

# Cooperating to Compete

## the case of

### ‘Cellars of Canterbury’

#### Introduction

The five directors of ‘Cellars of Canterbury’ recently found themselves seated at the oval table in their Sockburn office during one of their regular fortnightly meetings debating the benefits of the alternative strategies available for entering the United Kingdom (UK) and United States of America (USA) markets with their newly formed ‘Cellars of Canterbury’ wine label.

Shortly before this, the company had employed a salesperson whose primary role would be to lead the pitch of the jointly produced wine into these potentially very large and profitable markets. The discussion at the meeting principally centered around the issue of what proportion of these markets should be targeted and consequently what restrictions should be imposed on the breadth of the sale area to ensure that the salesman’s efforts remained focused. Essentially they were confronted by two options, firstly, to aim the product at specific regions and states where demand would closely match their supply capabilities, or alternatively, give the salesperson a free reign to access the largest market possible, and in doing so adopt a position where they would be selling short.

Currently, 'Cellars of Canterbury' has only a relatively small amount of wine in stock, compared to the volume these markets potentially represent, and discounting any surpluses arising in the future from their individual labels, they have no raw material secured for the 2001 vintage. Initially when the idea to produce a joint venture wine was proposed the individual partners of 'Cellars of Canterbury' were collectively producing a surplus of grapes and wine, which could be contributed to the common brand. However, since then, the markets for their individual private brands have expanded significantly. As a result the individual partners now require the majority of grapes and wine they produce to support their own private brands. This, however, poses a serious problem for 'Cellars of Canterbury': should the new markets open up as envisaged, they will be drastically short of produce.

Some may see this as a vulnerable position. However, the individuals involved are more optimistic: rather than seeing this situation as a potential problem, they look upon it as an advantageous position to be in. By not having committed themselves to any capital land purchases or grape procurement contracts they have provided themselves the flexibility to secure markets for the final product before purchasing the raw materials. That is, of course, so long as the inputs are available, when needed. As Chris Morkane noted, 'Cellars of Canterbury' have taken a short position in the market.

## Global Wine Industry

[Data for the following section draws from the Rabobank market study by Geene *et al.*, 1999]

There are four important trends being observed in the global wine industry. First, over the past two decades a structural oversupply of wine has developed on the world market.

Demand has declined by 21% during this period. However, there has not been a similar reduction on the production side: while grape acreage has fallen by 19%, yields have increased due to technological improvements resulting in only an 11% reduction in grape production. This misalignment of supply and demand has been compounded by improved processing methods that require fewer grapes per liter of wine produced. As a result excess wine is now frequently distilled to produce industrial alcohol.

Second, the volume of world wine exports continues to increase rapidly and now accounts for 20% of the total world wide wine production. In 1992 the value of total world wine exports was USD 8.8 billion, however by 1997 this value had increased to USD 12.4 billion.

Third, increased market penetration and recognition of wines from “new world” wine countries is presenting a competitive challenge to the traditional position of wines from “old world” wine countries. The distinction between these two factions may not be well understood by the general public: The “old world” countries are principally found in Europe and include France, Spain, Portugal, Italy, Greece, and Germany, whilst the “new world” countries encompass North and South America, South Africa, Australia, New

Zealand, Argentina, and Chile. The exact position of these countries in the 'life cycle' of wine countries varies (Exhibit A). Most "old world" countries are now characterized by declining domestic markets, whereas "new world" countries tend to be in an emerging phase or phase of growth. USA and Chile, on the other hand, are in their 'second life' stage, characterized by an upswing in their industries following innovations implemented after previous declines in their respective domestic markets. Argentina also looks set to enter this phase. Of the "old world" countries it is only those that have adopted a more market-oriented approach, such as Spain, that are now once again experiencing growth. Germany has been losing a lot of ground, but with the right changes they may be able to take on a second life as well. Eastern Europe appears to be embarking on this at present.

Fourth, the market for alcoholic beverages is reaching saturation point worldwide. Internationally consumption levels of pure alcohol are converging. Countries where consumption levels were originally high have decreased consumption and vice versa. These levels are expected to converge and stabilize at 6-10 liters of pure alcohol per capita annually. At the same time there are also changes in preference for different types of alcohol occurring. In the UK market the consumption of beer is declining while wine is on the rise, whilst in France the beer market is stable and the decline in alcohol consumption since 1976 can be attributed to decreased wine consumption. Currently, total world wine consumption stands at approximately 225 million hectoliters, this is significantly less than the 300 million hectoliters consumed in 1980. However, consumption is expected to stabilize at this level and may even increase slightly in the near future.

