

MKF

MOTTO, KRYLA & FISHER
Wine Industry
Accountants and Consultants

WINE INDUSTRY

UPDATE

"Wine industry financial, business and tax ideas."

WHERE DO THE MARKETING DOLLARS GO?

Mike Fisher

With an ever increasing emphasis on wine marketing, MKF is often asked questions like, "How much do wineries spend on their marketing programs?" and, "Are there any guidelines?" These issues are of particular importance to those just entering the industry.

MKF separates marketing into three categories:

- Brand development and maintenance
- Selling
- Distribution

Brand development and maintenance include expenses related to implementing a winery's marketing plan such as:

- Promotion
- Hospitality and entertainment
- Advertising
- Public relations
- Travel costs incurred by the owner, sales manager or winemaker
- Payroll related to public relations and a portion of the sales manager
- Supplies, materials, marketing studies and consulting

Higher prices don't necessarily require higher marketing costs . . .

Selling expenses are those incurred in dealing directly with the distributors, the trade or consumers, to complete a sale. Examples of selling expenses are:

- Payroll and travel expense of sales reps
- Commissions



Dave Graves (left), Saintsbury; Mike Fisher, MKF and Dick Ward, Saintsbury, enjoy the fruits of marketing dollars effectively spent.

- Point of sale material
 - Distributor programs
 - Retail sales expenses
- Distribution expenses consist of:
- Freight
 - Bottled wine storage
 - Wine taxes and licenses
 - Order processing and administration
 - Compliance

The cost and effectiveness of any marketing plan is heavily influenced by several factors. When developing your marketing strategy, ask yourself the following:

How will the brand be developed and sold? Many successful wineries depend upon the personalities of the owners, whose involvement can be critically important. In most instances, the winemaker is the next most promotable figure, followed by

the marketing/sales staff. Non-exclusive sales representatives provide the least image building assistance.

How mature is the brand? The mature, successful winery needs to spend less to influence the market. However, continued brand maintenance is important; and, if expansion is contemplated, it requires an increased marketing commitment.

What is the long-range plan? The greater a winery's ultimate production, the greater the need for heavy marketing expenditures currently. In the best environment, production will increase with market demand, allowing you to maintain or increase case prices. In the worst environment, production exceeds sales, resulting in discounting and a detrimental impact on brand image.

What is the distribution mix? The closer to the consumer the wine enters the distribution channel, the higher the marketing costs. The two extremes are selling all production through the tasting room or mail order (single tier) vs. a national distributor (four tiers). At retail you sell bottles; at the national distributor level you sell pallets.

What is the pricing strategy? Higher prices allow the winery more dollars to spend on marketing. Pricing is a complicated issue, but as seen from the study mentioned below, higher prices don't necessarily require higher marketing costs.

There is no "right" or "average" amount to invest in marketing. Each situation has its own set of variables making generalizations difficult. Marketing plans require constant monitoring. Effectiveness is analyzed by dollars spent per case sold compared with the revenue per case.

Continued on back page

THE HIGH COST OF CABERNET



Vic Motto

In a previous MKF newsletter article, 'California Cabernet is Too Cheap' MKF research was cited concluding

that most well-made Cabernets must retail for about \$20 per bottle in order for a winery to make a normal profit. Here are the numbers:

