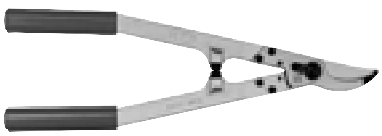
WINE MARKETING

Build brand equity



PRUNE your PORTFOLIO

BY **Deborah Steinthal, Scion Advisors**

Do you analyze your brand portfolio to identify pruning opportunities as often as you prune your vineyards? If pruning vines is the selective process of removing diseased or excess wood to encourage balanced productive vineyards, then pruning brands is the disciplined process of identifying weak wines and brands and eliminating unprofitable ones.

Although regular pruning takes tremendous discipline, without it, many winery portfolios become chockfull of marginally profitable wines. The proliferation of wine SKUs (store keeping units) illustrates the problem. *Wine Trends Quarterly Report: Competitive Concentration,* recently released by Motto Kryla & Fisher (St. Helena, CA), found that California brands alone accounted for 5,807 SKUs in 2003, a 6% growth rate over 2002 and a significantly higher rate of growth than was seen in California wine shipments.

The proliferation of brands, increased competition, and increased consolidation are squeezing winery margins by producing slower growth in revenues and higher sales and marketing costs. In fact, the cost to compete has escalated dramatically, and many wineries are seeing a 20% to 30% increase in these costs.

Since many winery owners and executives have their roots in winemaking, until recently, most Californian wineries developed their product strategy from the production side of their business. We call this "production push," and this strategy yields wines that are exciting to the winemaker, but not always to the market. This approach to product development is also partially responsible for the proliferation of brands in the market.

However, as winery owners are experiencing slower growth in earnings, some are learning to follow "market pull" strategies and to scrutinize their portfolios with a deeper awareness of the need to build brand equity.

The surprising truth is that many wine products don't make money. Many wineries earn almost all of their profits from a small number of wines. A recent *Harvard Business Review* article ("Kill a Brand, Keep a Customer," December 2003) proposes that this is not solely a challenge in the wine industry: "Many companies generate 80% to 90% of their profits from fewer than 20% of the brands they sell, while they lose money or barely break even on many of the other brands in their portfolios."

When I work with clients, we seek out the hidden costs — the real and psychological costs that are unnecessarily affecting their bottom lines. These costs keep winery teams from optimizing their resources: their position in the market, their return from financial and asset structures, and their organizational resources. I call this the CIRD syndrome.

Hidden costs: The CIRD syndrome

1. **Complexity**. Multi-brand strategies and large product portfolios require coordination — from production and packaging changes to distributor relationships and retailer promotions. This coordination requires costly managerial resources and time-consuming price and inventory adjustments. Moreover, you will bear the biggest cost of brand proliferation not in the present, but in the future. As your brand manager focuses on present concerns, such as budget allocation issues and inventory turn, future planning takes a back seat, making you more vulnerable to rivals who are more future-focused and disciplined.
2. **Inefficiency**. Wineries that maintain a large stable of brands or wines in a single brand portfolio, each operating on a relatively small scale, incur large setup costs (vineyard, winemaking, and packaging), which result in higher production costs. Additionally, the impact of your sales team may be diluted by the need to leverage your sales force across many brands.
3. **Retailer margins**. A retailer may agree to carry all of your brands, including the weak and marginal brands, only if you offer substantial promotional allowances and higher margins.
4. **Differentiation**. Your brands or wines may compete with and cannibalize one another. As a result, your revenues do not grow, and may even decline, while costs rise.

