How to avoid getting crushed – critical success factors at a (profitable) boutique small winery

A tale of two wineries

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Peter Demediuk
School of Accounting and Finance,
Victoria University,
Melbourne, Australia
Email: peter.demediuk@vu.edu.au

Abstract

The way a business articulates and actions its critical success factors is a major determinant of sustainability and success. Dire times have been predicted for small wineries in Australia, with a high risk of being crushed by the combined weight of competition, changing market structure and evolving consumer preferences. Yet despite these gloomy predications, some small wineries have avoided that crush. This paper presents a case study of how a newly-profitable small boutique winery approaches the articulation and operationalisation of critical success factors in its effort to be sustainable. This winery's current response has been born of bitter experience, and shows the utility of having a balanced set of critical success factors which promote a reassessment of the fundamental nature of the business from a risk perspective and encourage the re-deploying of resources from the more mechanistic and measurable tasks to relationship building and feedback.

Introduction

> ***"That's what is so great about the wine industry to work in - it's because it's an agricultural industry, it's a manufacturing industry, and it's high end fashion retailing. And that's what's wonderful about it. In one particular day, you can be doing all three".***
>
> – manager Winery A

Dire times have been predicted for small wineries in Australia, with a high risk of being crushed by the combined weight of competition, changing market structure and evolving consumer preferences. The momentum and scale of winery development in Australia is phenomenal: "…a new wine producer every 61 hours over the past 3 years!!" (ABC, 2003). There are about 1,650 wine producers in Australia and the top 22 wine companies control 92% of domestic sales. This leaves the other 1600 or so producers fighting over just 8% of the market and the majority are very small family businesses and the immediate outlook is tough. Put simply, there are too many people competing for a tiny slice of the market place. The access to the marketplace for a small winery is constrained by (ABC, 2003; ACIL, 2002; Halliday, 1997): increased competition from other small labels; a lack of differentiation between competitors with regions; static consumption rates domestically; despite exports increasing 20%, the limited interest of overseas distributors and merchants in low volume producers; increasing competition from US, South American, and Eastern European producers; and the loss to the forces of Woolworths and Coles-Myer of independent wine merchants who traditionally took product from smaller producers.

The predicament facing the burgeoning small wine producers is emphasised by the CEO of the Victorian Wine Industry Association who has observed that many vineyards surrounding Melbourne are not viable, and in fact there are "Too many grapes…(and)…"It's hard bloody work and not the pot of gold everyone thought its was…" (Erlich, 2001). The repercussions are highlighted by the alarming estimate that "Up to 40 per cent of Australia's wineries are tipped to fail in the next few years as conditions change" (Todd, 2003).

As a result of the vagaries of nature and changes in competition, the very marketplace and consumer preferences, there are huge pressures an owners and managers of smaller wineries to improve efficiencies in growing, producing and marketing for short-term survival and longer term sustainability. In common with other small businesses, the owner/manager in smaller wineries is typically involved in every aspect of running the business. Such a hands-on approach has some redeeming features, but immersion in short-term problem-solving is also threat to competitiveness and growth. Owners typically focus solving immediate problems, and consequently their work and that of employees is not always focused in a balanced-way on activities that contribute to essential longer-term goals.

But despite these gloomy predications, some small wineries appear particularly successful in avoiding the crush - if judged show awards, presence in leading-edge bistros, bars and restaurants, and comment in the press and industry circles. We used purposeful sampling to choose two wineries who fitted this profile. Sampling involved drawing a short list of 'success' wineries as profiled in wine interest media publications and the Melbourne Age, and further refinement by discussions with proprietors of two retail wine specialist buyers from the hospitality industry. The selected wineries are designated Winery A & Winery B for anonymity. The longer term research project is to explore commonalities and differences in the critical success factors that these two such wineries focused on, and the initiatives & actions to achieve them. This paper presents a case study of how Winery A, a newly-profitable small boutique winery, approaches the articulation and operationalisation of critical success factors in its effort to avoid the crush. By reporting as clearly as we can, what it is that the Winery manager says they do at Winery A, we hope to demonstrate what Peter's (Solli et al 2000) describes as, the utility of a more microscopic analysis where descriptions that the actors "…provide of their working life provide a rich body of evidence…" about the way their organization really performs.

Sustainability in the tough economic, market and regulatory environment facing small wineries is largely contingent on having effective strategic and operational control (ACIL, 2002). Small wineries, like any businesses competing in dynamic and complex environments, must have a clear understanding of their objectives and the methods for efficiently and effectively attaining them (Olve et al, 2003). So a key driver of effective strategic and operational control is the ability to recognise, measure and react to critical success factors . So the way a business articulates and actions its critical success factors is a major determinant of success (Olve et al, 2001). Effective performance management is predicated on action aligning with strategy, and that the strategy articulates a balanced set of objectives, and the critical success factors which represent or drive these objectives (Kaplan and Norton, 2001).

