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Covid-19 and the US Premium Wine Market, Part II: Building an E-Commerce Team 101

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Summary

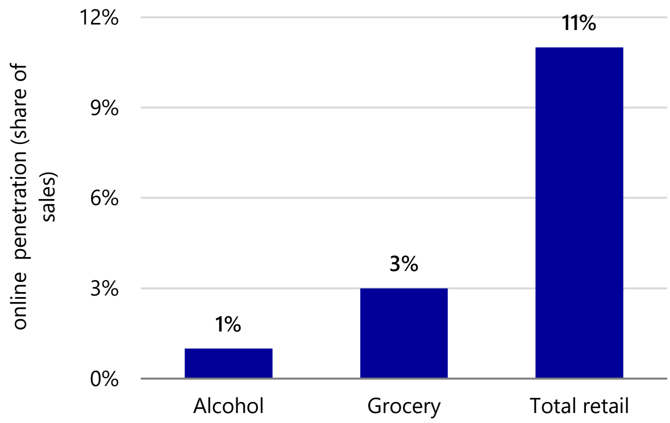
- **Building an e-commerce team**: Numerous wine industry executives have reached the conclusion that the recovery of the on-premise channel in the US will take years – as we argued in our last quarterly report – and agree with our conclusion that investing in e-commerce is becoming increasingly important. But once the decision to invest in e-commerce has been reached, they still face a myriad of pragmatic questions: What is the role of e-commerce within the organization? Should we buy or build a team? Who does the team report to? How are responsibilities divided between the e-commerce team, the sales team, and the marketing team? We explore these and other questions and try to provide some practical insights.
- **M&A**: The Covid-19 crisis appears to be slowing the pace of wine-related M&A deals in the market, but among the deals getting done, we note three trends to watch: 1) rising investments in wine e-commerce (even from spirits players), 2) spirits companies investing in champagne, and 3) European wineries investing in California.
- **Export trends**: Wine consumption is slowing in most major markets, due to the pandemic, and this is weighing on demand for wine imports. With a few exceptions, most major exporters have seen notable declines in exports during the first quarter of 2020, and for some, the pain may get worse before it gets better.
- **Currency trends**: The pandemic, coupled with political and regulatory changes, has created increased volatility in currencies, and there continues to be plenty of uncertainty looking forward.

No More Excuses For Delaying Your E-Commerce Investment

Before the current crisis, most decision-makers in the wine industry – and the beverage alcohol industry more generally – failed to proactively invest in their digital capabilities. Executives gave innovation and e-commerce plenty of lip service, but that talk rarely translated into additional personnel or bold acquisitions. Many large suppliers did not even have one dedicated e-commerce employee, let alone a stand-alone e-commerce team.

Then came Covid-19.

Figure 1: US e-commerce penetration by segment, 2019



Source: US Census, Rabobank 2020
*Alcohol excludes the direct-to-consumer (DTC) channel

Table 1: US alcohol e-commerce growth

Channel/Retailer/Platform	*April YOY growth*
Online grocery (Total US)	>250%
DTC wine*	340%
Instacart	>500%
Drizly	~700%
Wine.com	350%
City Hive	>1000%

Source: Interviews, company releases, Rabobank 2020
*Data from WineDirect for April and May 2020.
Note: Many of the above estimates were shared with Rabobank by the companies listed. The actual growth may vary significantly.

It was supposed to take years for the penetration of online alcohol sales to reach the levels we've seen during this pandemic. Indeed, the growth we are seeing in some channels is hard to believe (*see Table 1*). We should be clear: e-commerce sales will fade from their peak (sometime in early May, by our estimates), as social distancing measures are removed and fear of the pandemic wanes. But this crisis has shown wine and spirits companies just how unprepared they were to manage the e-commerce channel as it rose above 1% or 2% of their revenues. Covid-19 is serving as a deeply unfortunate wake-up call, but a wake-up call nonetheless.

Enlightened to the importance and urgency of having strong digital capabilities, executives now have to decide what their e-commerce investment will look like and what they should be looking to achieve with that investment. While we cannot give exact instructions for the path forward, we can point decision-makers in the right direction.

