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Chilean Wine: A Short- and Long-Term Assessment of one of South America's Oldest Industries

Jonathan Bradley

ABSTRACT

This paper will begin by taking the reader through a brief history of the Chilean wine industry and more specifically, the largest producer within that industry: Concha y Toro. My goal is to examine the current state of the global wine industry, and the selected company, to gather a greater understanding of where the company is and where it needs to go to remain competitive in the future. Using the Strengths, Weaknesses, Opportunities and Threats (SWOT) analysis, the paper determines the strengths, weaknesses, opportunities and threats of the company, and what can be done to exploit their strengths and mitigate their threats. It will also use Porter's Five Forces Model to help the reader get a better understanding of the competition in the global wine market. The paper will ultimately conclude, among other suggestions, that a change in pricing strategy and promotion, combined with investment in wine-making outside of Chile's borders is necessary for Concha y Toro to be a major market player in the long term.

HISTORY OF WINE IN CHILE



Figure 1: Photo taken by Eamonn Smith

Wine making has a long history in Chile that dates back to the 16th century, when wine grapes were first imported by the Spanish conquistadors, and the Catholic missionaries that followed. The Spanish tried to cultivate wine in places like the Caribbean, Mexico, and Peru, but never produced a quality product. The first vines to arrive in Chile were probably of the País variety (known as Mission in California) and were brought in through the port of Concepción around 1548. These vines were planted throughout Chile in areas that produce much of the country's wine to this day (Wines of Chile, 2008).

Throughout the 20th century, Chile became an example of seclusion and distance from the rest of the world, despite its success during the latter half of the 19th century. The two World Wars and decades of protectionism from the state coupled with bad regulations and high taxes during this time caused Chilean wine to fall off the map until the 1980s (Wines of Chile, 2008).



Figure 2: The trans-Atlantic travel of the time brought the Phylloxera louse from America to Europe which decimated the Old World wineries that were defenceless against this aggressive louse. The plague was then brought back to America, yet it never reached Chile. This proved to be a big break for Chilean wine-makers, because before the outbreak vines were imported from France to Chile. Due to the damage that had taken place in Europe and America, professional oenologists from Europe were willing to travel to Chile for work and they brought their expertise with them.

HISTORY OF CONCHA Y TORO

Concha y Toro is not only the largest wine-making company in Chile and all of South America, but is also the ninth largest producer in the world (D. Pérez, sommelier, Concha y Toro Pirque Wine Tasting Center, personal communication, November 24, 2008).

The Concha y Toro company was started by local politician and businessman Don Melchor Concha y Toro. He brought grape vines from Bordeaux to Chile and planted them at Pirque in the Maipo Valley, just south of what is now Greater Santiago. He also invited French enologist Monsieur Labouchere to Chile after the Phylloxera louse launched its attack on Europe (Concha y Toro, 2008a). This location is now the Pirque Wine Center, and I visited there to talk with a Concha y Toro sommelier (D. Pérez, personal communication, November 24, 2008).



Figure 3: Photo taken by Eamonn Smith

The success of Concha y Toro in the last 50 years has largely been thanks to Eduardo Guilisasti Tagle, who joined the company's board of directors in 1957, ascending to Chairman of the Board in 1971 where he remained until 1998. Don Eduardo focused the company heavily on incorporating new technologies and purchasing French oak barrels to produce a higher-quality product in the 1980s, and switching the sales focus to international markets in the 1990s (Concha y Toro, 2008a).

In 1993, Concha y Toro created a subsidiary called Viña Cono Sur in order to sell more budget priced wines without tarnishing the Concha y Toro name. Today, Concha y Toro and Viña Cono are the two most successful Chilean wineries in the United Kingdom (D. Pérez, personal communication, November 24, 2008).

In 1994, Concha y Toro became the first wine-making company to be traded on the New York Stock Exchange, which resulted in \$53 million in capital raised (Concha y Toro, 2008a).

