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PART FOUR – PERFECT STORM

PREDICTING TRENDS AND OPPORTUNITIES

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William Goldring (chairman of the Sazerac Company and the Crescent Crown Distributing Company, (Louisiana and Arizona) warned a crowd of mostly wholesale distributors at the 2011 Wine & Spirits Wholesalers of America (WSWA) convention in Orlando, FL that the three-tier alcoholic beverage distribution system was in danger from suppliers and retailers battling to undermine it. "Should any one of the tiers get greedy — and we do not hang together," Goldring said, "we will hang separately. I caution our supplier-friends here today about slicing the pie too unevenly."

Outside the convention center the sun was shining. The balmy April weather gave no hint of the storm within the alcoholic beverage industry itself — and in the last 24 months that storm has picked up speed, intensity, and power.

The authors of this report predicted in 2005, and again in 2007 and 2009, that a perfect storm was generating monumental change in the alcoholic beverage industry. The forces of globalization, consolidation, and market liberalization have been converging and bringing cataclysmic changes to the industry, producing an alcoholic beverage distribution system that will ultimately be more efficient – and more unforgiving of failure – than it is today. As the leadership at the WSWA convention recognized, only those industry participants who develop winning strategies will weather this storm and prosper.

Figure 1 shows how key industry participants at every tier will need to develop such strategies. In Figure 5, the authors provide readers with actionable insights to consider.

What will change over the next 24 months?

We offer new predictions for the next 24 months regarding five interlocking dynamics that are game-changing to the wine industry: 1) globalization of supply and demand, 2) producer consolidation, 3) distributor consolidation, 4) retailer consolidation, and 5) U.S. market liberalization. Figure 2 shows how these dynamics continue to have a profound effect on all tiers of the U.S. wine industry.

In 2011, the storm is brewing at near-tsunami level, and we maintain that by 2015 a very different industry from that of 2005 will have emerged. The U.S. wine market is undergoing its most exciting and dynamic cycle in 30 years.

As large wineries and producer groups dominate and control a more limited number of wholesalers, smaller wineries are being locked out, unable to sell profitably to traditional retail outlets through existing national distribution channels, at least until pre-Prohibition-era laws are changed to enable a fully liberalized market.

Ultimately, consumers will benefit — from better access to higher quality wines for the price, and from increased retail resources available to incentivize customer purchase behavior. Over the next 24 months, we will see the following developments:

1. Capital investments driving new marketing and distribution systems will continue to be slow, impeding innovation and limiting growth for smaller wine businesses.

2. Polarization, more than a chasm between the large and the small, will increase as the U.S wine industry splits into two different distribution systems, driven by very different margins.

3. Figure 3 illustrates how billion-dollar producers will continue to align with the very large distribution companies, while small producers seek new or alternative marketing and distribution systems. The long-term impact

Figure 2: Five interlocking dynamics continue to have a dramatic effect on the wine industry.

Figure 1: All three tiers need new strategies to stay ahead of a growing number of traditional and non-traditional competitors

- **Short global supply** will make it harder to serve growing U.S. market demand as the economy slowly expands.
- **Producers will focus** on growing top / bottom line again.
- **Economics are changing the distributor powerbase**, and new distributor solutions may dissolve traditional models.
- **Rise of billion-dollar retailer** is increasingly important to consumer choice, and is changing relationships among the three tiers.
- **Consumer choice** itself (Millennial segment specifically) has the potential to reshape the wine business over next 25 years.

of these shifts is dramatic on under 250,000-case wineries, especially small wineries with portfolios in the above $30 msrp/bottle categories.

Supply and Demand pressures

In July 2011, economies are slowly rebounding from the recession, and wine sales have improved; only grape supply is short again, driving prices up. Emerging markets in Asia and Eastern Europe continue to grow, although they are not expected to match the top Western markets in value and volume for the foreseeable future.

Consumer choice itself, and the Millennial segment specifically, have the potential to reshape what the wine business will look like over the next quarter-century. Despite this potential, there is a lot more competition for the American wine consumers' share of pocket.

Short supply cycle again driving higher grape prices – Short global supply will make it harder to serve growing U.S. market demand as the economy slowly expands again.

"The world has moved from a very 'long' position to a very 'short' position — in no time at all," says Steve Dorfman, partner at Ciatti Company (San Rafael, CA), a leading wine industry brokerage firm.