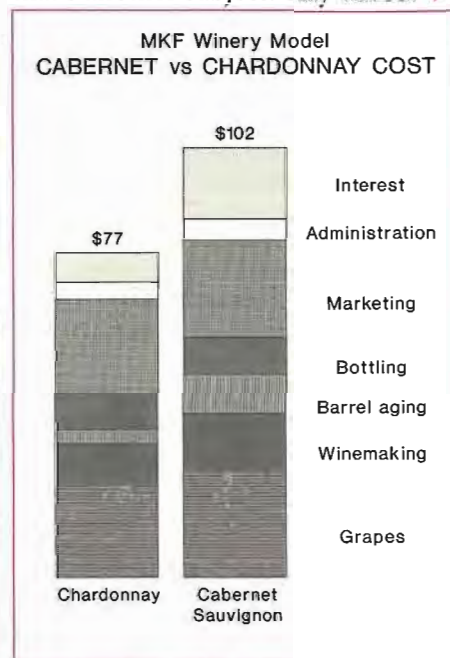
	CHARDONNAY	CABERNET
COST PER CASE:		
WINE:		
Grapes	\$22	\$25
Winemaking	10	14
Barrel aging	3	9
Bottling	9	9
Wine	44	57
MARKETING	22	23
ADMINISTRATION	4	5
INTEREST	7	17
WINERY COST (Chart)	77	102
INCOME TAXES	5	6
WINERY PROFIT	9	12
Winery F.O.B.	91	120
DISTRIBUTOR ADDS 33%	30	40
RETAILER ADDS 50%	60	80
Retail Price	\$181	\$240
BOTTLE PRICE	\$15	\$20

Chardonnay is shown for comparison because an interesting trend has been occurring. While Chardonnay has exploded in popularity and prices have increased, Cabernet prices have quietly and steadily surpassed Chardonnay. The value of California Cabernet is beginning to be recognized by many consumers and the cost to make and sell it is beginning to be understood by most wineries.

The chart shows a graphic comparison of the winery costs included in the above table. These costs are based on a 30,000 case MKF winery model and represents current costs for grapes, facilities, personnel and financing. At these costs and prices the winery makes a small profit. Of course with costs, 'your actual mile-

age may vary.' Wineries with lower costs should make higher profits. An older winery has lower facility costs, but should be making a return on the *value* of its facility. Wineries which grow grapes for less than market value are entitled to receive the grower's profit as well. Those with less debt and more equity deserve a return on that equity. And some family members deserve to be paid for their labor (more or less).

Obviously, cost is not the only consideration in pricing wine. But that's another subject. Stay tuned. ♦



HIRING A WINERY BOOKKEEPER

Carl Ebbeson

If you were to hire a bookkeeper tomorrow, what qualifications would you look for? Among applicants for this position you will typically find a broad range of experience and training. Many applicants will have experience in some facets of bookkeeping; others will have worked in businesses that function very differently from a winery.

A useful first step might be to examine the duties and responsibilities of the typical winery bookkeeper. The job description might consist of some or all of the following activities:

- Banking activities, which include cash deposits, cash flow man-

agement and monthly bank reconciliations

- Recording sales orders, preparing for shipping and preparing sales invoices
- Preparing vendor invoices for payment to insure that all discounts are taken and payments are made on time
- Preparing payroll either internally or through a payroll service. Also, ensuring that payroll tax deposits are made on time
- Maintaining the general ledger with the proper allocation of sales, cash receipts, cash disbursements and payables. Also, making necessary recurring and other journal entries
- Complying with the various federal and state filing requirements (payroll, sales, excise, business property taxes and state licenses) on a timely basis
- Preparing reports for lenders and insurers, which can include inventory, receivables and payables
- Reconciling inventory movements from the winery to the warehouse and finally to the customer
- Preparing management reports which may include financial statements, budget variations, sales reports, inventory reports, crush summaries, payables listing, and aged receivables
- Handling all other special projects and crises in a timely manner

These are important responsibilities and can have a significant effect on the success of your winery operation. An inadequately trained bookkeeper can be costly through inaccurate or less than timely reporting, job inefficiency or failure to record all transactions.

Before you hire, check references carefully. Ask specific questions, both of the applicant and his/her previous employers. If you are hiring a full-charge bookkeeper, a knowledge of bookkeeping principles is essential. Sometimes this can best be evaluated by administering a bookkeeping test. MKF offers assistance to our clients in evaluating and testing bookkeeper applicants, as well as in arranging training for newly hired or existing personnel.

It may be impossible to find someone with *all* of the right qualifications. If a new hire or an existing employee requires additional training, it is a worthwhile investment. ♦

EMPLOYEE BENEFITS

SHOULD YOUR WINERY HAVE A RETIREMENT PLAN?