A key driver of the changes in the wine industry is shifting patterns of consumption and demand. Traditionally, in the “old world” countries wine has been an everyday beverage, however it has now become much more of a ‘lifestyle’ drink. By the same token, what was previously an elite drink in the “new world” countries has now become a regularly consumed beverage. Additionally, consumers have begun displaying an increasing preference for higher quality wines, varietal wines, red wines, and for the wines produced in the “new world” countries. It is apparent from a comparison of world wine production that “new world” countries are gaining market share at the expense of the “old world” countries (Exhibit B). However, neither old nor new countries are homogenous.

Of the “old world” countries, France and Spain have increased their relative positions, whereas Germany has lost production share. Among the “new world” countries, USA, Australia, and Chile have all increased their market share rapidly, while South Africa and Argentina have lost market share.

Consumption has now stabilized in the “old world” countries after having been steadily declining over the past 30 years. The exception being Germany, which has seen consumption increase by 50% over the same time period. In the “new world” overall consumption has gradually declined as well, where increased consumption in some countries has been countered by significant declines in Argentina and Chile. On the other hand, traditional importing countries have seen rapid growth over the past 30 years with consumption almost doubling and indications are that this will continue. Similarly in the

emerging countries like Asia, although total consumption is very low, it is growing very rapidly. Hence, the industry is concerned about whether the consumption growth in the emerging and traditional importing countries of Belgium, Sweden, Denmark, Netherlands, Canada, and the UK will be enough to offset declining consumption in the wine producing countries. A recent market study undertaken in May 1999 predicted the scenarios described in Exhibit C.

In contrast to the demand for basic wines, which continues to decrease, the demand for quality wines has increased significantly in recent years. This reflects a rise in living standards and holds in almost all countries. There is no standardized international measure of wine quality used across the wine producing nations, hence price provides one of the few metrics available to compare and differentiate between the quality of different wines (see Exhibit D for price classifications). Thus, it is not surprising that the average price of wine has increased in countries such as Canada, the UK, and Germany with their shift toward higher quality wines.

Additionally, the consumption of red wines has increased in several markets: Canada, Germany, Japan and the USA are prime examples. Two main factors have been identified as underlying this shift away from whites to reds. Firstly, the wine market has matured; consumers have become more sophisticated thus they are demanding a more complex and challenging taste that red wine provides. Secondly, research indicates that red wine provides health benefits: scientific studies have linked consumption of red wine to reduced incidence of cardiovascular diseases.

Simultaneously, the consumption of “new world” wine in the traditional importing countries has almost doubled in the past 30 years. The “new world” wines are preferred because they are more full-bodied and have a favourable price/quality ratio. The increased competitiveness of “new world” wines is indicated by the tenfold consumption increase they achieved in the UK between 1990 and 1997: a market in which total consumption declined during the same period. The change in imports to the UK from some new wine countries between 1995 and 1997 can be seen in Exhibit E.

In contrast, however, market growth for “new world” wines has been much slower in the other “old world” countries. Here they must compete for consumers who are strongly loyal to both domestic wines and the wines of other old wine countries. In Germany for example, only 2.7% of imported wine came from “new world” wine countries in 1998, this percentage was lower still for other “old world” wine countries.

In a recent report, Rabobank provides a rosy outlook for the world wine industry indicating that overall demand will increase again for the first time in several decades. However, this will not make the wine industry any less competitive; the market has become demand driven and will continue to be so. Given the stable overall demand for wine, the shift to red wines will result in declining demand for white wines. The market shares of premium and super-premium wines are expected to continue increasing. Both old and new wine countries have concentrated their investments in this the quality segment so supply could well outpace demand. Production of premium and super premium wine is expected to increase by 10 million hectoliters by 2003 in the European

Union (EU), however, this will be at the expense of basic wines, so total EU wine production is expected to remain relatively constant. In the new wine countries production is expected to increase by 5 million hectoliters, stabilizing in South Africa, continuing to decline in Argentina, and increasing significantly in Australia, Chile, and the USA. It is likely that the majority of this wine will be exported to the EU, as the domestic markets in these countries are comparatively small in most cases.

