

Competitiveness of Small Companies in the Argentinean Wine Industry

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Although Argentina has experienced growth rates much higher than the industry average in the last decade, wine exports are a new phenomenon in the country. Evidence of this is the average age of wineries, which is only 5,4 years. From a total of 384 export wineries in 2009, 245 began exporting no more than 6 years ago and only 103 are older than that. These new companies represent almost a fourth of global Argentina's export value, with an average of 377 thousand dollars.

Age of export wineries

Age	Quantity of wineries	Export Value 2008 (Million u\$s)	Share of total exports
1 year	54	2,9	0.6%
2 years	38	15,0	3.0%
3 years	27	4,0	0.8%
4 years	44	16,5	3.3%
5 years	43	26,3	5.3%
6 years	39	27,7	5.6%
7 years or more	103	403,1	81.3%

Fuente: Área del Vino con datos de Aduana

Thus, Argentina's wine industry is sustained by new companies which are on the first stage of the life cycle. This situation requires special attention as the threats and weaknesses of these companies can sometimes shoot them dead. Their management and market focus are key elements to guarantee sustainability.

After a survey done by Area del Vino in the market during 2009, with the objective of understanding the industry dynamic, we could identify two main reasons explaining the increase in number of wineries:

- *High level of attractiveness:* most of the companies that chose to invest in wine were driven by the growing international demand. Additionally, this demand was concentrated in high average prices which increase the gross profits and thus the attractiveness. High gross profits expected and a growing market were the two elements that defined the rapid increase of the number of wineries.
- *Barriers:* at first sight the wine industry does not have high technological entry barriers and if investment hasn't been concentrated in fixed assets then exit barriers are not high either. This situation defined the interest of many investors for the wine industry. However, as we'll see later, this barrier was underestimated defining many companies' bankruptcies.

As for the reasons for companies' bankrupts, we could identify five:

- *Impossibility to increase working capital:* as sales grow so does the need for funds. In an activity with long stock periods and foreign sales credit, the ability of forecasting and

getting the necessary money is crucial for continuity. The lack of credit of the whole Argentina's economy makes things worst and thus only companies with strong stockholders can keep in the race.

- *Lack of focus at the beginning:* at the survey many companies explained how they were driven by the market sales potential when opening commercial offices or reaching sales agreements. At the end many companies found they were not able to maintain so many markets, with different requirements in products, labels, promotion and distribution, among others.
- *Difficulty to find distribution channels:* the size of some wineries together with the incapacity to do a complete market research turned into a high number of failures in relationships with distributors. Once established with certain distributor or importer, the costs of finding and hiring a new one were so high that many companies decided to get out of the market.
- *Inadequate and insufficient promotion:* generally the budget for promotion is not well prepared and as markets require investment, the winery starts to fail. The demand for promotion starts in early stages and many times the winery is not prepared to invest. Brand positioning is generally greatly affected by this.
- *Lack of product adaptation:* new markets and new consumers demand new and innovative products each year. In many cases, the winery is not well prepared for this, in the management team and in the productive facilities. Intense competition makes this weakness very hard to overcome.

From the research, we could verify that the fifth and sixth year of the companies were crucial for their future development. At this time, the request for working capital was the most and when able to overcome this need the future start to look promising.

On average, a company in its fifth year sells 629 thousand dollars, jumps in the sixth year to 1,8 million dollars and in the seventh year reaches 3,2 million dollars. The request for funds during these years is huge, reaching 3,5 million dollars in the sixth year.

Chart 1: Flow of sales in average company (u\$s)

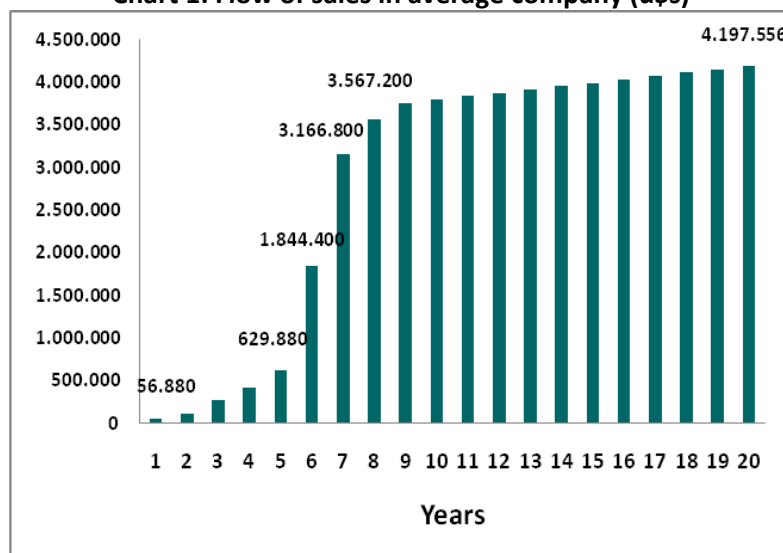
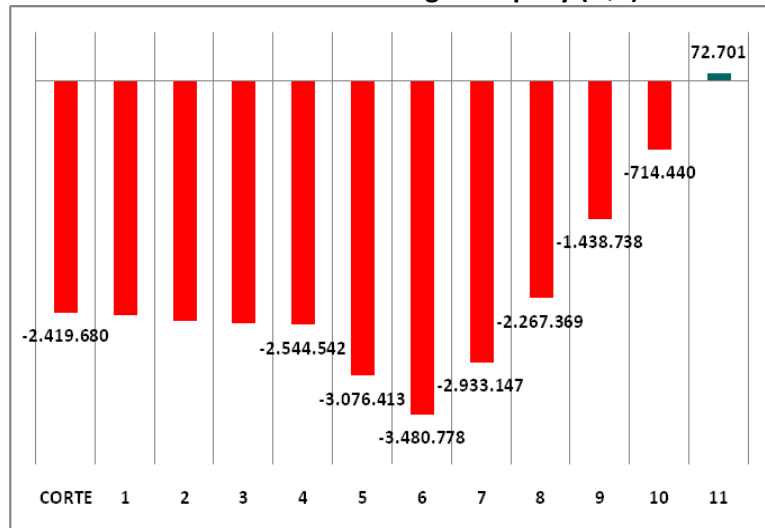


Chart 2: Cash Flow in average company (u\$s)



Additionally, we were able to work some financial indicators. Over a sample of 65 wineries, only 19 showed profit rates over 10%. And for almost half of them the IRR was not even 5% and for 15 wineries, the rate was between 5 and 10%. For these last two groups, the situation was generated by a strategy of low average price and small export value. To overcome this one can suggest two possible strategies: growing in total value or increasing average price. Volume expansion doesn't seem to be the most appropriate as it requires big investments and the increase in IRR is not so important. But, increasing average price does increase IRR considerably and can be done with fewer funds. For small and young companies, as the 70% of Argentina's wine industry, the most intelligent strategy appears to be this last one. To run this, wineries need to invest in quality programs, promotion, market focus and training for executives.

All in all, Argentina's wine industry has experienced great transformation in the last decade mainly driven by exportation. The creation of new wineries and brands has been very fast, encouraged by a growing external market but threatened by local crisis and vulnerability of small young companies. This phenomenon, which is widespread among New World producing countries, needs to be addressed to ensure a long and profitable performance for the industry. Availability of working capital and market focus are definitely the two key factors to work over.