The weakness of the U.S. dollar is keeping foreign bulk wines at bay, which allows Americans to "drink" their way through any excess in American Chardonnay and Sauvignon Blanc. Experts are concerned about access to enough supply to cover growth in future market demand, due to inadequate planting in California.

Growing the United States wine market – America has become the world's largest wine-consuming nation by volume and value. "Overall, Americans spent $30 billion on wine in 2010, with the average American drinking only 2.6 gallons annually," says Jon Fredrikson of Gomberg, Fredrikson & Associates, a wine industry consulting firm. "With the average Frenchman drinking 12.3 gallons per year, the U.S. market still presents huge future growth opportunity."

1. The short-term future for the U.S. wine industry looks rosy, with sales growth for the fine wine segment forecasted to be 11% to 15% higher year over year, and for winery profits to marginally improve.[1]

2. U.S. off-premise wine sales were up 4.1% in volume in 2010 and 4.7% year-to-date through May 15, 2011. Anticipate sales to increase 21% over the previous year in the priciest wines — in the $20+ categories.[2]

3. While on-premise numbers lag behind those of off-premise, growth is also returning to the restaurant market.[3]

4. Total imports in 2010 were 107.5 million cases, including 20.2 million equivalent cases of bulk wine, not all shipped into trade channels, notes Fredrikson.

5. A weak U.S. dollar at press time means imports are down, especially from Australia and Chile. But while bulk wine imports were down 23% by volume in 2010, imports are up over 50% from 2008 numbers. There are 25 countries that ship at least 50,000 cases of wine to the U.S.

6. While bulk wine imports are down, bottled wine imports continue to climb — by more than 7% in 2010.[1] New Zealand, Argentina, Germany, and Spain led the pack in terms of percentage increases, and only Australia showed a decrease (2%) among the top 10 importing countries. Other countries increasingly want a share of the U.S. wine market — witness the 2011 purchase of Fetzer Vineyards by Chile's Concha y Toro.

Increasingly global, savvy, and younger Americans consume wine – With more and more Americans choosing to drink wine for lifestyle and health reasons, the potential to reach these millions of consumers is irresistible. U.S. wine producers will face increasing competition from other countries. The producers that survive and thrive in the global marketplace will do so by determining how to appeal to the globally savvy American consumer.

"The Millennial generation[2] offers the wine industry the kind of growth potential not seen in more than 30 years," noted the Wine Market Council in its 2009 consumer tracking study.

1. "Many [Millennials] are well-traveled, Internet-savvy, and total networkers, encouraging and sharing wine, beer, and cocktail favorites as never before."[6]

2. Although beer remains the beverage of choice for this group, accounting for 42% of their alcoholic beverages, wine captures 20% — up from 13% for GenXers when they were a similar age 10 years ago," according to Danny Brager (VP Group Client Director, Beverage Alcohol Team, The Nielsen Company).

3. "If the usual pattern holds true for Millennials [of drinkers shifting from beer to wine and spirits as they get older], wine will account for 26% of all alcoholic beverages consumed by all U.S. generations by 2020, up from 24% today, while beer will fall from 41% to 38%," according to Nielsen.

Giant wine producer Constellation Brands, appealing to this critical market segment, has introduced more "whimsical" brand ideas at lower prices to capture this market. The company's Rex Goliath brand, sporting a large rooster on the label and selling for less than $10 per bottle, is an example, which Jay Wright (Chief Operating Officer) says has "been on fire" with Millennials.

Long-term impact of discounting and flash sales – The big question of whether pricing has taken a permanent reset with the recession and the shift in consumer demographics is a major concern among producers.

The CEO of one large wine company asks: "Will the value system of the Millennials ever permit them to embrace luxury/icon wines to the same degree as Baby Boomers did, or should the wineries who depend on these price points focus more intensely on China, as the French have done?"

1. In just a few years the "flash wine market" grew to about $100 million in annual sales, fueling new wine sales models including WinesTilSoldOut, Invino, Lot18, Cinderella Wines, Groupon, Gilt Group, and ideeli.

Tim Bucher (founder and CEO of Tastingroom.com, an innovative online marketplace that enables wine consumers to "sample before buying"), asks: "What is the long-term impact [of flash sites]? Are we educating consumers that the Internet is the discount channel for wine? Or are consumers learning they can buy wine online — opening up this channel to innovative marketers looking to capture consumer share of wallet?"