## New Zealand Wine Industry

The first wines were produced in New Zealand (NZ) early in the nineteenth century but it wasn't until the 1950's that commercial wine production began to gain a foothold. A report highlighting the prospects of viticulture in NZ was published in 1895, which subsequently brought about a flurry of vineyard plantings. But the fortunes of the wine industry tended to undulate dramatically over the following half century, due predominantly to government legislation. The turning point came in 1950 with the election of George Mazuran as president of the Viticultural Association. The ensuing decade saw a number of legislative breakthroughs as Mazuran exercised his ability as a lobbyist among the political powers in the government chambers (Cooper, 1984).

From 1960 to 1990 the vineyard area of NZ increased by over 15 times its size and by over 31 times by 2000. During this same period wine production increased from 4.1 million liters to 59.2 million liters in 2000 (Statistical Annual, 2000). The initial boom in the 1960's was achieved at the expense of quality, as an indiscriminating and

unsuspecting public snapped up large quantities of cheap adulterated Sherries and Table Wines (Cooper, 1984). The 1970's brought an overall improvement in wine quality and a heavy emphasis on the production of table wines. The focus of modern day production in NZ has continued to be on quality and has tended toward export markets with 32% of NZ's total wine production being exported in 2000.

As a result of this rapid expansion over the last half-century, competition in the domestic NZ market has increased markedly, particularly during the past decade. The number of wineries has grown substantially and now totals 358. This is more than double the amount that existed in 1993 and is an increase of 173% since 1990 (Exhibit F). The wineries of NZ can be classified into 3 categories: Category 1- Annual wine sales not exceeding 200,000 liters; Category 2- Annual wine sales between 200,000 and 2,000,000 liters; Category 3- Annual wine sales exceeding 2,000,000 liters (Exhibit G). The greatest expansion over the past decade has come from category 1, which represents small family owned and boutique wineries. However, the domestic market in NZ is controlled by the relatively large corporate category 3 wine companies, which now consists of only three: Montana Wines Ltd, Nobile Vintners Ltd, and Villa Maria Estate Ltd.

During this same period domestic consumption of NZ wine has fluctuated widely, principally as a result of competition from imported wine. Comparing the consumption and import data in Exhibit H, a direct negative correlation can be seen between the domestic consumption of NZ wines and imports. The volume of wine imported to NZ peaked in 1994, this resulted in the lowest ever consumption of domestically produced

wine last decade. NZ wine producers have traditionally found it difficult to compete in the markets for cask, red, and discount sparkling wine which are imported at price levels below which it is economically profitable for NZ wineries to produce.

As a result the NZ wine industry has recently shifted its focus towards pursuing more of an export strategy. However, these forces also pose the greatest threat to the ever-increasing number of small-scale category 1 wineries. For the most part these wineries are effectively excluded from the lucrative and largely monopolized domestic supermarket and liquor outlet markets, the largest two sellers of wine in NZ, due to the high entry and transaction costs involved. They also struggle to compete in export markets due to insufficient size and volume to complete export orders. Consequently they are restricted to niche marketing whether that be selling wine through their own restaurants/wineries store, merging or forming an alliance with other producers, or up scaling the size of their operation, which is often financially unfeasible. New Zealand's shift towards becoming an export producer is clearly depicted in Exhibit I; where domestic market wine sales have remained practically stagnant since 1997 indicating saturation, while export volumes have steadily increased since 1995 and now total 50% of the domestic sales by volume.

Although the NZ wine industry has recently experienced rapid growth, it is still seen as a small producer by world standards, making up only 0.2% of total world wine production and 1% of "new world" wine production. This is partly due to the industry's goal of positioning itself at the high priced, high quality end of the market. Exhibit J is testimony

to the shifting emphasis within NZ towards producing quality wine. As can be seen, the producing vineyard area has continually increased over the past decade, whilst the quantity of wine produced has remained relatively constant when seasonal effects are disregarded. This has resulted directly from viticulturalists restricting crop yields with the aim to increase grape and thus wine quality. Recognizing this the Wine Institute of New Zealand, the national governing body of the wine industry, has implemented a generic marketing strategy using the slogan “The riches of a clean, green land” to reinforce to consumers the shift that has occurred in the NZ wine industry.