Concha y Toro has also expanded its vineyards into the nearby Mendoza Region of Argentina. By doing so, they were able to add new varietals to their collection and take market share away from their largest continental rivals in Argentina. Their Trivento Bodegas y Viñedos in Argentina is now the second largest producer of wine in the country.

By 1999, *Wine Speculator*, one of the world's foremost authorities on wine gave Concha y Toro the title of the most important producer of wine in Chile and Argentina. That year, the magazine also named Don Melchor the Best Cabernet Sauvignon and the Trio the Best Merlot of the Decade.

In 2001, the company's first office abroad was opened in the U.K. and since then Concha y Toro has continued to grow its stake in the world market (Concha y Toro, 2008a).

THE COMPANY TODAY

Today, Concha y Toro is Chile's largest producer and exporter of wine and one of the top 10 wine-making companies in the world. Their business strategy is based on market diversification to participate in all segments of the wine market. At the moment they have leadership positions in key markets like the United Kingdom, United States, Canada, Scandinavia, Eastern Europe, Japan and Latin America.

According to the company fact sheet (2008), Concha y Toro's strength is built on the foundation of heavy investments into the latest technologies and production techniques. As a result, they are able to consistently produce a quality wine at low cost. Concha y Toro is working hard to extend their brand image and penetrate new markets. (Concha y Toro, 2008b).

ASSESSMENT OF THE GLOBAL WINE MARKET

I will now conduct an assessment the competitiveness of the global market for wine using Porter's Five Forces Model (1980). The Five Forces that Porter refers to in his model are: the threat of entry of new competitors, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers, and the degree of rivalry between existing competitors.

The first of these is one of the more severe threats to the Concha y Toro company, particularly in the long term. The threat of new entrants into the market will raise the overall level of competitiveness in the market. Chilean wines are classified as part of a group called New World wines. Some of the markets that are considered to be part of the New World wine scene are Australia, Chile, South Africa, California, New Zealand, and Chile's most dangerous New World competitor Argentina. Argentina is the most dangerous threat to Chilean wine-makers as it possesses many characteristics similar to Chilean wine; however, Argentina has 80 per cent more arable land than Chile. (Wharton School, 2008). Furthermore, Argentina has a stronger relationship with Brazil, a country that Chile has selected as a potential source of growth (D. Pérez, 2008).

In the long-term forecast, by far the most threatening new entrant to the global wine market is China. I found two recent articles that outline the rapid growth of wine consumption and production in China. The first article is called "Chinese Wine Production Soars" (Evans, 2008) and states that last year's numbers make China the number six producer of wine in the world as it has seen the emergence of over 100 new wineries since the 1990s. The second article is called "Will China Lead the World in Wine Production by 2060?" (Styles, 2008) and outlines a report by London-based wine merchants Berry Bros. and Rudd that claims that China will in fact lead the world in wine production by 2058. The report argues that with growing internal demand and a vast geography that undoubtedly holds some areas that will "rival the best of Bordeaux"; China is set to dominate the world market for wine. These views are shared by sommelier Christopher Kerridge (personal communication, December 5, 2008).

However, the threat of new entrants into the market is mitigated by the high barriers to entry that exist in the wine-making industry. Large investment requirements are needed to create a wine-making facility, especially one capable of taking a stake in the export market. Great time investments are also required to launch a vineyard, which means that not only is it expensive to enter the market, it also takes many years, and the empty space once perceived in a market may be filled by the time you are ready to make sales. Furthermore, there are barriers to entering the distribution systems used by wine-makers as there is limited space on liquor store shelves and restaurant menus that is already aggressively fought over by existing competitors.

