



3535 Hagen Road
Napa, CA 94558
707.258.9130 tel.
707.258.9132 fax
ScionAdvisors.com

Future Scenarios

Discover and quantify your business potential

Hank Salvo, *Scion Associate*
hanksalvo@sbcglobal.net

Scenario planning is a dynamic tool that helps businesses in complex and uncertain environments better prepare for the future. By examining a variety of possible actions and quantifying potential outcomes, this method drives lower risk and more flexible long-term plans. In contrast to the single-dimension forecasts on which most businesses rely, wineries effectively using this process will benefit from more robust and reality-based strategies.

Most long range plans are optimistic views of the business or, at best, a straight line extension of current performance. The wine business has been anything but straight line over the last ten years. In fact, with over 30,000 brands on retail shelves and restaurant menus, success in today's wine business is a difficult proposition even for the best of companies.

Scenario planning is more rigorous than typical planning processes which simply define objectives for the organization then develop strategies to reach those goals. This approach examines and quantifies a variety of situations based on assumptions specific to your business and niche, which are then quantified through financial models.

We recommend this method particularly when winery leadership has to make expensive long-term decisions in uncertain situations. For example, various scenarios can be modeled in response to the question: "What happens to cost of goods and pricing on my primary brand, if I bottle my excess wine as a second label to manage oversupply?"

By building a financial model for learning about the future, a winery's business strategy is formed through quantifying a small number of scenarios about how the future might unfold, and how these might affect issues confronting your company. Through this exercise of analyzing contrasting possibilities, a winery's leadership team identifies realistic company goals.

Scenario planning may take the response to the question posed earlier in an entirely different direction, that is: "Sell the oversupply in the bulk market, even if at a loss, in order to protect the image and pricing of the primary brand."

EXAMPLE

Let's assume you are a 60,000-case Sonoma County luxury wine producer and want to increase gross profits as a percent of sales to 60% over a three year plan period.

[Table I](#) illustrates how scenario planning works.

Scenarios 1 through 3 demonstrate three alternative financial scenarios when pricing, product, volume and channel assumptions are adjusted.

Scenario 1: Volume growth accelerated by 50%. Gross profit as a percent of sales is only 49%, because growth is driven by a much lower margined wholesale business. If this winery adopts this scenario, they will need to decide how to effectively expand distribution, source more grapes and efficiently manage production capacity, marketing and other overhead to achieve the volume growth while minimizing the effect on their bottom line.

Scenario 2: Volume sales remaining flat with accelerated price growth. While operating income is slightly higher than Scenario 1, gross profit as a percent of sales bumps up to 57%, because of pricing and a more favorable split between the wholesale and retail/consumer channel. This north coast winery will need to understand the real cost of building brand strength in its distribution channels and also realistically *assess the pricing risk on volume* as a function of this strategy (e.g. will volume take a hit as a function of price growth?).

Scenario 3: A combination of price growth and direct to consumer channel emphasis. Operating income clearly is stronger than all other scenarios AND gross profit as a percent of sales bumps up to 61%, because of the emphasis on the higher margined retail/consumer channel. The winery has set aside more marketing and overhead dollars to support this growth. Before choosing this scenario, an analysis of this channel's capacity and what the competitive response might be is important.

Through these scenarios, winery leadership has learned more about profitability drivers and what it will cost to grow the business most effectively while improving gross profit. The final scenario choice may end up being a synthesis of all three scenarios. Cash flow and balance sheet affects will also be vital to this winery's decision about its future and will need to be analyzed to complete the plan.

Your final plan will most likely be a combination of scenarios. The family winery in our case study chose to develop a long term plan around a variation on Scenario 3. They actually took their volume down to 45,000 cases by eliminating an unprofitable brand and within 3 years grew gross profits from 31% to 60% of sales through price growth and increased direct to consumer emphasis.