This is reinforced by the recent critical acclaim that NZ’s Marlborough Sauvignon Blanc has gained internationally. It is now recognized as one of the best in the world<sup>1</sup>. This has prompted a spate of Sauvignon Blanc plantings in the Marlborough region during the past three seasons. The first of these plantings will begin to produce fruit in 2001 but will not reach peak production until 2004. This has provided the basis for the predictions of many that there will be an over supply of Sauvignon Blanc grapes in NZ within the next 3-5 years.

## Canterbury Region

In 1968 Lincoln College (now Lincoln University) made its first grapevine plantings for anticipated research purposes. By 1973 research had begun with the intention of finding the most suitable wine producing varieties and testing the proposition that Canterbury’s

cool-dry climate favored the production of German style wines (Cooper, 1984). The results of testing over 60 varieties of grape indicated that the Canterbury climate was marginal for mid-late season ripeners such as Sauvignon Blanc and Cabernet Sauvignon but Pinot Noir and Chardonnay appeared particularly promising. They found that the warm days and cool nights of the long dry autumns in Canterbury enabled the fruit to ripen slowly producing grapes with high levels of acidity and extract (Cooper, 1993).

Canterbury provides a temperate climate with cold winters and warm, dry summers. Its proximity to the Pacific Ocean tempers extremes of heat or cold and warm Northwest winds add to the heat accumulation and reduce the incidence of fungal disease by drying the vines. Total heat accumulation for grape ripening is relatively low at 900-1100 degree days and in this respect it is similar to parts of the Rhine and Moselle in Germany, and Alsace and Loire in France. Early autumn and late spring frosts are a risk as is the cool northeasterly sea breeze. These factors make site selection of utmost importance and have led to viticultural practices whereby crops are heavily thinned to increase the speed of ripening; this very technique also increases concentrations of phenolics and aromatics in the grapes, which increase the quality of wine (Tipples, 2000). Due to these reasons Canterbury winemakers have tended to focus towards the quality end of the market.

On the basis of Lincoln Universities early research Mr. Robin Mundy made the first plantings in 1978 of what became the earliest commercial winery in Canterbury, St Helena Wine Estate, after nematodes rendered his potato growing enterprise unprofitable

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<sup>1</sup> NZ has won the Silverado trophy for the best Sauvignon Blanc at one of the worlds most prominent wine contests – The International Wine and Spirit competition – 9 times since it was first established 11 years

(Cooper, 1993). In only its second year of wine production St Helena sculptured the future of wine making in the Canterbury region when it won a gold medal at the 1983 New Zealand National Wine Competition for its 1982 Pinot Noir. Today, this is considered the wine to have made the most significant contribution to the development of Pinot Noir wines in NZ. Pinot Noir (109ha) is now the most widely planted variety in Canterbury followed by Chardonnay (102ha), and Riesling (85ha), then other less prominent varieties (Tipples, 2000).

Shortly after the advent of the St Helena Wine Estate three German brothers immigrated to NZ. The Giesens, stone masons by trade hailed from the wine-growing region of Rheinpfalz where they, like many German families owned a one-hectare plot of grapevines and made wine for their personal consumption. The two oldest brothers Theo and Alex were contracted to work for a Canterbury construction company specializing in natural stone. After sampling an array of NZ wines they were astounded at the lack of dry Rieslings and decided they would attempt to make some wines in the style they had back in Germany. They inspected potential vineyard sites throughout the eastern parts of NZ. But since they particularly wanted to grow Rieslings, which flourish in a cool climate, they headed South and settled on a site at Burnham, 18 kilometers South of Christchurch in the Canterbury Region. The Giesen Wine Estate is now the largest wine producer in Canterbury (Cooper, 1993).

Canterbury is now the fourth largest of the ten wine producing regions within NZ (Exhibit K). However, at 4.5% of NZ's total producing vineyard area is much smaller

than the principal wine growing regions of Marlborough, Hawkes Bay, and Gisborne (see map as appendix A).

