Barrels, Wine Blending and Business – Surviving the Great Recession

By Tony Lima and Norma Schroder

What can your winery do to survive the Great Recession? Bundling, a relatively obscure topic in economics, provides considerable insight. In this article I'll discuss how a winery owner can do wine blending and use ideas from bundling to weather the current economic downturn.

The Basics of Bundling

Crushing individual lots of pinot noir

Bundling is selling two (or more) products together at a single price. In the real world bundling is very common. For example, you can purchase a bundle of software from Microsoft called the Office Suite.* The price of the Office 2007 Standard Suite is $399.95. All the Office Suites are *pure bundles*.

But it's also possible to buy individual components of

Office. A copy of Word all by itself has a list price of $229.00. Other individual applications have similar prices. Clearly Microsoft would like most people to buy one of the bundles.

Selling both bundles and individual titles is called *mixed bundling*. When there are differences in either production costs or the buyers' willingness to pay, mixed bundling usually will increase profits.

What do computer software and wine have in common? Read on.

Bundling Wine

Being good economists, we begin by listing our assumptions. We assume our boutique winery is operating at capacity, say 10,000 cases per year. Production is the same in each of two years. We think of the 2007 and 2008 California vintages since those two years were very similar. The 2007 vintage is being released in 2009 with the 2008 vintage scheduled for 2010 release. Time is critical because the 2008 vintage is probably close to being ready for bottling. The only difference between the two years is consumer income and demand.

Let's suppose our hypothetical winery (LS Wines) is selling two high-end single-vineyard pinot noirs: Clos Tony and Norma's Vineyard. Norma's Vineyard retails for $80 per bottle while Clos Tony goes for $60. To make life simple, assume there are 5,000 cases of each wine produced. In previous years both wines have sold out and the winery has done very well. The owners have noticed that demand for the 2007 vintage in current release has begun to fall off. It looks like there may even be some inventory of both wines. This will undoubtedly be placed in the winery's library. But before bottling the 2008 vintage the owners should consider offering a new product – a bundle – in addition to their single-vineyard offerings.

Lesser grapes may spend time all mixed together in steel tanks

In the wine industry bundles are called blends. In this context, a *blend* is a mixture of wines from two (or more) different vineyards. The blended wine cannot legally be labeled single-vineyard but may still carry an appellation (such as Russian River Valley, Sonoma County or Paso Robles). Since the winery is operating at capacity the winemaker and owners must make the most profitable use of their barreled wine. Start by carefully selecting and bottling the best barrels for the two single-vineyard designations. (This may actually cause the quality of those wines to improve!) The remaining barrels from the two vineyards can be blended to produce one or perhaps even two new products. (The point of making two blends is to sell one at a higher price than the other, thus increasing revenue.) The 2008 blends will be offered at lower prices than either Clos Tony or Norma's Vineyard 2008 vintages. This solves the inventory problem while also dealing with the reduction in demand.

"But," your accountant argues, "won't we be selling our wine at a price less than its cost?"

The accountant's argument is correct but irrelevant. The cost of the wine in the barrels is a *sunk cost*, expenses that have already been paid. Since those costs can't change they are irrelevant to the decision. The winery owners should focus on future incremental revenue and cost to make their decision. After all, pricing a wine at $100 per bottle to "cover costs" won't make much sense if you sell zero bottles!

Selecting barrels at 18 months for Reserve and Single Field bottling

Recessions, by definition, reduce household income, especially discretionary income. To an economist the recession has caused a decrease in demand for boutique wines (aka the more expensive bottles). The strategic implications involve accommodating the reduced demand without reducing the prices of your established single-vineyard brands. Maintaining these prices and sticking with exclusively single-vineyard bottling won't work. There will be an excess supply of the 2008 single-vineyard wines. Instead, using the forecast excess supply to produce one or two lower-priced bundles allows the winery owners to accomplish three goals:

1. Maintain the retail price and quality of their single-vineyard wines in 2007, 2008, and going forward.
2. Eliminate the anticipated excess supply of the single-vineyard wines in 2008.

3. Increase revenue by selling one or two lower-priced bundles in 2008.

But there is a risk to this strategy. Selling a lower-priced blend may devalue the brand name of your label. The solution to this problem is straightforward: develop a second label. Ideally this new brand would have some visible connection to the original label. But it’s not necessary to devalue your brand to produce a blend.

Inventory Management is key

Conclusion

Surviving the Great Recession actually offers wineries the opportunity to expose new market segments to their brand. The bundled blends will be offered in a lower-priced segment. However they will still be pretty good wine. When the recession ends, consumers exposed to the brand in the low-priced segment will be able to afford to move upmarket. Sometimes a strategy for survival can have long-run benefits as well.

As this article was going to press we happened on the Black Dahlia pinot noir label. This wine is available in both reserve and non-reserve versions with the price difference about $5 per bottle. A quick examination of the back label revealed that these were produced by the Testarossa Winery of Saratoga, a well-known high-end pinot noir producer.

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* There are at least five versions of the suite, each containing different parts of Office. All the suites include Word, PowerPoint, and Excel. (Word processing, presentation, and spreadsheet software form the core of any office suite.) The Home and Student edition ($149.95) adds OneNote. The Standard edition ($399.95) adds Outlook. The Small Business Edition ($449.95) includes Outlook with the Business Contact Manager and Publisher. The Professional Edition ($499.95) includes Access, Outlook with the Business Contact Manager, and Publisher. The Ultimate Edition ($679.95) includes all the previous titles plus Groove and InfoPath – and probably throws in the kitchen sink, too.