

Padua 2017 Abstract Submission

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Elasticity of Demand, Wine Branding, Market Segmentation, Small Wineries, Growth Strategy, Margin Analysis

Research Question

What market opportunities exist for a new BC mid-value wine brand, and what are the potential economic benefits for small BC wineries?.

Methods

Secondary data is used to measure price elasticity of demand. Primary data collected from BC wine consumers was used to measure important brand elements as well as consumer purchasing patterns.

Results

Results indicate that there are opportunities for small BC wineries, with a reputation for quality, to extend their premium brands into the mid-value segment.

Abstract

Introduction

The British Columbia wine market is divided into three distinct market segments: premium wines, mid-value wines, and commercial Cellared-in-Canada (CIC) bulk wine. BC wineries have captured 67.7% of the premium segment, whereas the mid-value segment is supplied almost exclusively by foreign wines (Cartier, 2014).

The large mid-value segment offers an attractive growth opportunity for small domestic wineries if they can successfully extend their reputation for premium wines into this segment. However, the mid-value wine segment is highly fragmented, so wine branding innovation is a critical element in the marketing mix to differentiate BC wine products from the foreign imports.

Branding strategies for wine are complex and a rich source of discussion in the literature. Typically, these branding strategies relate to premium wines. Three broad themes emerge from the literature: origin, quality, winery identity/reputation (Aitken & Newton, 2011; Beverland, 2005; Bruwer & Johnson, 2010; Vlachveia, Nottab & Efterpia, 2011). In addition, a consumer's expertise about wine can moderate the importance they place on brand elements such as region of origin (Perrouy, d'Hauteville & Lockshin, 2006)

Although brand identity is important to consumers, especially brands associated with product quality, and can influence their buying decisions, wine drinkers are not necessarily loyal to a specific price tier and will purchase wine across multiple price tiers (Romaniuk & Davies, 2005). Although they cross price tiers, they are still influenced by other characteristics of the wine they purchase, such as quality, region, and brand. This implies that there may be a halo effect that extends from the premium quality brands identified with a specific region, such as the Okanagan region, to mid-value wines produced by wineries in the same region.

From the literature, two strategies can be employed to capture market share in the mid-value segment:

1. Price discrimination for premium BC wines: this is the practice of charging more than one price for a single product. In this case, BC VQA premium wine (priced at \$22.00/L) could be sold in the mid-value market at a discounted lower price (\$16.00/L).
2. A new mid-value wine product category: create a new mid-value brand for 100% BC wines. This new brand will be distinct from the BC VQA premium brand.

The purpose of this research is twofold. First, to identify the key elements of a successful mid-value wine brand, and second, to quantify the profit potential for small BC wineries that may choose to commercialize new mid-value wine products.

Methodology

Analysis of secondary data is used to measure the effects of price elasticity of demand on consumer purchase patterns across wine segments.

Price elasticity of demand is measured by applying a multiple linear regression model. Cross elasticity of demand was calculated for total wine, cider/coolers, beer, and spirits.

The economic implications of the brand diversification strategy at the business level is developed from secondary production data provided by local wineries and the BC Ministry of Agriculture secondary data. An economic model of the wine industry was developed from the secondary data. This model provides the information required to estimate the effect of product diversification on winery profitability, and overall industry growth.

A descriptive research design was used to measure important brand elements as well as consumer purchasing patterns and behavioural characteristics. Primary data was collected through a survey of 535 BC wine consumers. The survey collected data related to: frequency and quantity of wine purchases by wine category, importance of brand attributes, perception of price discounting strategies, wine region preferences, and demographic information. Data analysis included descriptive statistics, group comparisons, and regression analysis.

Results and Discussion

How price elasticity of demand effects brand loyalty across the premium wine, mid-value wine, and Cellared-in-Canada segments

Price and per-capita wine consumption

Average BC wine per-capita consumption is 14.3 Litres with an average price of \$12.19/L. BC VQA wines enjoy higher price points than for mid-value imported or CIC wines. Per-capita consumption of wine is higher for imported wines, 7.16 litres, than for BC VQA, 1.80 litres and for CIC, 5.22 litres. BC consumers purchase almost four times the quantity of foreign wines; this may reflect a demand for the lower price points associated with imported wines than for premium BC VQA wines.

Price and Per-capita Consumption Growth

Both the price of BC VQA wine and per-capita consumption have increased between 2000 and 2014, 1.62% and 8.46% respectively. Also, premium wine consumption is increasing at a greater rate than the price of these wines; consumption of BC wines is increasing and consumers are purchasing higher priced wines.

Wine Segment Demand

Per-capita wine consumption in BC is increasing faster than price increases. The resulting demand curve for BC is upward sloping with a positive coefficient of 0.952 and exhibits an inelastic behaviour.