Professor Tipples of Lincoln University quotes that “the cool climate wines of New Zealand’s South Island have built a reputation for quality and diversity of styles second to none and the best of Canterbury wines are among the finest of these”.

## Cellars of Canterbury

### *Forming the cooperative business*

In 1996 the NZ trade development board (Trade NZ) put a program in place to encourage the formation of business networks between individual companies. The rationale for this was that if businesses were prepared to cooperate together they could compete more successfully in the international market place. Peter Elvy was one of the business consultants in Christchurch selected to assist facilitation of these hard business networks (HBN), as they were termed, between companies. Trade NZ gave presentations at various events to promote the HBN program and generate interest among business owners. At about the same time, Dayne Sherwood of Sherwood Wine Estate was contemplating ways to implement a similar idea of his own within the wine industry, whereby a group of Canterbury wineries would simultaneously promote and market the Canterbury wine producing region as well as their own individual wineries collectively under a jointly owned banner on the domestic market. He already had the ideal partners in mind but just was not quite sure how to initiate the proceedings. It was at one of these Trade NZ

seminars, held at the Canterbury manufacturers association AGM that Dayne Sherwood and Peter Elvy crossed paths.

After the meeting Dayne approached Peter and explained his idea. Peter was positively enthusiastic and set about breaching the concept with the four other Canterbury wineries; Giesen Wine Estate, Rossendale Winery, St. Helena Wine Estate, and Sandihurst Winery (details of individual wineries, Appendix B). As it happens, they all realized that potential existed to capture benefits by cooperating with other wineries in one form or another. On the basis of this, they called a 'focus' meeting and set about putting some objectives in place for establishment of a cooperatively owned market promotion business. The key was collectively raising the profile of Canterbury as a wine producing region and thereby spreading the cost of doing so in the process.

Their initial strategy was to enter the regional NZ wine fairs under a collective banner. This way they could place one entry in the wine fairs, put their whole range of wines on the stand, and share the attendance duties among the partners, thereby spreading the fixed costs of entry, time, and travel. Meanwhile, Peter concentrated on forming a constitution for the new company and developing a set of ground rules, including a formula for exit and entry of business partners. They settled on the name 'Cellars of Canterbury' which they registered as a limited liability company. They felt this name was appropriate since it provided an immediate regional differentiation and recognition of the product origin. It was decided that directors meetings would be held on a fortnightly basis, which only the business owners could attend: this ensured that decisions could be made on the spot

without the need to confer with any other parties. Each winery held an equal share in the business and they maintained a completely 'flat' business structure meaning they all had equivocal voting rights and nobody was assigned to any specific duties. They each made a monthly contribution of \$540 per winery per month to cover expenses. The idea behind this being that if they were all financially committed to 'Cellars of Canterbury' it then became an integral part of their businesses, not just something they did after work or another growers organization that gets together but doesn't achieve anything.

Along with the collective promotion strategy, they made a conscious decision to monitor the quality of wine produced by each winery and improve it where at all possible. This involved employing Alan McCorkindale as their wine consultant and making a tour of each other's vineyards on a regular basis. These gatherings also provided opportunity for discussion among the individuals, which led to a number of transactions occurring; Rossendale and Sherwood made purchased a bottling plant together, partners traded fruit with each other, and shared storage facilities. They also developed what were some quite innovative marketing ploys at the time, like selling 'six packs' containing a range of their wines by mail order.

At the same time Peter began developing some small export trade relationships with distributors in Canada, Fiji, the Cook Islands, Rarotonga, the Falkland Islands, India, Sri Lanka, and Hong Kong. These were not ideal markets to enter but the options were limited by the exclusive arrangements some of the wineries had previously developed with distribution agents in the more attractive markets of the UK and USA. However, it

did provide an opportunity for St Helena and Sandihurst to experience export trading which they had previously not attempted. 'Cellars of Canterbury' presented buyers with an order form that included all of the wines produced by each of the individual wineries. Prices included an additional commission fee which went to the 'Cellars' company so wines were in fact more expensive than if purchased directly from the winery. As Peter Elvy indicated, "this system appealed to the small distributors they dealt with, since by dealing with just one company they were presented with a multitude of wines to select from, a whole wine list in fact".

