E j gallo wineries: a case study

Business

Winery, the wine industry is composed of all alcoholic beverages that contain between eight and twenty percent alcohol by volume.

This distinction is based on the assumption that beer and the typical malt liquor contain less than eight percent alcohol by volume. The twenty percent Limit Is a result of state and federal tax and licensing laws. The three top competitors that are Identified in this case study are E. & J. Gallo, Cannonading and Mongo David. This industry has seen very limited growth since 1986.

Based on Exhibit 4 (C-271, the total wine consumption In the US) and Exhibit 5 (C-271, per capita wine consumption in the US) the wine industry is in the maturity stage. It could even be argued that is entering the decline stage. However, if looking at the last 5 years alone there may still be some potential for growth within the industry. There appeared to be a Jump In the growth curve from 1984-88 due to the Introduction of wine coolers. There was also another short growth period resulting from the " booming stock market of the ass's and busy lifestyles" that contributed to more wine sales.

The bottom line for the wine Industry however is that both volume ND per capita consumption has stagnated after growing to a peak of nearly 600 million gallons in 1986.

This is evidence that the supply has outrun the demand and subsequently the profit margin of winemakers is decreasing. The following table shows the decline in growth rate of the retail value of US wine sales. It also compares the annual percent growth in retail value to the annual percent increase in

production. The next Issue to Investigate is the importance of technology in this industry.

Winemaking Is not a new Industry.

It Is a time tested process; however science can be big factor In making a time Intensive process easier and cheaper. There Is also a possibility that winemakers could offer more flavors. The process technology can be a factor. It is important to note that among the industry competitors there is a significant gap in the number of winemaking facilities and the gallons of wine produced. The ability to produce high quantity with low fixed costs allows the producer to reduce costs thereby increasing or at least preserving profit margins.

The case study did not expound on why there was such a wide expanse in the gallons produced per winemaking facility, but it is important to note hat the technology for mass production is an obvious advantage leading to economies of scale. The following table shows the gallons of wines produced compared to the number of winemaking faceless. Product technology, at ten surface, Is not a real Issue In tons case . Wine Is made Trot grapes and grapes grow in vineyards. There is very little room to apply technology to produce a change in wine.

It is possible that technology could produce more flavors or variety, but it is very unlikely. Although bio-technology is still young, it is being used in other agriculturally based industries. There is a potential to genetically engineer grapes that mature faster. This would reduce the risk of the grower that a crop is lost due to weather, disease, etc. A bigger grape that had the same

high quality and taste would require less time to harvest and possibly even be easier to process.

It could also increase the crop yield. Any new development that would allow the growers to get more crop yield per acre would be a significant event.

Agricultural land may not be expensive but crop yield means you need less property to keep production going. Economies of scale are becoming a very important factor in this industry. As noted earlier, the winemaking industry is a relatively mature industry and appears to be entering the decline stage.

The key to preserving profit margins and gaining market share seems to lie in becoming the low-cost producer. The following table does support the idea that economies of scale are important as the largest producer has the most efficient winemaking facilities.

Unfortunately, there is not date available to show the operating costs of the facilities. Although financial information is not available for all competitors, the top 3 competitors show a discrepancy in production efficiency. This would lead the analysis o support the existence of other significant factors influencing the value chain outside of production. These could be the cost of supplies, distribution and marketing.

The learning curve does not appear to be a significant factor in this industry because the winemaking industry has been around for a very long time.

The industry competitors have years of experience and low cost labor at their disposal. The following analysis will use Porter’s 5 Forces Model to identify the market power. The grape growers are the suppliers, the

winemakers are the sellers and the consumer is the buyer. This discussion could also include the suppliers of raw trials for bottling the wine, the shipping companies used to carry the wine to the point of sale and also the supermarket, liquor store and restaurant owners where wine is often purchased by the consumer.

The power of the supplier is very low since grapes are a readily available product both in the US and throughout the world. Most growers are also under contract with some of the major winemakers and therefore they are bound by law to provide grapes of specific quality to the seller. Grapes are an easily had agricultural commodity on the open market. This could change if the supply of grapes decreased significantly due to some type of disease or natural disaster. As a Tunnel AT ten nudge availability AT salary products, ten power AT ten Dryer Is conversely a strong component in this industry.

There are literally thousands of wines sold in the US. There are an innumerable amount of distributors from liquor stores to grocery stores and restaurants. There are numerous other substitute beverage products that contain alcohol, which further weakens the power of the supplier. The threat of substitute products is high in the US. Wine sales have been historically low as American’s are very infrequent wine drinkers.