Winery A

Winery A can be classified as boutique small wineries as it deals with just under 300 tonne benchmark of fruit (ACIL 2002), with most of its wines selling at boutique prices of $25 and above. It is a classic small businesses, as it can only compete against large high-budget but low-cost competitors by accessing niche markets.

Winery A has taken a major strategic decision in the last couple of years with a "…view that our business now is buy grapes, make wine, sell it". The winery is actively been divesting itself of vineyards and an associated vineyard management company. What led to that decision are mainly focus issues – it is a simpler proposition not having to also be an estate grower, and additionally it also means that they are not then really beholden to agricultural risk, which is an important factor in that region where some years yield one tonne to the acre and other years might yield four tonne. To have those yield issues and those capital risks involved in that, as well as having the risks of trying to develop brands, etcetera has is proven just too much for the business "…so we are really saying to professional growers is you concentrate on that part of the risk, we will concentrate on the risk of trying to take that fruit, manufacture it into a highly desirable fashion product and market it as such …there is enough risk in that for a little business for us, and we think if we concentrate on that and do that well we are better off for it". Victorian regional quality and price targets, on a continuum from warm climate ultra-premium, vary widely, indicative average costings still give a useful picture of variables and a typical decision context (Paton 2001). Appendix one indicates a cost differential to source rather than grow of 15%. Against these financials must be laid the decrease in growing risk, but an increased risk in potential suppliers being suited by competitors, and a decrease direct control of source product.
The most important critical success factor for winery A is the quality of the wine produced: "…if you make great wine you can sell it, if you make good wine you might be able to sell it…". But this quality is driven by four other critical success factors. Selection of the grapes, first and foremost; the quality and professionalism of the wine-making team; a planned access to capital for the winery to actually be able to buy the right oak and do all the things it needs to do with making that wine; and a planned market for the wines as well. The reason for having a clear view of the latter is that you have

to know what you are trying to do with that wine and where it's going to end up and what quality it needs to be: " its no use to have 10,000 litres of a wine which is average if your assured market is 2,000 litres of standout product – or vica-versa…"

Marketing, as a critical success factor, can only work in a sustainable way where wines represent outstanding value for money: our (second tier label) has taken off because as the critics confirmed …it is probably the best value $20 Pinot Noir around….It's not the greatest Pinot Noir in the world". If production can the quality of wine in the bottle, then it becomes a matter of communications so that, for example, the wine is going to get the favourable reviews because it has been seen by the right journalists.

But to achieve critical success factors in terms of quality product that can be profitably sold at a price point which represents outstanding value for money (and preferably substantiated by critical review and publicity) is not enough as there are a multitude of competitors who have done the same. Distribution channels form the next critical success factor. Cellar door and mailing-list sales represent one third of sales and carry the highest gross profit margin, but the two-thirds of revenue is via agents. "We the product of our work we have to be able to *let* them (distributors) say 'we've got these great reviews, this is a great wine, make sure you try it' and we need a way of *getting* them to say it …these are our two basic premises we operate our whole business on (emphasis added)". To achieve the latter premise, Winery A must to purposefully to work to motivate its distributor representatives who also carry the ranges of 20 other wineries on their portfolio.

To motivate distributor representatives takes levels of time, energy and resources that are difficult but necessary to divert from the more mechanistic tasks of winemaking. It is critical to act to, rather than talk about, developing really good relationships with all the distributor's sales team. The objective is to make enjoyable selling the Winery A label than a competitors wine. This will only happen if the winery has the right product and they get on well on a personal and professional level: "…they (distributors) must feel good about it (the wine) and every time they do sell it, it works for them…so they have a feeling of success, but we have really developed that through the fact that they like me and that we get on well together so they enjoy catching up with me. And then when you are in that spirit of catching up, you can gently keep reminding them about how good the next vintage is going to be, etcetera, without actually having to instruct them".