2. "The high-end market was extremely volatile in 2010," notes Christian Miller (Research Director of Wine Opinions, a leading wine research group). "Substantial numbers of high-frequency and high-end consumers are still reducing their purchases of over $30 wines (msrp), especially classics such as Napa Valley Cabernet and Bordeaux. Yet there were strong positive trends for wines from Oregon, Washington, and South America, and for Zinfandel, Sauvignon Blanc, and Pinot Noir."

Wine is mainstream in America – Wine Opinions' in-depth analysis of wine consumption at home and on premise shows strong signs of the increasing incorporation of wine into everyday life in the U.S.

"Fully a third of all wine that high-frequency wine drinkers consume is on Monday through Thursday," says John Gillespie, Founder and CEO of Wine Opinions. "Not only are we seeing more wine being enjoyed on a casual, everyday basis, but significant amounts of wine are being consumed without food at all, or while preparing a meal, or with snacks. The proportion of red wine consumed without food is astounding."

Producer consolidation

On the back of more cautious strategies formulated during the economic downturn to meet more conservative shareholder demands, as the U.S. economy recovers all producers will be focused on how to grow top and bottom lines again. They face decreased consumer demand for higher-priced wines, increased competition from bottled imports, and the loss of branded shelf space to large retailers' private label products.

While the large producer is ostensibly king and the small producer fights to survive, both segments have their own challenges and opportunities as consolidation within all three wine industry tiers intensifies. Increasingly, large producers with greater market share will compete with well-positioned small and mid-size wineries that have learned how to capitalize on brand building to capture the consumer's share of mind or have formed into brand groupings to capitalize on multi-brand distribution efficiencies.

Large producer challenges – After sluggish activity during the recession, the pace of acquisitions is increasing in 2011, and the market is far more active now than it has been in recent years. Privately owned wine companies such as Foley Family Wines and Boisset Family Vineyards are increasingly buying up standalone wine brands, and even the Chinese are entering the action with the recent purchase of Rutherford-based Sloan Winery. Answering to stockholder expectations for return on assets, large publicly-traded wine companies are offloading subsidiaries and brands that drag on investor returns:

1. Constellation Brands sold its Australian and U.K. operations to an Australian private equity firm for $290 million, shedding its value brands (wines that sell for $3/bottle or less).

2. In 2011, Brown-Forman Corp. sold Fetzer Vineyards and a portfolio of other brands to Chile's lead producer, Concha y Toro.

Also in 2011, the expected demerger of Treasury Wine Estates from Foster's Group became a reality, with speculation that the stand-alone Treasury may in turn sell some of its wine brands in a further effort to increase shareholder value.

Large Producer Opportunities: Reducing cost of sales through outsourced services – With traditional wine distributors no longer being paid for in-store support for many of the products they deliver, potentially hundreds of millions of dollars will stay in the hands of the producers or at the retail tier even after taking merchandising fees into account.

One of the biggest developments in the last twelve months has been the rise of alternative distribution services, potentially driving improved margins for producers and retailers though logistical service providers such as Warren Buffet's McLane Company[4] and Core-Mark, as well as third-party merchandisers such as Advantage Sales & Marketing and Daymon Worldwide Inc.

1. Logistics companies such as McLane Company have improved economies of scale largely through centralized warehousing and vast transportation fleets, potentially resulting in lower costs for producers. Large producers that work directly with retailers on private and control label brands (PL/CL) and do not need the in-store product management that traditional distributors provide are in a better position to take advantage of these non-traditional distribution channels.

2. Alcoholic beverage merchandisers are helping producers manage product at the retail store level. Unlike traditional distributors, these unlicensed third-party merchandising companies do not negotiate sales, are paid a flat fee for their services, and are more affordable. Large producers that deal directly with stores' category managers and do not need a distributor to facilitate sales at the retail level are able to benefit from these services.

Large Producer Opportunities: Capitalizing on technology and social media – Wine market leaders are using data to tailor products and customize direct marketing campaigns with customer information. Winning business models are those that allow each brand to maintain its separate and strong connection with customers. Developments in technology are increasingly facilitating this strategy.

While the rise of social media has provided unique opportunities for small producers, large producers also are capitalizing on this direct route to consumers. Constellation, Diageo, Kendall Jackson, and Treasury Wine Estates all have special teams of Millennial marketers to work on digital media advertising strategies.

One Constellation campaign includes a Facebook page for Arbor Mist, which reputedly has developed into the largest wine social network site. Another campaign includes a YouTube video contest for Constellation's Black Box line of wines.