The second of Porter's Five Forces is the threat of substitutes. This threat is significant primarily in the global alcohol market. The main threats to wine-makers around the globe come from spirits and beer (C. Kerridge, personal communication, 2008). These spirits include: scotch, brandy, and high-quality vodka. Ms. Pérez (personal communication, 2008) informed me that Concha y Toro is taking steps to take over some market share from these products in countries such as Russia, which has a high population of vodka drinkers. The willingness to substitute has an interesting component to it, in that the wine market has a great degree of national pride involved. This is especially true in the European countries like France, Spain and Italy.

The bargaining power of buyers in the global wine market is relatively low as there are many different wine options. However, in the global wine market there are several types of buyers.

In the sense of the individual consumer, there are many consumers of wine globally, and this limits their respective buyer power. There is much higher bargaining power in the restaurant market, especially because large chains of restaurant are growing in popularity and the wine list that is selected by head office will be duplicated in each location. There is, however, both a low threat of buyers integrating backwards into the industry and a low threat of suppliers integrating forward in the industry.

The relative bargaining power of suppliers in the wine industry is not that significant, considering that most of what Concha y Toro needs to produce their product, they have already purchased. As mentioned before, Concha y Toro has made the large investments that it needed in wine-production technologies; however, during my discussion with sommelier Chris Kerridge at the Bear Mountain Resort in Victoria, he informed me that the major threat from suppliers comes from the supply of barrels. The barrels that Concha y Toro uses are made from French oak which is three times as expensive as American oak, which could lead to potential problems for the company if the global demand for French oak surpasses the supply.

The final force outlined by Porter is the intensity of rivalry between existing firms. In the global wine-making industry, this competition is immense. The structure of the market is such that there are many firms competing for a piece of the market with no one, clear leader. The structure of industry costs in the market is that there are high fixed costs, which can make wineries cut their prices readily in order to compensate for an excess of production. The degree of differentiation in the market is great, which reduces its overall competitiveness. In a market with little differentiation, there would be great pricing competition. Finally, the exit costs of leaving the industry are low, even though there are high fixed costs; other companies are likely to buy a bankrupting company out in order to increase their own production.

SWOT ANALYSIS

The SWOT Analysis technique is used to determine the strengths, weaknesses, opportunities, and threats that face the company as a whole. I would like to apply this technique to Concha y Toro.

I believe that Concha y Toro is a well-positioned company whose strengths greatly out-weigh its weaknesses. The first of Concha y Toro's strengths is that it is a vertically integrated company with its own bottling facilities, vineyards, and wine production facilities. Its second major strength is that in the past it has made significant investments into the latest wine-making technologies, which now allows the company to produce wine with cost-efficiency and consistency. Concha y Toro also possess a strong brand image that is continually growing. Finally, Concha y Toro, and all Chilean wine-makers, have managed to avoid the spread of the Phylloxera louse to their vines. By avoiding this problem, Chilean vines do not need to be grafted, making the wine cheaper to produce.

Although the brand image for Concha y Toro and its subsidiaries is growing, the fact that it has not yet reached the point of truly global recognition proves one of the major weaknesses of Concha y Toro's operations. Given all the advantages that the company has, there should not be a problem with the global perception of the quality of their product.

For many people, Chile is an unknown country, and since it is in South America they know little about its business practices. When it comes to innovation, they know us in other sectors outside of wine. Clearly, Wines of Chile, an organization that promotes 90 Chilean wines from its offices in Santiago and London, has done little to change that. If you watch a Davis Cup match and then look at the promotions for Colombian coffee, for example, it becomes obvious that they are still investing little in Wines of Chile. (Wharton School, 2008).

In the past 30 years, Chilean wine-makers have successfully marketed their product as the best value wine, because it is quality wine at a reasonable price. With the emergence of Argentine wines that are pricing themselves at \$40 a case instead of just over \$25 (the typical price for a case of Chilean wine) (Ibid), it seems as though Concha y Toro has been pursuing a strategy that has left them undervaluing their wines and thus limiting their profit margins.

