zealand brand and they want a part of it", others, like George Fistonich, owner and managing director of Villa Maria Estate, says that the industry's standards are at risk. "If companies focus on increasing production, there is a chance people will become less interested in the unique expression of the wine ... we can't use the strength of our brand, then drop the level of quality and commoditize our wines."

Is the New Zealand wine industry destroying its brand in the global wine market?

The answer is yes.

The important next question is: Will it accept the reality of what has happened and alter course?

The Great Wine War

A hundred years ago in the western United States a great battle was waged between sheep farmers and cattle farmers over control of open grazing land. While sheep could graze land after cattle, the opposite was not always true. What ensued was an acrimonious and sometimes bloody confrontation over land use.

A modern version of this conflict is playing out in the New Zealand wine industry. Two competing forces, both using the same natural resource and country brand, have diametrically opposed strategies for creating economic value. One seeks to leverage the soil, site, and climate of New Zealand into high value, premium branded wines sold to discriminating purchasers. The others have elected to reap nature's abundant rewards and convert them into low cost, respectable wine, at attractive value prices. Both strategies have merit but only one is economically viable for a small country like New Zealand.

The likelihood that these two opposing forces can successfully co-exist under the same country brand is remote. A hundred years ago in the western United States the livestock wars finally ended when they put up fences. Were it that simple for the wine industry there might already be peace and prosperity.

The New Zealand wine industry requires a more creative solution. Old habits must yield to new behaviours, end customers must regain their rightful place in the hierarchy of defining product and opportunity, and marketing tactics must be tailored to specific niche markets.



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Supply side strategies offer limited returns. Real opportunity resides with a market driven approach that is built on four core principles.

1. The distinctive attributes of New Zealand wines must be the centre point of brand strategy. The soil, site and climate cannot be copied and are the last lines of defence against competitors.
2. The only markets worth pursuing are those where New Zealand can command premium prices by serving customers who value the distinctive attributes of New Zealand wines.
3. Production must be aligned with anticipated demand both in volume and mix. It is better to have some unfilled orders than excess stock.
4. The promotion and placement of wines must be controlled by New Zealand champions. Vesting this with independent distributors creates a conflict of interest that will not resolve in New Zealand's favour.

The challenges facing the New Zealand wine industry are daunting only to those unable or unwilling to look beyond the mistakes of the past. Salvation does not rest in the laps of corporate giants or within the boundary of traditional practices. Rather, it rides on the shoulders of a new generation of producers, committed to pushing the limits of wine making and marketing, prepared to aggressively defend the distinctive attributes of New Zealand wines, and refusing to accept a lesser fate than a proud nation deserves.

About the author

Mike Spratt and his wife Ann are the founders and owners of Destiny Bay Vineyards on Waiheke Island. Destiny Bay produces a limited release of estate grown and bottled cabernet blend wines for discerning collectors and wine enthusiasts around the world.

Prior to founding Destiny Bay, Mike was a senior partner in PricewaterhouseCooper's global Mergers and Acquisitions consulting business and an author of the business book: Five Frogs on A Log - A CEO's Field Guide to Accelerating the Transition in Mergers, Acquisitions and Gut Wrenching Change. He holds a Ph.D. in Psychology from the University of California at Berkeley, and has over three decades of experience as a business manager and an international management consultant.

Comments can be sent to mike@destinybay.co.nz.