The Global Wine Industry And Mondavi’s Current Strategy

Executive Summary

Robert Mondavi Corporation (Mondavi), is a large family owned winery and strong player in the premium wine industry with sales of $480M in 2001. Much of Mondavi’s success can be attributed to their geographic focus on California and their deliberate and controlled growth, as they focused on building a credible brand associated with quality, creating demand through educational experiences, and producing high-quality premium wines through technological innovation.

However, they play in a crowded market with over a million players that continues to become even more competitive as the industry experiences shifts around consolidation, changing consumer preferences towards high-quality premium wine, and climate change. As the playing field changes, Mondavi needs to consider how to modify their existing strategy to combat the potential disadvantages they could face with distribution as larger players with better relationships enter the premium wine space while preparing for the environmental changes that will affect the California wine regions where Mondavi has historically focused.

To address these industry changes, we suggest that Mondavi consider three main strategic implementations: a joint-venture with Constellation, acquisition of land in Argentina, and additional dedication of funds to marketing. By leveraging a partnership with Constellation, Mondavi can utilize their extensive distribution channels to earn market share. By purchasing land in Argentina, Mondavi can mitigate the looming risk of climate change. Lastly, by increasing marketing expenditures, Mondavi can increase consumer awareness of their wine’s high quality and gain new customers as the market size of premium wine increases.

The Global Wine Industry

Historically, the global wine industry has been a saturated market. As evidenced by the presence of over a million wine producers globally, a Porter’s analysis reveals that it is a highly competitive market with many players. Although supplier power is low due to the large number of growers supplying grapes to wineries, the industry exhibits low barriers to entry, many substitutes, high buyer power and high rivalry, and does not seem to be an attractive industry to compete in. In this environment, wine producers must rely on product, quality, and brand to differentiate themselves from other wines in the market.

However, in recent years, the industry has seen multiple shifts that are changing the competitive landscape. First, what was once a fragmented industry is now becoming more and more consolidated. As the industry consolidates and the number of competing firms shrinks, a small number of firms will begin to rise as leaders in the market. The competition in the premium wine space now includes traditional rivals focused on premium wines, commodity wine producers moving into the premium wine business, and global alcoholic beverage companies acquiring wineries. This presents an opportunity for current players in the market to take these leading positions and deter new entrants into the market.

In addition to consolidation, the industry has seen a shift in consumer preferences. Jug wines have historically dominated the market, but growth in the wine category has been primarily attributed to the increasing popularity of premium wines, growing at a rate of 8%-10% annually. The large number of inexperienced wine drinkers in New World markets has resulted in an emphasis on education, allowing firms to create additional demand for these premium products. With this shift to a more specialized product, firms must put greater control on the quality of the inputs that go into it. As such, in order to produce high-quality wines, wineries must control quality of their ingredients by either sourcing grapes from their own vineyards or being more particular about who they choose as their suppliers. Thus, the shift in consumer preferences for a finer wine has also made the space more difficult to compete in.

Moreover, as a result of consolidation and the entrance of other alcoholic beverage firms diversifying into the premium wine space, wineries now compete against larger players with greater power. One of the most challenging aspects of the wine industry is distribution. In the US, a large portion of distribution is controlled by 5 main distributors. Thus, having a good relationship with these distributors is crucial to success because bigger firms that offer more business to distributors have more influence and bargaining power. This is particularly advantageous for large alcoholic beverage providers that not only sell wine, but also sell products in the beer and spirits categories.

Finally, the wine industry has been facing the challenge of climate change. Increasing temperatures have affected the industry as a whole, but particularly the Napa Valley region. As the temperatures increase, the threat of invasive pests grows and the risk of poor grape quality increases, which impacts the flavor profile of the wine. As such, many wine companies are having to evaluate how they will address these challenges.