> *"A common mentality that you would see from a finance-centric team member may be, 'What's the incrementality if we invest in this area?' … but it's really about revenue protection. If we don't invest in these capabilities – if we're not thinking about how the consumer is going to be shopping in the future – we may not be able to protect that revenue down the road as the consumer shifts."*
>
> *- Wayne Duan, VP of E-Commerce, Constellation Brands*

Your E-Commerce Team as an Agent of Change, Not Just a New Sales Department

Companies like Nike have the resources to hire a separate digital transformation and technology team in addition to an e-commerce team. Few, if any, wineries have that luxury. It is important, therefore, for leaders in the wine industry to empower their e-commerce team with a broader mandate of digital transformation.

> *"Not only is it about the external consumer, but about internal consumers too… it is how do you transform the enterprise to think very differently?... How do we operate and transform the business internally to be faster, better, more data driven?"*
>
> *- Ratnakar Lavu, Global Chief Digital Information Officer, Nike*

The initial investment in your e-commerce team should not be based solely on the current value of your company's online sales. As with any organizational transformation, building out digital capabilities requires an initial surge of resources. An e-commerce team needs the headcount and freedom to create a digital strategy, to onboard the technology, insights, and skillsets necessary to execute that strategy, to build relationships with relevant stakeholders (both internal and external), and more. These are core responsibilities for an e-commerce team (more on this in a bit). For larger wineries and spirits companies, one or two full-time employees will not be able do it on their own.

Do not start panicking over budgets just yet. Our use of the term “surge” was intentional. After two or three years, the e-commerce team should have built the necessary infrastructure and delivered the necessary training to allow the sales and marketing teams to take over many of the day-to-day digital operations. As digital sales continue to grow, existing structures in your organization are able to absorb that demand, which should reduce the need for additional headcount in the future

Can You Buy an E-Commerce Team?

The short answer is yes. Though it is more common in technology than in food and beverage companies, many companies have chosen to *buy* rather than *build* their digital and e-commerce capabilities. McDonald’s bought Apprente to found their technology team, McD Tech Labs. Walmart bought Jet.com as way to accelerate their capabilities to compete with Amazon. AB InBev has acquired numerous technology platforms, and RNDC’s acquisition of LibDib became the foundation of eRNDC.

The most recent example is Constellation Brands’ acquisition of Empathy Wines. According to their press release, the purpose of the acquisition was to leverage “their rich consumer insights and analytics” and “high-performing digital technologies to build DTC and digital capabilities that Constellation intends to scale across its wine and spirits brands.”

Acquiring a data-driven, e-commerce-focused company would bring on the engineers, data scientists, and e-commerce and marketing skillsets needed to jumpstart a winery’s digital transformation. An acquisition will not be easy to execute effectively, but it can shorten a multi-year transformation to a matter of months. Such an acquisition would not be a one-way street either. The target company would also be able to take advantage of the production and distribution capabilities of the winery to unlock the scale and efficiency necessary to see profitable long-term growth of their business.

Who Does the E-Commerce Team Report To?

Wineries frequently ask: “What is the ideal e-commerce team structure? Should it have a sales or marketing function?” We find that the most successful e-commerce teams are typically housed in the sales department, with the e-commerce team split into two subgroups that work closely with one another: direct-to-consumer (DTC) and three-tier e-commerce.

Regardless of whether the e-commerce team reports to the head of sales, the director of trade marketing, the COO, or the CMO, it is an agent of company-wide transformation. This requires the team to work across organizational silos. So in some ways, it doesn’t really matter where the team sits. What matters is that they have the resources and freedom to fulfill their mandate.

On that note, another common question we receive is: “What is the best way to rate success?” That is a tough one. If sales are only one facet of an e-commerce team’s responsibilities, how do you measure success? The short answer is that you can’t. Senior leadership needs to empower the e-commerce team to do what is needed – even if success is not easily captured in key performance indicators (KPIs).

The Steps to Building a Great E-Commerce Operation

So… your company has finally decided to invest in an e-commerce team – either building the team organically or through an acquisition. What happens next? Here are the four steps that we believe a well-capitalized e-commerce team must take:

Step 1: Map the Market, Get the Data

The online alcohol ecosystem is very complex and difficult to measure (for details, read our report The 2020 Alcohol E-Commerce Playbook). The first part of this process is identifying which channels are mostly likely to be successful for your brands, both during the pandemic and once it has come to an end. It is a period in which the e-commerce team has to build relationships with key individuals within each e-commerce platform and identify how to support their brands within that environment (i.e. how to influence the consumer on their path to purchase) and how to enhance their relationship with that platform over time.