In recent years, Concha y Toro has made significant growth, and I believe that if they were fully able to expand on their opportunities, their growth would increase at an even more rapid pace. The first opportunity I had a chance to discuss this was with Daniela Pérez at the Pirque Wine Tasting Center (personal communication, November 24, 2008).

We discussed the notion of Concha y Toro’s expansion into growing markets. The example that was discussed specifically is Brazil. As an increasingly affluent market that is seeing levels of growth greater than many western nations, Brazil offers an excellent opportunity for growth.

Not only are is Brazil an increasingly affluent nation, but the country is one of the few markets geographically close to Chile, which would greatly reduce the transportation cost for shipping the product. I believe that there is also potential growth in other increasingly affluent nations like China and Russia.

Wine consumption is seeing growth in many markets; for example in Canada, wine consumption surpassed that of spirits in 2006 (C. Kerridge, personal communication, 2008). Opportunity for growth in the west could hinge on the growing preference for organic wines. As more and more chemicals like pesticides are being introduced into agriculture, many people are searching for products that do not contain these components.

Although I see many opportunities for the Concha y Toro company, I can also find some threats facing the company that need to be addressed. The first of these is the spread of spores and diseases to the wine that some feel will inevitably reach the Chilean wine-growing regions (C. Kerridge, 2008). The second threat is that since Chile is long, narrow country running north-to-south, it would seem inevitable that they will begin to run out of land that is suitable for the production of wine in Chile. Another major threat to wine-makers around the world is global warming. As noted in the article “The Future for Chilean Wines Turns Sour” (Wharton School, 2008), the world is generally uninformed about the value of Chilean agricultural products. The article puts much of the blame for this on ProChile, a government organization whose goal is to promote Chilean products worldwide. Finally, the global economy has dropped significantly in the last six months, which has the potential to drastically reduce the company’s sales.

Figure 4: Photo taken from Google images



Table 1: SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> • Unaffected by the Phylloxera louse • Vertically integrated • Growing brand preference • Latest technologies and techniques 	<ul style="list-style-type: none"> • Promoting the brand • Poor effort from Chilean organizations Wines of Chile and ProChile in promoting Chilean wines abroad • Pricing strategy
Opportunities	Threats
<ul style="list-style-type: none"> • New markets like Brazil, Russia and China • Increasing popularity of wine globally • Various climate zones in Chile • Increasing global preference from organic products 	<ul style="list-style-type: none"> • Running-out of usable land • Phylloxera louse could reach Chile • Global warming • Global economic recession • Poor global opinion of Chilean agricultural products • Limited world supply of French Oak

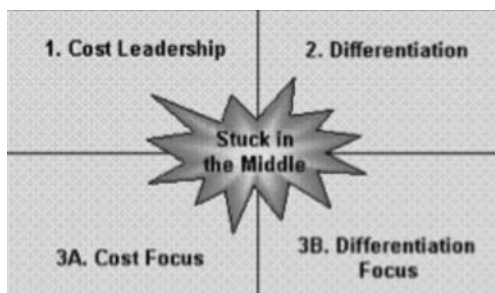
RECOMMENDATIONS

After performing the analysis, I have generated a series of recommendations designed to help the company mitigate threats and sustain growth over the short and long term. The first recommendation is designed to reduce a major threat to Concha y Toro and the whole Chilean wine-making industry. The Phylloxera louse that devastated the European vineyards in the 19th century could still make it to Chile in this day and age, especially as globalization spreads. Currently many vineyards in Chile go un-grafted. The process of grafting, while chemical-free, is costly and adds extra time to the amount needed for the vines growth. This has been a source of competitive advantage as Chilean vineyards claim that you can “taste the difference” (D. Pérez, personal communication, November 24, 2008) even though there is no difference in the composition of the grapes. The threat is that if the Phylloxera louse were to somehow make it Chile, it would decimate the crops. By spending the time and money needed to begin the process of grafting now and spreading the investment out over time, Concha y Toro and all Chilean vineyards can avoid the loss of harvest and the huge one-time investments that would be necessary to solve the problem, should it suddenly arrive on Chile’s shores.