Table 1 - Impact of three business scenarios on
Gross Profit as % of Sales

	#1 - Grow Volume	#2 - Grow Prices	#3 - Direct & Prices
Key Indicators	2009	2009	2009
PROFITABILITY			
Sales - Wholesale/Other	\$ 8,625	\$ 6,665	\$ 5,425
Sales - Retail/Consumer	5,625	5,440	8,000
Total Wine Sales	14,250	12,105	13,425
Cost of Wine Sold (Specific)	7,300	5,220	5,220
Gross Profit	6,950	6,885	8,205
Marketing	4,000	3,900	4,200
Administration	1,000	720	900
Operating Expenses	5,000	4,620	5,100
Operating Income	\$ 1,950	\$ 2,265	\$ 3,105
% OF SALES:			
Gross Profit	49%	57%	61%
Operating Expenses	35%	38%	38%
Operating Income	14%	19%	23%
CASES SOLD			
Wholesale	75.0	43.0	35.0
Retail	25.0	17.0	25.0
Cases Sold	100.0	60.0	60.0
AVERAGE RETAIL PER BOTTLE			
Wholesale	\$19	\$26	\$26
Retail	\$19	\$27	\$27
OPERATING COSTS PER CASE			
Sales - Overall	\$143	\$202	\$224
- Wholesale/Other	\$115	\$155	\$155
- Retail/Consumer	\$225	\$320	\$320
Cost of Wine Sold (Specific)	\$73	\$87	\$87
Marketing	\$40	\$65	\$70
Administration	\$10	\$12	\$15
PRODUCTION COSTS PER CASE			
Grapes and Wine	\$30	\$30	\$30
Winemaking	\$25	\$35	\$35
Bottling	\$18	\$22	\$22



Businesses that effectively use scenario planning can derive serious benefits.

1. **A more flexible strategic plan.** To manage risks related to investments that extend long into the future, your leadership team must be willing to look ahead and consider various issues. Scenario planning is a tool for helping managers develop multiple views of the future in an uncertain world, manage strategic risks and opportunities, and help create more dynamic plans. While no one scenario will be 100% correct, you will have developed a framework of alternatives that should increase your ability to adapt to your changing environment and manage it more proactively.
2. **A more robust, reality-based strategic plan.** As an exercise in contingency thinking, scenario planning drives a culture of discipline. The resulting knowledge provides your team with a better understanding of how volume, margins and costs react, or need to react, in a variety of circumstances. You will have discussed and quantified how each scenario impacts your business which could unlock potential changes in your structure to streamline costs while supporting growth. After quantifying and refining a variety of possibilities, you can now choose a plan to achieve your company goal. Your final plan may be a combination of different scenarios versus an initial, single-perspective outlook.

Poor use of the scenario planning tool can lead to trouble. Avoid these traps:

1. Treating scenarios as forecasts rather than a disciplined process of examining possibilities.
2. Constructing a set of too simplistic scenarios (e.g. optimistic & pessimistic).
3. Failing to make scenarios global enough in scope and missing opportunities/threats.
4. Focusing solely on profit or volume scenarios without taking in account the impact of how a better utilization of strategic assets may impact your business.
5. Not having an adequate process that engages leadership team in scenario planning.
6. Not using an experienced and skilled facilitator.

Conclusion

Scenario planning is the process through which winery executives develop and then consider various models of equally plausible futures. The objective is to uncover surprises and unexpected leaps of understanding. When used properly, scenario planning is an effective tool to increase and quantify your knowledge of the business potential.

Thorough discussions about wine demographics, economic factors and competition are critical for developing scenarios and their underlying numbers. For that reason, you may find it beneficial to involve outside advisors with a broad wine industry perspective to ask the tough questions that ensure your scenarios are grounded in reality. That's how Scion can help. Scion has a wealth of wine and consumer product knowledge, and an approach that guides you through the planning process to craft scenarios that make the most sense for your family wine business.