	RETAIL	WHOLESALE	PRODUCER
Large become larger	Club stores Chain stores	Distributors *Move from sales force to fleet drivers*	Large (>$1 billion) producers Large marketing agencies
WIDENING CHASM			
Small become specialized	Large retailers Small retailers	New specialized logistics companies New consumer networks	Mid-size wineries $60 million to $500M Small wineries <$60 million

Figure 3: Under 250,000-case producers need a new distribution system to grow profitability.

Small producer challenges – Increasingly, smaller wineries complain they have no voice within the national distribution channels. Small and mid-size wineries will be hard pressed to survive in today's competitive environment, as they are unable to compete against large producers through the current three-tier system or build alternative sales channels.

Even with DTC (direct to consumer) or DTT (direct to trade) opportunities, smaller producers still face the huge logistics challenges of getting their products to market on time, affordably, and with minimal wine damage.

1. Direct to trade strategies may not solve the small winery distribution dilemma. Many believe an elimination of the distribution tier would help their businesses, but there may be no easy alternative, according to a 2011 survey by Steven Rannekleiv of Rabobank. Retailers told Rabobank they would not add shelf space any time soon to make way for small producers' products sold outside the usual distribution channel.

2. The legal and regulatory hurdles facing any concerted DTT effort are significant. Truman Reynolds (VP of third-party order fulfillment company Pack n' Ship Direct) says: "Regulatory challenges still dominate as we tiptoe through the legalities of clearing product through customers in many markets." Pack n' Ship Direct (www.packnshipdirect.com), Wineshipping.com, and Winetasting Network are three dominant third-party logistics providers servicing the California wine industry.

3. With Washington and Oregon currently the **only legal direct to trade states** from out of state, huge hurdles must be overcome before direct to trade becomes a viable channel for smaller wineries — including how to reach and sell to trade customers.

4. Margins will continue to suffer in a market where consumers expect deep discounts, and short supply is driving increased cost of goods. Rachel Dumas Rey (CEO of Compli Beverages, a leading beverage compliance services company) says: "I am surprised we have not seen more small producer consolidation into business models where front end [market muscle] and back end [economies of scale] are leveraged more — for example, administrative, purchasing, and licensing economies."

5. Overwhelming challenges may tempt many producers to sell out. Top properties with stellar reputations, valuable brands, and winning management teams will always be attractive to buyers. However, this does not make for a practical exit strategy for a majority of small and mid-size properties. While private equity remains interested, the asset-intensive nature of the wine industry is not a top investment choice when times are tough, except for the rare occasion where family succession dynamics push top brands to sell, as in the recent sale of Seghesio Family Vineyards to the Crimson Wine Group.[5]

Small Producer Opportunities: Wine purchasers are shifting to the digital world – U.S. wineries are expecting the DTC channel to be their fastest growing sales channel for 2011, especially online sales. The savvy small producer is already engaged with consumers and learning the best ways to use social media, making this a key part of its marketing strategy. Figure 4 shows how social media, with its promise of direct conversations and meaningful exchanges between customers and producers, fits perfectly with these trends.

Some observations about wine DTC:

1. U.S. consumer direct wine sales — online, wine club, tasting room, and event sales — grew 12% in 2010 to $3.4 billion.[5]

2. Online wine sales alone grew 38%, and projections for 2011 are even higher.

3. Many expect online sales to speed up, doubling by 2012 to a $500 to $600 million channel (depending on the rate of growth of flash sales as the economy improves).[10]

4. Big upside with focused resources: Online sales are constrained by inadequate strategy, resource commitment, and tools/platforms. "Only 25 to 30 U.S. wineries have a full-time dedicated ecommerce staff person," says Paul Mabray (founder and CEO of Vintank, the leading wine industry digital marketing think tank). Most ecommerce staff are still wearing multiple hats (wine club, tasting room, ecommerce).

5. Flash sales grew to become a $100 million digital retail channel. Since many of these transactions are accom-

60% of core wine drinkers and 40% of marginal drinkers use the Internet to get information about wine.

Wine Opinions' 2011 Consumer Trends Report shows that wine consumers increasingly tune in to their favorite passion through social media.	• 38% of core wine drinkers use social media to discuss wine. • 45% who use Twitter "follow wine people" on Twitter. • 46% Tweet family or friends about wine. • 41% are Smart Phone users. Among these Smart Phone users 39% use wine/food/restaurant applications.