Mondavi’s Current Strategy

Headed by a member of the Mondavi family for 35 years until finally relinquishing the reins to a non-family CEO in 2002, the Robert Mondavi Corporation found success by leveraging its independence and tight control of all aspects of the winemaking process. Unlike its competitors, its geographic choices were focused and deliberate, with Mondavi neither owning or leasing land outside of California and entering into only five international joint ventures. Mondavi had not pursued a strategy of haphazard acquisitions, but instead chose to grow organically, focusing evermore on its mission to create a pristine reputation of quality across its brand portfolio, while democratizing wine consumption for its consumers through education and more accessible brands that serviced the popular premium segment. In leveraging its three primary resources—brand reputation, geographic expertise, and technological innovation—the company had a unique competitive advantage that fueled its success.

Mondavi maintained a focus that its rivals in the premium wine business lacked. Mondavi had correctly diagnosed the increasing popularity of affordable premium wines and leveraged its intangible resource—its brand—when launching Woodbridge in 1979 by including the Mondavi name on the packaging. When its Coastal brand faltered, Mondavi again leveraged the valuable Mondavi name by adding it to its products. Over time, Mondavi had become synonymous with quality, which created barriers to entry for large-volume producers who potentially sought to enter into Mondavi’s market space without its credibility of quality. Thanks to Mondavi’s adept sequencing, it had established itself with its flagship RMW brand first, and only later expanded

down-market, again ensuring that all 16 of its brands were distinct, premium, and did not cannibalize each other.

Mondavi's tight geographic focus allowed it to be clever in utilizing its manufacturing capabilities across company properties. For example, the bottling of La Famiglia di Robert Mondavi took place at RMW, while crushing, fermentation, and aging took place elsewhere. While not as vertically integrated as large-volume producers such as Gallo, Mondavi was able to minimize unnecessary capital costs by increasing the utilization rate of existing equipment. This practice was further incentivized by linking executive compensation to returns in excess of the respective executive's business unit's cost of capital. Unsurprising, Mondavi's ROA increased 7.7% from '98 - '01 to 5.6%.

Mondavi exerted control throughout the production process, particularly in its grape and land strategy. Mondavi looked to source its grapes internally, with a soft target of 25% by 2005. This contrasted with other California wineries, who outsourced 70%-85% of their grapes. When it was not possible to source internally, Mondavi would work closely with its growers, ensuring that Mondavi's demanding quality standards would be met even at the highest levels of it brand portfolio.

Sourcing locally allowed Mondavi to differentiate itself in two respects. First, it allowed Mondavi to fully implement one of its tangible resources—its technological innovation. Mondavi has invested heavily in research and development to improve the process of making wine, including working with NASA to improve vineyard management. Second, it focused Mondavi's geographic expansion in the areas it knew. However, in an environment with a potentially drastically changing landscape due to climate change, this concentration is also a source of competitive disadvantage relative to competitors who had been diversifying land ownership among locations worldwide.

Mondavi had been a first-mover when it came to promoting the California wine industry. The company increased brand awareness and knowledge of wine through partnerships with chefs and a failed attempt at maintaining a flagship winery and The Golden Vine Winery at Disney's Adventure Theme Park. While this inextricably tied Mondavi to the California wine industry, which was rising in prominence, promoting the California wine industry as a whole also legitimized other competing California brands. Mondavi recognized it needed to broaden its customer base to a new generation of wine consumers, but with 91% of its sales in the US, Mondavi would need to start thinking more internationally not only when it comes to sourcing, but also its customers.

Recommendations

Mondavi's strategy must address four main issues moving forward: consolidation in the industry, shifting consumer preferences, issues around distribution, and the looming threat of climate change. In order to encourage growth while combating these core issues, our team recommends that Mondavi consider three main strategic implementations: a form joint-venture with Constellation, purchase land in Argentina, and increase overall marketing spend.