So a critical success factor which underpins the distribution is an ability to develop relationships that eclipse those maintained by competitors. Financial or material inducements (dinners etc) are not the differentiators here: "We don't badger our agents, we don't criticise them, we are always positive and supporting them. There is (sic) two attitudes which I can't understand, your agents are the people that represent you and most of the time they are being beaten over the head with performance issues: you didn't do this, or how come I'm not there? And it's like: don't get negative, people aren't going to work that way. Whereas we're on the phone going: congratulations, that's a real success, you've helped us get somewhere. And then by the fact that I have been able to win their confidence and say: this wine is great, and I can tell you now the next wine is going to be even better…help us do the hard work now and we will reward you with better wines to sell. It's good for their ego so that they can then turn around - what agencies do you represent? (Winery A). Oh, gee, that's impressive, they're doing well. They feel good about themselves. Once then you've got them on side, now the very best agents have great relationships, they have those sort of relationships with their customers. Then, all of a sudden, they're the ones going around saying: look, you have to give this wine a crack. A restaurant wine list might have eight Pinot Noirs from around the world and there is probably 500 producers who can have one of those eight spots. What do we do to get that spot? Well, if our agent has already got a good relationship with them and then they said: I'm looking for a good Pinot and so of the 10 or 12 Pinots they've got in their portfolio they go: (Winery A) is the one. Bang!".

Winery A's management philosophy in setting and acting on critical success factors is tempered by past setbacks and a new clear view that as a small business they should take more of an incremental approach. While a number of close competitors have rushed to major export initiatives (with associated costs of recruiting an agent, supplying samples, and opportunity costs of time and resources) Winery A has recognised that they are neither organised nor ready to export: " We have had to take the business on and turn it around…so the first thing we did was said: okay, we've got a fairly strong brand in Melbourne, let's make it stronger. Then we said: okay, once we have got it stronger in Melbourne, let's get Sydney firing. And now that we have got Sydney and Melbourne firing, we're now fielding export opportunities, very small ones…It will represent, longer term, about 25 per cent of our sales only".

Besides the quality of the wine, the marketing and distribution relationships, another critical success factor is capital planning. Most small wineries are seriously under-capitalised, and that then has all sorts of quality and focus issues because all of a sudden a winery runs short of funds and can't buy what is needs to generate cash flows: "…you might think your Pinot Noir, to be the best Pinot Noir at that price, needs 25 per cent new oak and all of a sudden you can only afford 10 per cent. The quality goes down and you get in that spiral of chasing your tail, cutting costs instead of pursuing growth. One of the reason why, for example, there is not many wineries that get swamped and taken over, And that's why you get to a certain size and you are not a speed boat business anymore, that's when you start becoming liable to takeovers and that's why, for example, most of our wineries are being taken up by the biggies.

For wineries there is that element of fashion in keeping ahead in changes in taste. But this is not something Winery A has tried to do: "In terms of actual product fads, etcetera, that's probably not our real area to be in and it doesn't suit our business model, it's a bit more conservative.…we're too small to worry about that and the tastes don't change so much…more incrementally".

The final critical success factor is feedback loops to measure progress against the afore mentioned critical success key factors – to determine what is being done well and identifying areas for improvement. All wines undergo own regular benchmarking trials. Besides perceptions of Winery A staff, of particular importance is their agent's assessment, for the latter are tasting wine every single day from a number of sources in the marketplace. Winery A also gets feedback on a regular basis about the number of places that are listing its wine and how it's selling. They also get specific feedback by going out into the marketplace and just talking to people about how the wines are travelling. And then at cellar door they do the same, where sales data and surveying gives empirical feedback. Surveying is done in a casual but methodical manner: "…you probably did not realize it but you were being surveyed when you got here by (tasting room staff member) just asking questions: hi, how are you? Etcetera, etcetera. So we know how many are repeat visitors, how many are word of mouth, and if certain percentages of those drop we can then go from there". In addition excel spreadsheets track inventory movements and whether sales have increased or not and what restaurants are buying what products.

How much is luck a critical success factor in the business? To get a really great review in Wine Spectator or win the Jimmy Watson would be seen as a fluke. Besides the luck in weather causing lousy local fruit or a more radical disease than Phylloxera coming through the region and wiping out all grapes, luck takes a back seat to good planning and control: "…I really think what I like about this business is there is no magic, it's just all about incremental growth and a lot of hard work. And as a result of that there is also, I don't think, much risk for failure. We know what we've got to do to be successful, we just now have got to keep doing it".

Conclusions

The most important critical success factor for winery A is the quality of the wine produced, but grape quality, wine-making capability, access to capital, planned access to target markets, deep relationships with distribution agents, and robust feedback mechanisms are critical success factors which drive the quality of the wine, its conversion into economic returns, and therefore sustainability. A single case does not permit generalizability of findings, but this research generates some key themes for further exploration of wider patterns and experiences amongst other small wineries.