Figure 4 - Wine consumers are heavily engaged through social media.

plished through the three-tier system, producers do not always benefit from a direct sale margin.

6. 13 to 14 million conversations were about wine online in 2010 — predicted to grow to 20 million by 2012. "This provides wineries with intelligence and visibility to mass consumers and means to sell product," adds Paul Mabray.

7. Consumers are increasingly enamored of artisan, handcrafted products in a world of mass production.[5] Wine consumers are engaging with producers directly in the tasting room and through social media channels, or indirectly through shopping for wine online or at a bricks and mortar store.

Consumers are heavily engaged through social media – Both small and large wine companies are now engaging with consumers. Social media is no longer just the turf of founder-run smaller artisan businesses. This is both an opportunity and a competitive challenge for small producers.

"Social CRM (customer relationship management) is a critical tool that winery marketing and PR departments need to effectively leverage and convert into online sales," says Paul Mabray. Over the next two years, we will see maturing industry skills and platforms, enabling these social connections to convert to commerce.

Small Producer Opportunities: Retailers are positioning uniquely with consumers – On- and off-premise retail physical and Internet outlets (see Retail consolidation, below) are blurring the lines between winery tasting rooms and sampling at home and in stores.

1. Sample sizes or tastes of different wines (www.TastingRoom.com), beers, spirits, and sakes are being offered online and in wine bars, stores, restaurants, and hotel lounges. Small producers who participate are building customers faster and more affordably by getting more people to sample their products, telling their unique story through more outlets and offering educational experiences that build meaningful memories and more loyal brand ambassadors.

2. Wineries are seeing a surge in local and regional restaurant chains catering to consumers' heightened drive for taste adventures. Top restaurants have become much more creative with their beverage programs, inviting distilleries and wineries around the world to give customers more choices than ever before.

3. Specialized retail grocers offering ethnic foods or local artisanal products are faring well even in the aftermath of the economic downturn. Small producers who might otherwise get lost in the mass of products at mainstream supermarkets now have more opportunities to hand-sell through specialized retail outlets where customers are more likely to expect to pay for quality.[9]

There is no question the big will get bigger. But small, highly specialized wineries can survive and even thrive through quality product, untraditional trade channels, and niche marketing.

Distributor consolidation

Though distributors have increasing clout, economics are changing the distributor powerbase, and new distributor solutions may change traditional models. In late 2010, *Wine & Spirits Daily* speculated that Buffett's McLane entry into the alcoholic beverage distribution business meant more mergers and acquisitions, as distributors seek improved efficiencies in a changing marketplace. Since that article was written, more distributor consolidation has indeed occurred.[10]

As the legal battles over maintaining the three-tier system demonstrate, distributors worry about maintaining their protectionist system. Their continuing efforts to strengthen legislation already favorable to their tier point to their discomfort with the economic and social forces that question the value of the current system. Big forces of change at this tier include:

1. Increasingly, distributors are expressing concern over the rise of big retailers.[11]

2. A growing market share of private and control label products (PL/CL) is driving much lower distributor margins, with distributors acting essentially as delivery services for PL/CL.[9] Experts estimate PL/CL has grown from 22% to comprise 30% of the market today;[9] other large producers speculate PL/CL represents up to 40% of total wine sold on the U.S. market.

3. We noted back in 2005 that by 2015, large retailers would increasingly work directly with large producers on pricing, marketing, and merchandising, with distributors no longer getting paid for these services – moving potentially $1 to $22 billion in income to the producer or retailer side of the ledger.

Distributor Challenges/Opportunities: Economics are transforming the powerbase in the middle tier – With new logistics providers ready to step in and offer delivery services at lower (often fixed) cost and greater efficiency, and with third-party merchandisers dedicated to providing producers with in-store display and related services, where does this leave the middle tier?

1. Margin squeeze is one result. Some distributor margins are starting to resemble those of spirits distribution margins (18% to 20%), and the PL/CL dynamic may be pushing these margins much lower. The modern wholesaler is measuring productivity by margin contribution and less by case volume. The proliferation of PL/CL may in fact re-incentivize wholesalers to pursue more branded products with higher margins, such as brands in the under 250,000 case range.

2. Some speculate that beer distributors — traditionally used to lower margins — may step into this changing landscape, where unrealistically high fixed distributor margins (25% to 35%) are no longer the norm.