Due to the increasing consolidation of the wine industry there is greater pressure on family-owned wineries to compete on cost and reach. Additionally, it puts these wineries at a

disadvantage when dealing with distributors because they lack the influence that larger firms have. Historically, most of Mondavi's sales have come from their largest distributors, so it would be beneficial to have more of the top distributors selling their wine. Mondavi will need to create a joint venture to achieve better bargaining power with distributors and to combat the increasing consolidation within the industry. We strongly recommend Mondavi perform this joint venture with Constellation for the following reasons. First, Constellation is a leading player in the jug wine segment, the second-largest beer importer in the US, the fourth-largest domestic distilled spirits producer, and the third-leading global wine firm. They have strong relationships with distributors which would help Mondavi expand their footprint by giving the company more inroads within distribution. Constellation also recently purchased a leading alcohol beverage wholesaler in the UK. This relationship can serve as a gateway into the European market, diversifying the risk of being a single market company.

Constellation would be interested in this joint venture for a few reasons. They attempted to acquire Trinchero Estates, but they decided not to due to the high asking price and their considerable amount of debt. Constellation has entered into joint ventures in the past, most recently with BRL Hardy in an effort to market Australian wines in the US. They are looking to further penetrate the premium wine segment, and a joint venture with Mondavi would seem to be the perfect solution.

In addition to threats around consolidation and distribution, Mondavi must consider how climate change and shifting consumer preferences will affect their sustained growth. We recommend Mondavi purchase land in Argentina to protect against these negative forces. The effects of climate change are yet to be seen; however, it is anticipated that most of the vineyards in Napa Valley will become inhospitable to grapes or will cause production to become more difficult and more costly. With these projections, there is new opportunity in South America with land that is currently suitable for growing grapes as well as with land that will become suitable for production in a couple of decades. This enables Mondavi to immediately begin producing a premium segment wine in Argentina that can be exported while protecting the company against climate change by having land that will be suitable for production when growing in Napa is potentially no longer a viable operation. We suggest determining which subset of the premium market to target after further market research in Argentina.

We recommend buying land in Argentina for two primary reasons. First, Argentina is currently experiencing an economic depression making for a cheap investment in this valuable land. They recently defaulted on their debt causing foreign investment to essentially stop. Selling of public land is one of the governments few ways of attracting foreign capital, which plays into Mondavi's favor. With the cheap price of land and high unemployment rates, input costs will be very low, allowing Mondavi to produce wine at a substantial discount as compared to other producers – even Australia. Additionally, Argentinians consume the third highest per capita amount of wine. Argentinian wine is only rarely exported, which presents an opportunity to not only brand this wine as Argentinian wine to the local market, but also to become the largest exporter of Argentinian wine to the rest of the globe. This will also diversify Mondavi's consumer base through creating more inroads into South America.

In order to support these strategic implementations, Mondavi should increase overall marketing efforts with a focus in two segments – the Woodbridge brand and the new Argentinian wine. First, the premium wine segment of the market is continuing to grow. We want to be sure to market towards and educate these new consumers in the premium segment. Woodbridge has

historically been Mondavi’s most successful brand within this segment, with consistently increasing YoY growth rates. Due to this brand’s strong success, we suggest introducing Woodbridge into the UK, and expanding into the rest of Europe when appropriate. The joint venture will be a revenue sharing model with Constellation, and the additional sales from the partnership will offset these costs. Additionally, Mondavi will be introducing a new Argentinian wine into the global market. With shifting consumer preferences and the success of Australian wine as a cheap alternative, it will be imperative to support this new product with lots of branding and consumer awareness campaigns.

In terms of cost and funding for these strategic implementations, we project and recommend the following. For the Constellation joint venture, there are no upfront costs, with an all revenue sharing agreement. The second strategic implementation regarding the purchase of Argentinian land will require an initial investment of $2,500/acre of land. Given Argentina’s current economic situation, land is selling at a highly discounted rate. We recommend Mondavi purchase 5,000 acres for a cost of $12.5M - 2,500 acres in land that is adept for growing grapes now and 2,500 acres in land that will be adept in the next few decades.

Lastly, the increased marketing will cost an extra 10 cents per bottle, or $20M, resulting in a total of $40M in marketing spend next year. By increasing total marketing expenditure, Mondavi can both launch its Argentinian brand and increase its overall TV and radio presence to counter the investments of other competing firms that have begun advertising nationally. Within the joint venture, we anticipate that if enough volume is sold, Constellation will foot some of the marketing costs associated with this program.