A second threat I found from my research is that there is a limited supply of French oak in the world, and Concha y Toro runs the risk of either being forced to pay extremely high prices for the material, or having to make the switch to a different type of oak for use in their barrels. Some suggest that Canadian oak is the middle-ground between French and American oak, while the Italian have a long history of using oak from Eastern Europe, which is also cheaper than French (Robinson, 2003). Concha y Toro will need to begin searching out alternatives to the French oak that is in limited supply.

Concha y Toro prides itself on being a company with a highly-diversified product line; however, after talking with Daniela Pérez and Christopher Kerridge (2008), it is apparent that there needs to be a heavier focus on organic wine-making. Concha y Toro has already made the capital investments required to make this possible and, according to Ms. Perez, already has a line of organic wines under the name Emiliana. I suggest that Concha y Toro invest more of their marketing efforts on promoting this specific line, as well as creating new lines of organic wines to fulfill the demand for this specific type of wine. Although this is only one product type that I feel they need to further promote specifically, this leads me to my next major suggestion.

Figure 5: Photo taken from 12manage.com



A new pricing strategy combined with a new focus on promotion of the product and industry as a whole is needed in order to advance the interests of the company. I recommend that Concha y Toro change their pricing model to be more similar to that of Argentina. For years Chile has been producing high-quality wines, but selling them at a value price. This strategy has worked in the past as crop production increased year after year, but Chile has to realize that they are operating with limited amounts of land space and that being the low-cost producer will not be a successful strategy in either the short or the long term.

As mentioned earlier, the company and the two organizations devoted to the promotion of Chilean wine need to advance their promotion efforts. The two strategies for competitive advantage are either low-cost producer or differentiation. For years, Chile has been successful in a dangerous place: the middle. Although Concha y Toro has wines in almost every segment of the industry, I suggest that they put a heavier focus on differentiation. They could do this by focusing more of their investment on advertising and promotion. I suggest that they exploit their history of nearly 500 years of wine-making to compare themselves with the Old World wines, instead of the New World.

The most effective use of their time and money would be to work with the two organizations and other Chilean wine-makers to promote Chilean wine as a whole.

Although this strategy would not put this focus on Concha y Toro in particular, as Chile's largest producer of wine, they would benefit the most. By working with the other wine-makers to raise funds for promotion, they can also reduce some of the investment necessary from their company.

It is in my opinion that in the long-term Concha y Toro cannot count on being the low-cost producer of wine in the world because of the lack of space available and the predicted emergence of China as a major producer. With China's land resources and investment money that can greatly out-match Chile, it is going to be imperative to the survival of the industry in Chile to move towards differentiation.

My final suggestion to the Concha y Toro company focuses on the longer term. As discussed earlier, there is a limited amount of land in Chile that is suitable for producing wine. In order to remain in a leadership position in the global market for wine, Concha y Toro is going to have to expand its operations beyond the Chilean borders. I suggest that they start this process by moving into Argentina. They are already the second largest producer of wine in Argentina through their subsidiary Viña Trivento, but they should work hard to secure more land in Argentina in order to secure their position as the largest producer of wine in South America (Concha y Toro, 2008b). This is a position that they cannot afford to lose. With global warming being an imminent threat, Concha y Toro ought to seek places to invest in emerging areas for wine production. The article "China Will Lead the World In Wine Production by 2060?" (Styles, 2008) says that some of the new wine-making hubs of the world that will emerge in the next 50 years will be: Canada, China, Eastern Europe and even the United Kingdom. They should take a lesson from history as it always repeats itself. When the Chilean wine market was just emerging, there was plenty of investment from existing wine giants in France and Spain. Now that Chile is wine-making giant in the world, it is their turn to make investments in emerging wine-producing regions to secure their long-term existence.

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