3. We foresee a new generation of smaller regional and specialty wholesalers emerging to serve small to mid-size producers. These niche product specialists, often veterans of large distributor organizations with specialized product knowledge, will market to on-premise and specialty retail chains, and independents. Their challenge is building a strong enough balance sheet to afford inventory and pay suppliers.

The recent TTB approval of bailment warehouses[9] (essentially consignment facilities where suppliers continue to own their own inventory until orders arrive, at which time inventory is transferred to the wholesaler) may strengthen this channel further in the near to mid-term future.

Distributors are still a powerful group responsible for selling more than 300 million cases of wine in 2010, and federal and state laws still protect their power base.

Retail consolidation

"The growing pace of retail consolidation in the U.S. may be the most significant dynamic over the next 24 months," says Danny Brager (VP Group Client Director, Beverage Alcohol Team, The

Figure 5: Next 24 months – Seven winning strategies to leverage trends and overcome hurdles

1. Win share of mind by developing strategic marketing and sales programs.

• Target the growing casual, everyday wine drinker, and consumers having wine without food, while preparing a meal, or with snacks.
• Develop unique digital media advertising stratagies: Experiment every week with affordable Facebook and YouTube tactics. Track results.
• Understand how new integrated, cross channel, go-to-market strategies will drive consumer awareness and sales. (See *PWVJ,* Summer 2011: *Winning consumer share of mind.*)
• Populate the Internet with information and stories about your wine brand – more than half of all U.S. wine drinkers are on Facebook, and 25% also use MySpace, YouTube, and Twitter.

2. Differentiate or die!

• Carve out a niche to maintain a separate and strong brand connection with customers.
• Find niche retailers, such as wine bars, where consumers can sample your wines and hear your story.
• Initiate direct conversations and meaningful exchanges between customers and your company through social media and other tools. Think conversations, not sales pitches.

3. Grow online sales by converting social conversation to social commerce (sales).

• Develop an integrated sales and marketing strategy, and detailed plan.
• Dedicate experienced staff full-time to the ecommerce channel.
• Invest in the platform: Use data and CRM tools to tailor products and customize direct marketing campaigns with customer information.
• Connect website information to travel and blogging (biggest digital categories).
• Make website information and technology work with mobile applications (50% of Internet conversations).

4. Tailor new products through non-traditional retail channels.

• Sell sample sizes or tastes of different wines online (www.TastingRoom.com), in wine bars, stores, restaurants, and in hotel lounges.
• Develop local and regional restaurant chain relationships, with venues catering to consumers' more adventurous tastes.
• Focus on specialized retail grocers with a niche offering, such as ethnic foods or local artisanal products, where customers are more likely to expect to pay for quality.

5. Service retailers better: they want to sell a lot of wine, too.

• Teach retailers about your business: Share goals, strategies, and tactics, and do a better job of making recommendations suit those goals.
• Show objectivity: Put the category first, and have a professional sales process focus on the customer rather than your portfolio.
• Deliver insights/answer the question "So what?" If you have data, explain why it is useful.
• Share post-program analysis – help retailers learn what went well and what did not.
• Make every seller a fan of your wine.
• Keep products streamlined to avoid sales staff retraining.
• Find your segment, establish your message, and educate about how you distinguish your brand.

6. Assess alternative distribution services, third party merchandisers, and regional wholesalers.

• Experiment with alternative distribution strategies that are better aligned with target markets, or provide more control over margins and pricing.
• Find ways to collaborate with distributors or brokers who are more aligned with your goals.
• Build a meaningful distributor relationship through innovative brand building, partnering, or acquisition strategies.

7. Manage and control supply sources and costs more tightly.

• Consolidate back office support, especially mixed, decentralized vineyard and wine operations.
• If market demand is there, secure growth financing or capital to support growth strategies.
• Negociant brands: Secure access to the right balance of supply sources through acquisition or strategic partnering.

Nielsen Company). Large retailers are growing larger, in part spurred by PL/CL products. The rise of the large billion-dollar retailer is of increasing importance to consumer choice and is changing the relationships among the three tiers.

One example of the giant retailer trend is Total Wine & More, the largest privately owned, multiple-state alcoholic beverage retailer in the U.S. Co-owner David Trone predicts that 2011 revenues (chain-wide) will be more than $1 billion. Private label is an important part of Total Wine's business, although the company has declined directly to give numbers.