For the first year these strategies worked well: they sold some wine and certainly raised the profile of Canterbury wine in NZ. But the public failed to grasp the concept of what 'Cellars of Canterbury' stood for; they would arrive at shows looking for the individual brands unable to find them because they were all within the 'Cellars' tent.

### ***Local Market Focus***

Nearing the end of 1997 they made a decision to change the direction of 'Cellars of Canterbury'. They felt that to some degree the individual wineries had lost their identity, to rectify this they wanted to raise their profile in the local Christchurch market. In an attempt to do so, 'Cellars' employed a salesperson whose objective was to place the wines of the 'Cellars of Canterbury' partners on the wine lists of as many licensed restaurants in Christchurch as possible. This was a success and within 12 months the wines of the 'Cellars of Canterbury' members could be found in many of the fine dining establishments in Christchurch city.

### ***The Addition of Morworth Estate***

In September 1998 the Sandihurst winery made it clear that they wanted to withdraw from the co-operative. They had decided that as far as Sandihurst was concerned ‘Cellars of Canterbury’ was not meeting their initial expectations and the path that the cooperative business group had chosen to follow was not leading to their desired destiny. This was of little concern to the remaining partners since they had originally put in place exit provisions should this situation arise and had a number interested parties prepared to buy into the cooperative on the departure of Sandihurst.

During the preceding months numerous parties had enquired about the possibility of joining ‘Cellars of Canterbury’. Among the enquiring parties was a large winery from the Waipara sub-region of Canterbury and a joint syndicate of very small vineyards<sup>2</sup>. Of the interested parties it was Morworth Estate, a winery smaller than any of the existing members, whose mix of resources were most appealing to ‘Cellars of Canterbury’. The owner, Chris Morkane was also managing director of Gardener Smith a large Australian commodity trading company and thus brought a wealth of experience in international business and export trading to the table. So they offered the share to Morworth, who promptly accepted the invitation.

### ***Joint Vineyard Purchase***

As the markets for each of the individual wineries wine grew, they experienced an ever-increasing demand for Marlborough Sauvignon Blanc, which by this time had gained

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<sup>2</sup> This would have meant that one person represented 6-8 wineries who collectively held a one fifth share in ‘Cellars of Canterbury’, which understandably presented an undesirable situation.

profound recognition both domestically and internationally. Recognizing the vital importance of Sauvignon Blanc to the success of their wineries, Sherwood and Giesen both purchased Sauvignon Blanc vineyards in Marlborough to secure enough supply. As opposed to following suit and purchasing vineyards, the other wineries decided instead to contract with Giesens for their Sauvignon Blanc grape and wine requirements. Giesens thus by default became the key Sauvignon Blanc supplier for the group, as they had the largest supply available. However, as orders grew they began to find it ever more difficult to meet the groups requirements, whilst still covering their own needs and obligations. A more permanent arrangement was required.

Dayne Sherwood suggested that they may be able to adopt a forestry industry model he was aware of, whereby they could set up a company, float it, take in shareholders, and purchase vineyards that way. So he invited an acquaintance to a board meeting to discuss this option with them. However, after the meeting they decided between themselves that if they could raise the required financial resources it would be better to go into a joint ownership arrangement to purchase the vineyards amongst themselves. So in November 1998, literally only weeks after the addition of Morworth Estate to the cooperative, they made the three-hour journey North to Marlborough where they inspected a number of vineyards over a two-day period. They came away having signed land purchase agreements, subject to finance, for two separate 36 and 20 acre lots of fully grafted, Sauvignon Blanc vineyards, both carrying a crop.

Back in Christchurch, using his accountancy background, Dayne Sherwood ran some cash flows and made comparisons between the options they had available, including the development of bare land or continuing with the status quo. Meanwhile, the other partners utilized their personal contacts to see if they could find a suitable second mortgagee that would allow them to purchase the vineyards using 100% debt financing. At the same time they all had to consider how the purchase was going to affect their own operations. After a further two weeks they had settled: They had found financiers willing to back them as first and second mortgagees and they had all agreed that the purchase price was acceptable, on the condition that they received the harvest that was on the vines to pay the first years' interest bill.

This decision however, meant that suddenly they went from a group of five companies trying to build their brands, collectively, with a monthly contribution of \$540 per month to keep their office open, to a capital asset owning company which required payments of \$6000 per month per winery to support the maintenance and management of their new collectively owned vineyards.

