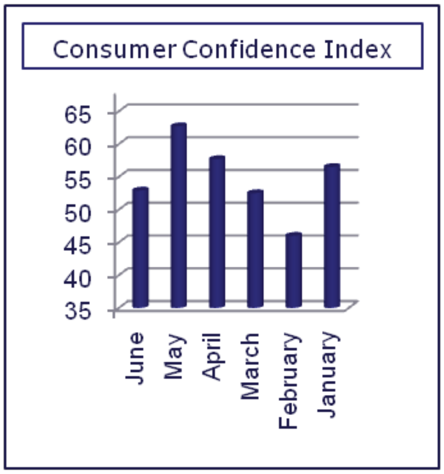
Luxury Wine Market Struggles in Face of Recession

Over the course of the past two years, the effects of the downturn in the global economy have been reflected in consumer buying habits across myriad industries, but perhaps nowhere more than in the luxury goods sector. The global wine industry, in particular, is an especially effective model to measure consumer reluctance to spend their incomes on non-essential purchases costing more than the commonly accepted impulse purchase price of $20.00.

Changing Consumer Buyer Habits

In 2009, overall U.S. wine sales increased 5%, but this has been fueled by sales of what are commonly termed "everyday wines," bottles that cost $10 or less. Consumers have not displayed a willingness to entirely forgo consumption of wine but have increasingly restricted their purchases to lower cost wines. Indeed, even as overall U.S. wine sales increased, sales of bottles that cost $25.00 or more decreased by 12%.[1] Moet Hennessey Louis Vuitton (LVMH) reported that its wine and champagne sales decreased 17% in 2009.[2]



Producer's Reaction

The downturn in sales of high-end wines has resulted in widespread price corrections across the American market. High-end wineries are being forced to drastically reduce the price of their wines in an effort to move product as retailers and distributors are responding to the declining demand for luxury wines by either deciding to forgo orders of those products, or by demanding drastic discounts on high-end wines. As these discounts are passed on to the consumer, it is becoming increasingly common to see what was once a $90 bottle of wine selling for $50.[3] The effect of such discounting has been the devaluation of many esteemed luxury brands, and the return to prominence of mass produced, group wines – those owned by giant beverage companies such as Fosters, Gallo, and Diageo.

Realigning Business Models

Even the beverage giants have not escaped the negative effects of the downturn, and are realigning their business models to adapt to new consumer buying habits. The only segment of the U.S. wine market to experience growth over the past year was the $5.00 - $8.00 bottle. Additionally, consumer preferences have shifted towards the purchase of well-recognized brands, likely a result of a desire to ensure satisfaction with their wine purchases. At a local level, this has led distributors to reduce their inventories, the rationale being that consolidating inventories to feature prominent, high performing brands will lead to rapid inventory turnover and greater profitability.[4] As local distributors have realigned their business models in response to consumer buying preferences, the global beverage giants have undertaken a similar restructuring to align with market changes. Diageo announced in May 2010 that it planned to eliminate up to 90 jobs in its U.S. wine business and planned to sell several of its smaller brands, focusing instead on larger, more recognizable brands such as Acacia, Beaulieu Vineyard, Rosenblum Cellars, Sterling Vineyards and Provenance.[5] Fosters also announced plans to sell 37 underperforming, low-end brands in February 2009.[6]

A Daunting Challenge

These changes signal challenging times for producers of luxury wine, especially for boutique producers. While high-end producers able to rely on the capital support of investors or arent companies may survive the financial crisis, boutique producers without stable capital reserves face a daunting challenge as long as consumer confidence remains depressed. Not surprisingly, the downturn in the American luxury wine market may still not have reached its lowest point. Experts have stated that the effects of the downturn on American producers have been mitigated by the fact that California's grape production has been relatively moderate in recent years, and has kept supply in line with demand.[7] In Australia, where the vast majority of wine production focuses on the under $10 bottle, grape production has reached the point where 20% more grapes are grown than is needed to accommodate production capacity. Therefore, Australia has amassed a surplus of 100 million cases of wine, despite the fact that the vast majority of its wines fall well below the luxury price point.[8]

A Possible Solution

A fleeting hope for high-end, boutique American wine producers is the Asian market, which has maintained its affinity for luxury goods, even in the face of the global recession. Given the fact that Asia has been relatively unaffected by the financial crisis, it is not surprising to see the desire for luxury goods remain similarly unaffected.

The growth of a wine-culture in Asia over the last several years has been a surprising development to many in the industry. As more and more wealth is amassed in Asian society, a wine connoisseurship that sees wine primarily as a status symbol has been developed. These collectors are currently focusing their attention on first and second growth Bordeaux, and on Champagne, with Chinese sales of Bordeaux increasing 40% in 2009. Comparatively, sales of Bordeaux in the United States decreased 44% in the same period.[9]

While it remains to be seen whether China will assign the same status symbol classification to high-end American wines as it has to Bordeaux, the Chinese market has remained impervious to the decline in consumer confidence that has stunted the sales of luxury wines in America. Until that confidence returns, the Asian market may remain the last fleeting hope for domestic producers of sophisticated wines.

FCSI Insights

Given the intense competition in the U.S. wine industry with more than 1,800 companies in the game, the importance of monitoring major players, market conditions, consumer spending, advertising, packaging designs, innovation, disruptive technologies and emerging trends are crucial for success. The growth strategies and business models of the U.S. wine industry are evolving and becoming more complex. The requirement for accurate information and insights are key to the formulation of a good strategy, and in developing tactical responses by helping to understand every factor the industry competes on. Fletcher/CSI's General Practice Group conducts extensive reviews and analysis of major players in the food and beverage industries, and in the adjacent restaurant and hotel industries.

[1] Jim Carlton and David Kesmodel, "Luxury Wine Market Reels from Downturn," Wall Street Journal, 8 July 2009.
[2] Christina Passariello and Vanessa O'Connell, "Luxury Goods Sales Still Soft, Recovery Unlikely Before 2011," Wall Street Journal. 20 October, 2009.
[3] Carlton and Kesmodel.
[4] "The Future of Luxury Wine," http://www.vinography.com/archives/2010/02/the_future_of_luxury_wine.html. 22 July, 2010.
[5] David Kesmodel, "Diageo Revamps Wine Unit, Cuts Jobs," Wall Street Journal, 12 May 2010.
[6] Chris Snow, "'Underperforming' Foster's to Split Wine and Beer, 37 Brands Cut," Decanter Magazine, February 2009.
[7] Carlton and Kesmodel.
[8] http://wineeconomist.com/2009/11/11/australia-at-the-tipping-point/. 22 July, 2010.
[9] http://www.independent.co.uk/life-style/food-and-drink/bordeaux-vintners-look-to-asia-to-drain-cellars-1922527.html