Price Sensitivity in Market Segments

Price sensitivity for wine in the three market segments: premium, mid-value, and CIC was measured. Price

elasticity increases as the price decreases.

The key brand elements for a mid-value BC wine brand.

Does brand identity help explain the behaviour of the wine demand curves?

Importance of Brand Attributes

The three most important brand elements are region, quality, and price. Moreover, the respondent's knowledge of wine has a significant influence on the importance of brand elements: experienced wine consumers place higher importance on region and quality than do novice wine consumers. Survey respondents show a distinct preference for BC wines.

Wine consumer purchasing behaviours and the extent to which wine consumers purchase wine across multiple price tiers

The quantity of wine purchased per person per month was measured across six price tiers. The survey data indicates that although there is a preference for premium wines, those over \$18.00 per litre, these same consumers purchase from the mid-value range, most of which is imported foreign wine.

As the price of wine increases, knowledgeable wine consumers purchase greater quantities/per person of these wines than do novices.

The economic benefit to wineries of diversifying their product mix

As newly planted vineyards come into production, the quantity of grapes is expected to increase. An additional 4.5 million litres (500,000 cases) of wine could be produced from these grapes, exceeding the quantity demanded by the premium wine segment.

Wine Category Margin Analysis

BC wine produced for the premium wine segment shows a \$4.40/litre contribution margin. This margin is adequate to cover the operating costs of most BC estate wineries, since all BC wineries are vertically integrated with their own retail outlets (Cartier (2014)). Those BC VQA wines that are currently sold into the mid-value segment capture a lower margin for the winery - \$1.00/L.

A new wine category could be created to meet a lower quality standard than for BC VQA, and incur a lower production cost. Variable production costs could be reduced by paying \$491/ton less than what is currently paid for the premium grapes; the resulting margins/litre for mid-value wine would increase to \$1.82.

Grape Growers' Margin Analysis

The lower prices paid for the mid-value grapes would have a negative effect of the contribution margins realized at the vineyard, reducing the margins from \$745.22 per ton to \$253.67 per ton. This may render this segment of the grape growing segment un-economic. Currently grape yields for premium grapes is 3.0 tons/acre. Increasing the yields for mid-value grapes to 4.0 - 4.5 tons/acre could result in margins of \$651.24 - \$783.76/ton.

For vertically integrated small wineries, entering the mid-value segment could add an addition \$33.0 million to their revenues and increase profit margins by \$8.1 million.

Conclusions

The British Columbia wine market displays an elastic demand and elasticity increases as the wine price decreases. This is consistent with studies conducted in other wine markets. The positive coefficient reflects the increase in wine consumption in BC; the increase in consumption between 2000 and 2014 has been greater than the increase in price, and in BC, the increase in per-capita wine consumption appears to be at the expense of beer.

Price sensitivity impacts brand loyalty across the premium and mid-value wine segments. Although BC wine consumers report a preference for locally produced high priced premium wines, the lack of BC products in the mid-value segment drives consumers to purchase lower priced foreign wines. The most important brand elements for BC consumers are region of origin, quality and price, and these elements are important in both the premium and mid-value segments. There are opportunities for BC wineries, with a reputation for quality, to extend their premium brands to the mid-value segment.

Wine consumer survey data illustrates the extent consumers purchase wine across multiple price tiers. Although they report a preference for premium local wines, they purchase across all price tiers. The purchasing behaviour reported on the surveys is consistent with the analysis of secondary data. The price point that distinguishes the premium from the mid-value segment is \$18.00/litre. Wines sold above this price is perceived as premium quality while wines below \$18.00/litre are perceived as lower quality mid-value wines.

There are opportunities for small BC wineries, with a reputation for quality, to extend their premium brands into the mid-value segment. Currently, anecdotal evidence indicates that some of these wineries already sell BC VQA premium wine at discounted mid-value prices. Wineries that pursue this practice run the risk of devaluing the premium BC VQA brand. A preferable strategy for the industry is to create a new quality standard for local mid-value wines that clearly differentiates these wines from the premium product and introduce these new lower quality wines as distinct from premium BC VQA.

Analysis of grape acreage data indicates that as BC grape production increases, grape production may exceed market demand for premium wines. These grapes could be repurposed to produce wine for the mid-value segment.

A margin analysis shows that selling high cost or production premium wines at discounted prices lowers the contribution margin at the winery from \$4.00/litre to \$1.00/litre. If these same wineries were to use lower quality grapes produced specifically for the mid-value market their margins would increase from \$1.00 to \$1.82/litre. Increasing the vineyard yields for mid-value grapes from 3.0 to 4.5 tons/acre restores a profitable margin for grape growers, and further increases the supply of grapes targeted at the mid-value segment. Data modelling shows that those small wineries that choose to diversify their product mix to include mid-value wines could increase and improve their profit margins.

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