Karen Kryla

In a recent salary survey (see box), we found surprisingly few wineries with retirement plans—less than 25%

of those producing 50,000 cases or less.

Qualified retirement plans can allow a vintner to shelter substantial sums on a tax-deferred basis. Not only is there a current tax deduction for the plan contributions, but the funds continue to grow with no current tax.

Retirement plans can also encourage the long-term loyalty of a valuable winemaker, sales manager or other key employee by means of a better benefit package ('golden handcuffs').

The gain in improved employee morale and loyalty may be worth the cost.

Qualified retirement plans allow an immediate tax deduction for the winery even though the employee-participants don't have to report income until retirement or distribution. Under certain circumstances, the employees may take advantage of favorable tax rules for reporting that income.

There are two basic types of retirement plans:

Defined benefit plans—Contributions to the plan are aimed at a specific benefit (generally a percentage of current salary) to be provided upon retirement. The amount of contribution is determined actuarially based on the ages of the participants, i.e., the older the employee, the larger the total contribution.

Defined contribution plans—Contributions are a stated amount rather than aimed at a specific retirement benefit and allocated to employees based on current compensation. Generally contributions may be up to 15% of compensation, with a maximum contribution per person of \$30,000.

The rules concerning who must be covered by the plan to meet non-discrimination rules and other rules for qualification are very complex and will vary greatly depending on the particular circumstances in each case. A general rule of thumb is that—a plan benefitting only a small percentage of employees or only highly-compensated employees may have difficulty in satisfying the qualification requirements.

Some employees may be omitted from coverage in the plan without

the discrimination rules kicking in:

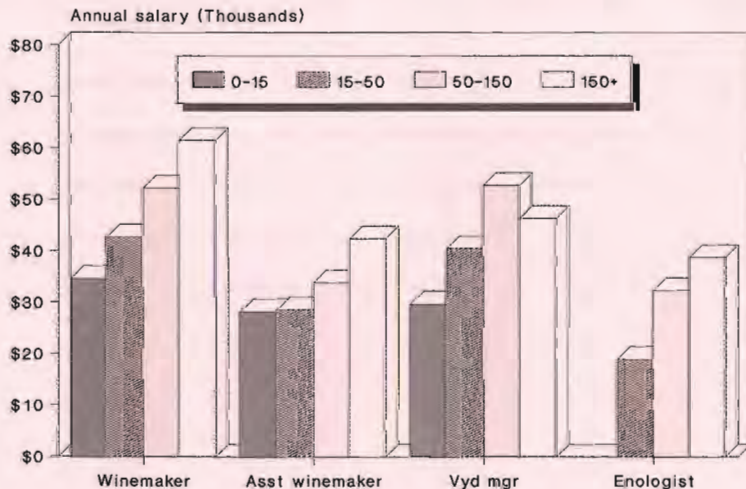
- certain employees covered by collective bargaining agreements;
- employees under 21;
- employees with less than 1 year of service; or
- seasonal or part-time employees with less than 1,000 hours of service in any 12-month period

The bottom line:

The decision to implement a retirement plan is often a good one. In many instances, the vintner will receive the lion's share of the contribution by virtue of either his relative age or compensation; and the gain in improved employee morale and loyalty will be worth the incremental costs to cover the other employees. ♦

Motto, Kryla & Fisher has recently assisted the *Practical Winery & Vineyard* (PWV) magazine in a salary survey of employees working in the premium wine industry. Unlike many salary surveys which ask employers for information, we went directly to the employees, using the PWV subscriber list and other sources. The survey included such questions as salary, position, benefits, size of winery, etc. The results of the survey appear in the March/April 1990 issue of PWV. Below is a graph of the average salary by job title for four winery capacity brackets.