Retail Opportunity: National retail chains see significant growth through Millennials – Successful large-scale retailers are capitalizing on current trends and opportunities by catering to the choices, experiences, value, and convenience customers now expect, and tailoring products and marketing efforts toward Millennials.

"We are targeting Millennials because they like convenience and to try new products," says Jesus Delgado-Jenkins (7-Eleven's Senior VP – Merchandising and Logistics).

A November 2009 Symphony/IRI Group report, "Winning with Millennial Women Shoppers," assesses Millennial psychographics:

1. Millennials are eight times more likely to relocate than Baby Boomers in the next few years, mostly to emerging cities in the Southeast, Southwest, and the Rockies.
2. Demographic shifts, especially among Millennials moving from north to south, favor the large chains. They expect the level of service and variety of products they experienced in one state to be available in another.
3. Millennials tend to shop less and spend more when they do shop, prefer big box stores, and are believers in private labels.
4. 70% of those surveyed in a Symphony/IRI Group report think store brands represent high quality.

Retail Opportunity: Retail players find creative ways to engage customers – Some U.S. airports now allow liquor to be sold around the clock. A few provide tastings at terminal locations. Upscale locations at airports where passengers can drink while waiting for flights are on the rise. Vino Volo was launched in

September 2005, bringing high-quality wine and food to airports. "Vino Volo has grown rapidly," says CEO Doug Tomlinson, "with 17 stores in operation by Spring 2011 with plans to grow to 50 stores within the next three years."

Retail Opportunity: Wine bars are the coffee bars of the 21st century – Wine and beer bars at grocery stores and coffee shops may become the wave of the future.[6] The retail wine industry is taking advantage of the same trends that are hitting beer and tea. Whole Foods is experimenting with this concept in some stores and, if successful, will roll it out on a wider scale. Starbucks may begin serving regional wine and beer in at least some of its 16,000 stores around the world if the idea meets with customers' approval in the company's Seattle home base, where the concept is being tested.

Wine bar concepts in general are exploding around the country, with multiple bottle lists, themes, and many wines by-the-glass (50 to 100 offerings are common).

Online retailers, despite legal issues that vary from state to state, continue to grow. Leveraging more than 10 million online viewers who tune in to their TV programs, the Food Network launched an online wine club in July and could soon become the largest online retailer in the world.

U.S. market liberalization

The influence of the retail tier on wine market liberalization is significant. This tier has 90% of wine inventories and is energizing an increasing wine-savvy customer base — including a growing number of Millennials. Increasing consumer demand — for variety, convenience, value, personal experience, and communication — is distinctly at odds with three-tier alcohol beverage distribution. How the law evolves to reflect this rapidly transforming marketplace will, in part, determine the pace at which the wine industry itself can change to meet consumer demand.

We are halfway to 2015. What effect has the U.S. Supreme Court *Granholm* decision had?

Two steps forward, one step back – Litigation and legislation continue to shape this dynamic.

1. The CARE Act, intended to legislatively reverse the *Granholm* decision, is a sign of the desperation of the wholesale tier attempting to hold the line against modernization of the industry. Backed by the Wine & Spirits Wholesalers of America and National Beer Wholesalers Association and roundly condemned as cynical and unnecessary by every U.S. producer-organization in wine, spirits, and beer, the CARE Act has yet to find a Senate sponsor in spite of a record level of political spending by distributors hoping to influence politicians.[17]

We predict the CARE Act will fail, and that failure will accomplish exactly the opposite of what was intended by its authors. It will show the American consumer the inability of current delivery systems to provide the products they want when they want them.

2. The retail tier lost its effort to apply the Commerce Clause principles of *Granholm* to interstate shipping by retailers when the Supreme Court declined to hear the Wine Country Gift Baskets case[19] in March 2011. The Supreme Court's denial of cert leaves retail-based wine clubs, flash marketing sites, marketplace sellers, specialty wine clubs, and auction houses and specialty stores holding older vintages and rare wines vulnerable to state laws challenging their right to ship wine directly to consumers.

3. Consumer refusal to accept the restrictions of the three-tier system is confounding regulators across the country, whose only recourse is to arrest their own consumers for unlawful importation of alcoholic beverages, something they are loath to do.

The loss of the retail case served to drive more commerce underground. Some determined collectors are using every tool at their disposal to obtain wine they want regardless of where they live, and others are purchasing their wine in the state of the merchant and importing it themselves.