The land purchase was made under a newly registered company name 'Cellars of Marlborough'. At the same time they registered a further 'shelf' company, 'Cellars of Hawkes Bay'<sup>3</sup> with the thought in mind that they may one-day purchase vineyards in this region to provide access to the heavy red wine varieties that can be produced in this area. Before long the section in front of their 20 acre lot came up for sale. The owner was prepared to leave the capital in the property for a further three years, since he had

received payment for the back section from them only months earlier. So they purchased this property also, giving them 76 acres of vineyard in Marlborough. This vineyard was predominantly Chardonnay but the Sauvignon Blanc cuttings had been ordered ready for grafting. Again they stipulated that the fruit presently on the vine belonged to 'Cellars of Marlborough'.

It was agreed that the fruit from the jointly owned vineyards would be crushed to juice on contract in the Giesens' plant in Marlborough then trucked to Canterbury and evenly split five ways between the company partners. They would each buy their share from the 'Cellars of Marlborough' company at market value and spread this cost over a 12 month period (the same \$6000/month), this way the company could fund the maintenance and management of the vineyards under contract and meet the interest cost of financing. With all the added transactions and extra administrative work involved it became time for Peter Elvy to step aside and for 'Cellars of Canterbury' to begin leasing their own office and employing a part-time administrator. The option was also available to put this work through the office of one of the partner's wineries, however, they all agreed that it would be better to incur the extra cost of duplicating these resources in order to keep this side of the business independent.

### ***International Promotion***

Early in 1999 at their six monthly policy meeting they decided it was time to refocus the direction and purpose of 'Cellars of Canterbury'. The local salesperson had done a good job domestically marketing the individuals' wines, however, the domestic market was

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<sup>3</sup> Marlborough and Hawkes Bay are the key wine producing areas in NZ.

becoming increasingly more competitive, the number of suppliers was increasing rapidly and overall demand for wine was stabilizing. The only restaurants remaining that their marketing representative had not targeted and served were those whose wine lists were bought and controlled by one of three substantially larger NZ wine producers. There was thus a realization amongst the partners that their initial success in the NZ market was just a short-term victory. Further expansion of market share would require them replacing the wine of another producer on these wine lists, and sooner or later they could just as easily be replaced themselves. It was no longer a consumer choice that got them onto wine lists but that of the restaurateur, and another salesman could on another day convince him otherwise.

Entering the supermarket trade was not a viable option for the smaller members of 'Cellars' either as the cost of retaining shelf space made the profit margins too narrow. The cost of servicing the small orders they were receiving from restaurants throughout NZ was also becoming too great. They needed to locate some larger volume markets for their products. They decided that the best way to do this was to focus their efforts internationally and expand the export trading side of their businesses. This began by entering some high profile promotional events, such as, the Vinexpo in Bordeaux, the London wine trade fair, and various other wine tasting events throughout the UK. As before, they did so under the collective, 'Cellars of Canterbury' banner. From here, those who did not already export to these countries aligned themselves with distribution agents and began developing new markets for their product.

### *The 'Cellars of Canterbury' Label*

Back in NZ the jointly owned Marlborough vineyards proceeded to function independently. They were re-valued and subsequently 'Cellars of Marlborough' had made a capital gain of \$1.1m NZD in the year since purchase, however, sooner or later some debt would have to be repaid. The company needed a means to raise capital that did not require a large input of cash directly from the partners. The solution they arrived at was for each of the wineries to sell a quantity of the juice they had recently received from the jointly owned vineyards, to 'Cellars of Canterbury'. With this juice 'Cellars' would produce its own 'Cellars of Canterbury' labeled wine. They envisaged that in the future a proportion of the crop from these vineyards would automatically go toward the 'Cellars of Canterbury' label. This was not only a relatively low cost means to raise some capital but also provided the partners with an alternative market for surplus fruit from their own vineyards, rather than selling to a third party. In addition, another advantage of producing a joint venture wine was that it could be sold in countries where members were already selling their own brands, without breaching the exclusivity arrangements they had with distribution agents there.