Unlike Winery A, most of the non-hobby wineries in the region aren't profitable, though: "Profit is a matter of definition too. For the tax man. (Tape turned off)". At the time of the field research Winery A was slightly 'in the red' but has since moved, in line with its forecasts, into 'the black'. But Winery A acknowledges that to maintain the current profitability is a real juggling act from a management perspective in terms of working out, even from a year to year, vintage to vintage basis, plans and action for production and marketing. In the wine industry "…you must virtually start again each year with every facet of the business (which) is so it's very different in that respect to a lot of other industries where industries once you once get it right, you have got it".

However for Winery A, their performance of the juggling act that faces players in the industry appears to be a skilled one that is informed by a clear line of sight about the critical success factors for sustainability, and about the practical actions to achieve them. The romance of the industry had initially diverted management's attention from the practicalities of operating in a quixotic and volatile market, but as the narrative demonstrates, Winery A recognizes and reacts to the need for a balanced approach to the articulation and operationalisation of critical success factors.

The Balanced Scorecard is widely as advocated a performance management tool for improving strategic and operational control in small businesses, and hence results, by translating strategy into action (Chow et al 1997; Birch 1998). The Balanced Scorecard is predicated on the view that action must align with strategy, and that strategy must articulate a 'balanced' set of objectives, and the critical success factors which mirror these objectives, across financial, business process, learning and growth, and customer dimensions (Kaplan and Norton, 2001). A balanced set of critical success factors is argued to be a tool to clarify the direction in which a business needs to go, communicate that direction, align stakeholder's work to those ends, and ultimately promote efficient competitive performance (Frigo and Krumwiede, 1999).

The assumption is that every business must chart its own pathway to success, and a balanced scorecard can help identify the destination and guide the journey so that change is in the right direction for sustainability. Whilst Winery A does not have a formal Balanced Scorecard, its critical success factors span all of the perspectives valourised by the formal model, and so appears to nevertheless be doing an effective job of 'scorecarding' to inform positive change.

> **"…we are always in the middle of some change or other. Always in the middle, never at the end of a change. Always in the middle of something…"** *-manager Winery A*

Appendix 1 – typical costings

Winery case cost breakdown

Sourced fruit costs
- Typical cost of sourced grapes @ $1,500 per tonne (range 750-2800 per tonne)
- Typical **litres** per tonne crushed @ 680 litres
- One case = 12 X .75 litres = 9 litres
- Typical cases per tonne = 76 (680 litres per tonne/9 litres)
- Average cost per litre = $2.20 (rounded up 2 decimals: $1,500/680 L)
- Average cost per case = $20 (rounded up zero decimals: $9 L X $2.20/L)

Estate grown fruit costs
- Typical yield per hectare @ 10 tonnes
- Typical operating costs @ $7,000 per hectare (range $6,000 to $10,000)
- Average cost of estate grown grapes per tonne = $700 per tonne (rounded: $7,000/10)
- Average **litres** per tonne crushed = 680 litres
- Average cost per litre = $1.03 (rounded up 2 decimals: $700/680 L)
- One case = 12 X .75 litres = 9 litres
- Average cost per case = $10 (rounded up zero decimals: $9 L X $1.03/L)

Other costs
- Winemaking @ $1.25 per litre *or* $11.25 per case ($1.25 X 9 litres)
- Oak treatment @ $1.10 per litre *or* $9.90 per case ($1.10 X 9 litres)
- Contract bottling and corking @ $2.40 per case
- Labels, capsules, cartons & liners @ $25.00 per case
- Marketing and promotion @ $10 per case
- Average total other costs @ $58.55 ($11.25+$9.90+$2.40+$25+$10)

Total case cost comparison
- Case via sourced fruit = $79 per case (rounded up zero decimals $20+$58.55)
- Case via estate grown fruit = $69 per case (rounded up zero decimals: $10+$58.55)
- Cost differential to source rather than grow = +15% ({$79-$69}/$69)

Front end costs
- Vineyard establishment on own land @ $30,000 to $40,000 per hectare
  - non-grafted* vines @ 1 each or $2,000 per hectare
  - grafted vines - disease resistant @ 4 each or $8,000 per hectare
  - cost benefit: early vigour, vineyard resale value, devastation risk reduction V cost
  - lead time to commercial yield @ 4 to 5 years
- Facilities establishment (buildings, plant, equipment) @ $2,500 to $3,000 per tonne crush capacity *plus* additional for power, roading, effluent etc
- a 20,000 case winery will need about $4 million worth of capital, $4-$6 million at any time. Double that case output and the capital probably triples, not doubles.

Small winery sales

50 per cent of our wine by dollar value typically gets sold through distributors but the percentage of gross profit from that is quite low.

Via mail order and via cellar door is where small wineries can generate gross profit returns of about 65 per cent.

The balance is ideally two-thirds of wine via agents, one-third of wine via mail & cellar, with this one-third will probably representing 50 per cent of gross profit.

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