In 2000, per capita consumption n the US was less than 2 gallons a year, compared to the 18 gallons per year consumed by people in France and Italy.

Substitute products could include all other alcoholic and non-alcoholic beverages and even some illegal drugs. If the consumer can get a better “

high" they may choose to use illegal drugs instead of alcohol. All of these possible substitutes are priced very similarly to the price of wine, can potentially provide the same satisfaction as wine and cost the consumer nothing to switch products. The market strength of the soft drink and beer industry is very strong and makes this substitute threat even greater.

It can also be assumed that the use of illegal drugs in the US is growing and also presents a threat, albeit hard to quantify. The threat of new entry is relatively low as most market entrants will see that growth is stagnating from sales figures and per capita consumption of wine. This is the most critical determinant of the threat of new entry as most potential entrants will see that growth and profit prospects are not attractive enough to enter the industry. It is also important to note, that although extremely small scale wine production could be handled with low startup costs it is a negligible force on the market.

Compared to the argue competitors outlined in this case study, competing in the industry requires significant capital investment to include: starting their own vineyards or purchasing the grapes from growers that are already contracted to the larger competitors, building the winemaking facilities, bottling the wine, shipping to the stores, restaurants and distributors, convincing distributors to actually put the product on their shelves. Rivalry among the industry competitors appears to be high.

The focus on products that gain market share support this theory.

It is very evident that market share is a key success factor in this industry. The availability of substitute products further increases this rivalry. As

evidenced by exhibit 7 (C-273) low cost wines between $3 and $7 make up forty one percent of the US market share by volume, with wines selling for less than $3 holding thirty nine percent of the market. The drivers of change within this industry are social concerns and subsequent government regulation resulting from the medical and social costs of alcoholism. Another issue could be the economic status of the US.

The socioeconomic condition AT ten consumer will determine want, IT any, type AT alcoholic Diverge teen condos to consume. Wine consumption is very unlikely to be eradicated from society, as it has been prevalent throughout recorded history. It is linked to certain cultures and nations more strongly than others. It is very important that competitors in this industry not find themselves regulated out of business by government. The key success factor in the wine industry is the ability to be the low cost producer in order to gain market share.

A well-known and respected image that produces higher quality wines will allow the business to gain recognition. The low cost provider is able to remain in the market when profit margins are squeezed tight. It is also evident from this case that image and quality allow business to gain government influence that gives them advantage over their competitors. Should the drive toward a free market continue, there is considerable threat from global competitors that are being locked out by tariffs and governmental regulation. Another key success factor is control of the supplier, the grape growers.

This does not mean that a company needs to grow its own grapes, as this could increase potential risk.

It is important to have the apprehend in price bargaining and quality control from the grower. Long term contracts with growers provide this and create a barrier o entry for other potential competitors. Strategic group map of the wine industry could compare the low-cost with the high quality, but this information is not available from the case study. Limited knowledge of the wine industry and lack of data within the case prevent this particular strategic group map.

However, brands sold, number of winemaking facilities and gallons produced were mapped to determine if they could be used to show a particular area of opportunity and identify market areas that are already saturated. The strategic group mapping supports the idea that a wine producer with 6-8 acclivities, producing 150 million gallons a year under twenty to thirty brands is most likely to be successful.

E. & J. Gallon's strategy is to " shed the winery's image as a maker of low-end wines sold in screw-top bottles and Jugs".

Gallo wants to position itself as maker of better- quality, moderately priced table wines and then later as a maker of truly fine wines. Gallo not only wants to be the best quality winemaker but also the largest producer of wines. This goal, although not impossible, may contradict itself.

In most industries the largest producer does not hold the highest quality in the industry. A little pacifistic in a vision statement would clear up this

confusion. It appears that right now the low quality, high production section of the market is where most US winemakers realize their largest profit.

In 1998, the Wine Spectator rated one of Gallon's chardonnays very high. In 1998 and 2001, Gallo was internationally recognized for its quality winemaking. There are numerous other examples of recognition and awards that prove the success of the marketing campaign Ana Image overhaul AT ten Gallo wellness.

It appears Tanat strategic objectives are being achieved. The financial objectives are a little more difficult to discern. Gallo is a private many and is very tight-lipped about its financial standings.

However, industry analysts did estimate that Gallon's sales revenue in 2000 at $1. 35 billion.

This places them as second in sales revenue behind the Cannonading winery. It is important to note here that Gallo produces almost twice as much wine in volume compared to Cannonading and does so with seventy percent fewer winemaking facilities. A question that remains unanswered is the profit margin from the sales revenue. Opportunities – Global market for high quality wines, capitalizing on awards and recognition – Medium cost, high quality wines within the US that are profitable