In December 1999, shortly after producing the first batch of 'Cellars of Canterbury' wine a decision was made to employ a sales representative on commission, dedicated to seeking markets for the wine in the UK and USA. If they were going to invest money in finding these markets they wanted to target the top players and distributors. They wanted a top performance salesman with a proven track record and believed they had identified just the person for the job. However, the salesman's background was in selling meat, not

a luxury commodity like wine. Consequently, he would be using a different channel of importers and distributors than other NZ wine companies had traditionally used, this would require him having to instill a wine culture into their importers and distributors. Some partners saw this as an advantage, others as a serious disadvantage.

Within three months, the salesman had secured distribution outlets in both the UK and USA markets. In the UK 'Cellars' were aligned directly with a retailer, who happened to be one of the largest wine importers into the UK, but as yet had not dealt specifically with NZ wine. In doing so they had cut two middlemen out of the supply chain, providing significant savings for 'Cellars' and allowing them to be far more price competitive on the retailers shelf. Nine years previous, this retailer had taken on a South African wine, they now control 50% of South African wine entering the UK market. They made the claim that by 2004 they would control 10% of the NZ wine entering this same market. In the USA at least one middleman was eliminated and sales predictions of 25-30 containers were made for the first year.

The UK retailer was familiar with Alan McCorkindale, the wine maker 'Cellars of Canterbury' had contracted as their consultant, and the person who would produce the generic brand of wine. His reputation alone provided guarantee enough to the retailer that 'Cellars of Canterbury' were what they proposed to be. For 'Cellars', Alan himself provided a wine-maker, independent of the owners, who had a high profile within NZ that would be of benefit when procuring grapes and parcels of wine off the open market.

He was also someone with the ability to blend and refine these wines to the standard that 'Cellars' were aiming, the super premium range.

In a move out of the ordinary for a NZ producer the UK distributor stipulated that the label and packaging design be produced in the UK, by a UK designer. They felt that rather than take a successful NZ design and try to force it on the unfamiliar consumer it would be better to design the label specifically for the market. This did not present a problem to the 'Cellars of Canterbury' members since they had all produced their own labels before and had this ego adjustment out of their systems. They trialled the same design in the USA where it was well accepted so found no need to make any amendments for this market.

Come the grape harvest of March 2000, the larger partners of 'Cellars of Canterbury' found that their demand for Marlborough Sauvignon Blanc had grown substantially. In fact, so much so that for some it had become their dominant product and they could no longer afford the liberty of contributing part of their share to the combined brand. The initial purpose of the jointly owned vineyards was to provide the individual wineries with a supply of Marlborough Sauvignon Blanc for which they were developing markets; they now required the whole of that one-fifth share. 'Cellars' would have to source their raw material elsewhere.

As it happens, a particularly high quality 20,000-litre parcel of Marlborough Sauvignon Blanc wine came on the market. 'Cellars of Canterbury' were able to purchase the wine,

have their wine maker blend it, make some small adjustments, and again they were back in the 'red' from a supply standpoint. However, by buying in product, they were now faced with a number of issues, primarily regarding price and quality. They were not prepared to buy just any wine; it had to be of gold or silver medal winning quality. They would rather forgo a sale than sell an inferior product and risk their reputation. But to purchase top quality wine they had to pay a top quality price and this would squeeze the sales margin on this component of the shipments. Never the less, they realized that they were buying a market and when demand was secure then they would go out and purchase more vineyards to the specifications of the market.

Time was moving on and although the markets had been identified, linking the constituents of the supply chain together was taking more time, particularly in the USA where they operate a three-tiered distribution network. The 'Cellars of Canterbury' representative had identified an importer and a network of distributors in each state, each with their own network of retailers attached to them. The importer wanted the salesman to tie these distributors to him and since he would be purchasing the wine directly from 'Cellars' wanted distributors with enough market influence to be able to shift the product. In return the importer was prepared to pay a share of the travel costs involved. Likewise, the distributors wanted a guarantee from the importer that they would be the distributor for that state. Meanwhile, back in Canterbury, the 1999 vintage was still being held in storage, this presented 'Cellars' with another decision, should they distribute this vintage into the market place before the 2000 vintage reached the shelves – making the 1999 much more difficult to sell – or wait and hope the orders come through in time.

As it happens the first shipment of a container for each market, both the USA and the UK, left the Littleton port from New Zealand on the 25<sup>th</sup> November 2000.