Instilling brand discipline

Begin the pruning process by conducting a brand portfolio audit (see *Quick Audit* sidebar). It is important to allocate fixed and shared costs to each brand and to survey your retail customers to understand how you are performing in the market. In order to prune

Quick Audit

YES	NO	
☐	☐	Are we losing money on any of our brands or wines?
☐	☐	Are any of our brands category laggards or losers?
☐	☐	Are we unable to match our competition's marketing muscle?
☐	☐	Do any of our brands overlap in our portfolio?
☐	☐	Do our customers think our brands compete with each other?
☐	☐	Are retailers stocking only a subset of our brand portfolio?
☐	☐	Does our sales team have a hard time prioritizing which wine to show during a sales call?
☐	☐	Are we discounting some of our wines on a regular basis to push inventory?
___ YES	___ NO	TOTAL

If you answered ***"Yes"*** to:

0–2 questions: Minimal brand pruning opportunity

3–6 questions: Considerable opportunity to prune your brand(s)

7–8 questions: Pruning should be a top priority your portfolio, you will have to develop and apply consistent decision criteria that support the profitable growth of the brand. Take time to analyze your portfolio on a regular basis. By pruning your portfolio, based on an understanding of market opportunity, brand strategy, and business returns, you will be able to reduce hidden costs, maximize profits, and perhaps most important, better serve your customers.

Case-in-point — A 60,000-case Sonoma County luxury wine producer

Many wineries don't realize that when you launch several brands or wines in a brand, you incur hidden costs, because multi-brand strategies suffer from diseconomies of scale. We frequently observe a decline in (hidden) costs when a winery reduces the number of brands it sells or the size of its wine portfolio.

One Sonoma County producer's business had become overly complex with two brands that had to be sold through a three-tier system already overburdened by brand proliferation and distributor consolidation.

The escalating cost of sales and marketing was eating into the winery's bottom line profits, and the 15,000-case (second) brand that had been selling at $15/bottle required considerable *pushing* through the wholesale system. Distributors and retailers were exacting costly "favors."

Members of the sales team weren't clear whether to pull the $15 secondary wines or the $30 estate wines out of their bags during the 10-minute sales call. The marketing director had just invested in expensive new packaging to upgrade the second brand, so it wouldn't detract from the estate brand's cachet.

This second brand's *raison d'etre* was purely as a revenue generator; its brand identity was not clear or differentiated. As the CEO stated when we first met, "It fills a gap while our estate brand slowly comes on line at the quality and quantity levels we hope to price for; it helps support our infrastructure needs."

Table I: Impact of pruning out a non-performing wine brand

*Key Indicators**	**Scenario A** *Winery with multiple brands*	**Scenario B** *Winery minus a non-performing brand*
PROFITABILITY		
Annual Operating Income (000)	$3,105	$3,240
Operating Income Per Case	$51.75	$72.00
PERCENTAGE OF SALES		
Gross Profit	61%	63%
Operating Expenses	38%	35%
Operating Income	23%	27%
Cases Sold	60,000	45,000
Average Retail Price/Bottle	$26	$30
Operating Costs/Case		
Sales — Overall	$224	$264
Cost of Wine	$87	$99

** A few key indicators were chosen for illustration purposes*

What the CEO failed to grasp were the other cost factors that caused the second brand to hurt the company's overall performance. Table I illustrates the basics. Scenario A shows the winery's key performance indicators when producing two brands. Scenario B shows the improved financial picture when the second brand is pruned out.

The project for this winery was straightforward. Scenario B in this *pro forma* analysis reveals that the CEO was right on one count; by eliminating the second brand, the winery would be operating off a smaller base of 45,000 cases, contributing to an increase in operating costs as a percent of sales from $224/case to $264/case — with a commensurate increase in the cost of wine.

However, he also learned that the second brand was contributing higher operating expenses as a percent of sales than anticipated. Most important, by eliminating the non-performing brand, the Sonoma County producer would increase his average retail price/bottle from $26 to $30. The take-away lesson was that the winery increased its operating income by $135,000 (from an average $51.75 per case to $72), moving gross profit from 61% to 63% of sales — while actually getting smaller in volume.

Conclusion

What this winery learned is that you can show improved performance by eliminating declining and marginally profitable brands. You can use the resources you've freed up to make your remaining brand(s) stronger and more attractive to customers. *Thus, killing a non-performing brand or wine can be the best way for you to serve both customers and shareholders.* Done right, portfolio pruning can result in a more profitable winery that is poised for margin growth. ■

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