Average Salary by Position
Grouped by Winery Size
Annual case production in 000's



Source: MKF/PWV Salary Survey

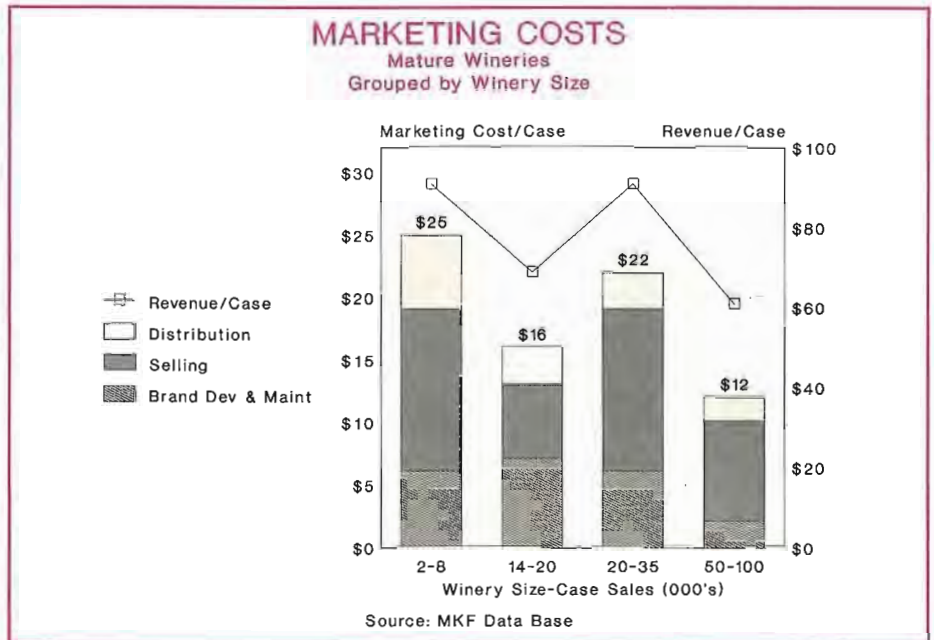
Marketing Dollars continued

From the MKF data base we prepared a study of our winery clients which represents a good general cross section of premium wineries. This group would be classified as "ultra" or "super" premium—high prices and low volume. This study included marketing costs broken into the three categories listed above, annual case sales and revenue per case. We also differentiated between start-up and mature wineries. Start-up wineries are those with current case sales measuring less than 50 per cent of their ultimate goals.

Our data may differ from general wine industry surveys. The main problem with these surveys is the lack of comparability among wineries due to individual winery maturity, size, selling prices, and consistency and accuracy of accounting and reporting standards.

For the MKF study, the consistency and accuracy of the accounting and reporting standards is not a problem because we serve as the accountants and consultants for all of the wineries involved.

We separated the wineries into groupings by ranges—revenue per case and winery size. With these ranges we prepared graphs using averages. In some instances there were gaps between ranges which made separation easy, e.g., no



winery had revenue per case between \$90-\$110 nor case sales between 35,000-50,000.

Our overall observations from this study are:

- Start-up costs are very high.
- Higher wine prices do not always require higher marketing costs.
- Lower prices *necessitate* lower marketing costs and require higher volume.
- Wineries falling in the size range of 10,000-20,000 cases may have lower marketing costs but have a

much lower revenue per case which may be a "catch 22"—they can't raise prices because they don't have the revenue to spend on marketing nor can they increase marketing expenses because they don't have the revenue, etc., etc.

- Possible support of our optimum capacity theory (see our December 1989 issue): The 20,000-35,000 case range commands much higher revenue per case than the 14,000-20,000 case range (\$91 vs. \$69), but the difference in marketing costs is only \$6 (\$22 vs. \$16).

Our conclusions regarding the survey and working with the industry are not surprising. Marketing costs are high during brand development and decline with product maturity. However, significant efforts must continue to maintain brand viability and must increase if expansion is considered. ♦

MOTTO, KRYLA & FISHER
Wine Industry
Accountants and Consultants
 999 Adams Street
 St. Helena, CA 94574
 (707) 963-9222

This publication is intended to provide accurate and authoritative information on the subject matter covered. The analysis of income tax laws and discussion of financial advice are based upon general knowledge of the wine industry. There is no implied application to a given set of facts. Any person contemplating actions based upon the information contained herein should seek appropriate professional services. © 1990 MKF