We expect the ultimate winner will be the consumer, and breakthroughs within the next two years will include development of legally compliant shipment systems, using new technology to decipher the complexities of the three-tier system and 50 different state laws. Consumer demand justifies the cost of system development.

4. Retailers are using their clout with consumers to fight back. Battles over selling wine in grocery stores are raging in New York, Tennessee, and Kentucky, and fights over retail license limits have been placed on the ballot in Massachusetts and are the subject of legislative hearings in New Jersey.

New tactic: the initiative process – First with court battles[20] and in 2010 with its failed Initiative-1100, big-box retailer Costco has attempted to overturn laws in Washington state that uphold restrictive alcohol regulations. In 2011, Costco introduced another measure, Initiative-1183. Potentially less objectionable to anti-alcohol forces, the new measure would allow quantity discounts and central warehousing for wine and spirits (although not for beer), and privatizing liquor sales in this currently control state.

Will Initiative-1183 be successful? In 2011, Costco is NOT being opposed by a competing initiative, as was the case with Initiative-1100, but rather by a combination of wholesaler, public entity unions, and anti-alcohol forces who have, thus far, not stepped in with anywhere near the funding opposition that Initiative-1100 faced.

If Costco wins, this may establish the initiative process as the tool of choice to change laws and reform systems, in spite of entrenched (and immovable) political interests in state houses all over the U.S., where wholesalers have their power base.[21]

Winning strategies and actionable insights

Over the next 24 months, all three tiers need new strategies to stay ahead of a growing number of traditional and non-traditional competitors, and win consumer share of mind. Figure 5 illustrates how small and large producers can use winning strategies to leverage trends and overcome hurdles. ■

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References/Footnotes

1. Silicon Valley Bank's 2011-2012 Annual State of the Wine Industry Report.
2. According to Symphony IRI Group (Chicago, IL).
3. Wine Market Council's 2010 overview of the industry.
4. Impact Databank.
5. Millennial cohort: 50 million between the ages of 21 and 30 in the U.S., and another 25 million turning 21 in the next few years.
6. Scion Advisors' Trend Watch 2011 report.
7. McLane is a U.S.-wide grocery and food service supply chain business, that has entered the alcoholic beverage distribution business by buying existing distributors in Tennessee, South Carolina, and elsewhere, and applying for state wholesale licenses across the U.S.
8. www.pressdemocrat.com/article/20110601/BUSINESS/110609985?Title=Napa-wine-group-acquires-historic-Seghesio-winery. [*Press Democrat*, June 1, 2011]
9. VinterActive LLC 2011 report
10. Online wine sales have only doubled in the last 10 years, to $200 million in 2010.
11. In Texas, the large South Texas Anheuser Bush distributor and L&F Distributors (20-million case wholesaler), entered an agreement to purchase Avante Beverage, a statewide wine distributor based in Dallas. Young's Market Company and Republic National Distributing Company recently combined forces to create a single alcoholic beverage distribution company in Arizona.
12. Community Alcohol Regulatory Effectiveness Act, HR 1161, currently stalled in the House of Representatives.
13. 2010 Rabobank survey.
14. Including Charles Shaw and Oak Leaf Vineyards as control labels.
15. Estimated by owner of Total Wine when speaking to 2009 WSWA conference.
16. See TTB guidance on bailment warehouses, available at: www.ttb.gov/main_pages/bailout-warehouses.shtml.
17. Specialty Wine Retailers Association cites public records showing that distributors spent $82 million between 2005 and 2010 on contributions to federal and state political campaigns and federal lobbying efforts. *SWRA Report*, "Toward Liquor Domination" June 2011.
18. www.facebook.com/AmericanWineConsumerCoalition
19. Wine Country Gift Baskets.com v. Steen, 612 F. 3d 809 (5th Cir. 2010).
20. Costco's initial victory in the Washington district court was largely overturned by the Ninth Circuit, when it upheld the state's laws regarding uniform pricing, minimum markups, quantity discount, credit, and central warehousing bans. Costco Wholesale Corp. v. Hoen, 2006 WL 1075218 (W.D. Wash. April 21, 2006), overruled by Costco Wholesale Corp. v. Maleng, 522 F. 3d 874 (9th Cir. 2008).
21. During the past three election cycles, wine, beer, and spirits wholesalers have contributed more than $58 million to state political campaigns, and spent countless millions in lobbying efforts at the state level. [SWRA Report]

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