The second part of this process comprises identifying data sources for measuring sales within each of these platforms and, if possible, data on how and why consumers shop on the platform. This is essential for measuring progress, setting KPIs, and monitoring changes in where or how consumers shop online. Brands need to close the information asymmetry gap. Otherwise, they are not able to make informed decisions with regards to their e-commerce strategy, nor accurately advise their retail and distributor partners.

Step 2: Onboard the Tech, Build the Infrastructure

The e-commerce team has to decide which technologies are needed to realize their digital ambitions. That could include anything from building a platform for ingesting e-commerce sales data to identifying the best platform for their DTC business.

For many brands, content management is the greatest challenge they face in the e-commerce channel. Last year, the head of one large e-commerce team told Rabobank that if a brand wants to update content on a grocery retailer's website, "It is a multi-month project every single time." Tools like Salsify and Syndigo can help companies more effectively and efficiently manage their content as it appears on retailer websites, as well as the content that appears on distributors' business-to-business e-commerce platforms, like eRNDC and SGProof.

It can take months to onboard these kinds of technologies and months to learn how best to deploy them in your business. Unfortunately, the e-commerce team can't press 'pause' on the rest their responsibilities, so the more support they get, the more able they are to transform *and* perform simultaneously.

Step 3: Educate Everyone, Internally and Externally

The e-commerce team has to raise the awareness of the e-commerce channel across their organization. Marketing teams, sales teams, senior management, distributors, and retailers often need help in understanding how to support the e-commerce channel. Here are a couple examples:

Last year, one e-commerce manager told Rabobank that their team would never meet with a retailer partner unless the account manager could attend. Their goal: familiarize members of their sales organization with what is required to be successful in e-commerce.

Costco's 2019 launch of online alcohol sales is a good example of external education. Costco is one of the largest – if not *the* largest – wine retailers in the country. In 2019, 4% of Costco's sales were executed online, but it was not until Q4 2019 that they started offering the alcohol category online. While retailers recognize the importance of the alcohol category in driving traffic and margins in-store, they need to be reminded that it plays a similar role in an e-commerce environment. Suppliers sharing their knowledge and focus no doubt played an important role in getting Costco to pull the trigger on their online alcohol offerings.

Step 4: Delegate Most Day-To-Day Digital Operations

As we mentioned earlier, many of the day-to-day responsibilities of managing a winery's e-commerce business should be taken over by existing structures within the organization. This is why internal education is so important. Brands, for example, need to create digital content tailored to each retailer's unique specifications. The e-commerce team should not be responsible for creating that content. That is the responsibility of the brand team. Also, given that the majority of sales are picked from the shelf, the account manager for a major grocery retailer should probably coordinate purchasing decisions with both the online and in-store teams of that retailer.

This transition can take a couple of years, but it is necessary to give scale to your e-commerce operations. Some people refer to this process as building out your organization's 'digital muscles' or making digital part of your 'DNA.' Without support from the broader organization, your e-commerce operation will not be able to unlock its true potential.

What About Innovation?

Building these capabilities starts with (1) investing in the knowledge necessary to create a strategy, (2) building the infrastructure to support that strategy, (3) educating and developing the skills of the individuals and teams needed to execute that strategy, and (4) empowering individuals and teams to take responsibility for the aspects of their business that intersect with the digital environment.

We find many industry leaders are easily distracted by shinier, sexier topics like social commerce and forget that they first have to build out a robust infrastructure to identify and execute more innovative ideas. We feel that most companies will find the most benefit from investing energy and resources into 'boring' tasks, like mapping out the industry and educating your account managers about how to support the e-commerce channel.

Once all these steps are completed, however, you can really start having fun.

Innovation: The Final Level

The e-commerce team should do more than focus on growing e-commerce sales. They should explore how the data, intelligence, and brand-building opportunities in the digital world can enhance sales through more traditional channels and vice-versa. Data is core to the success of Facebook, Google, and Amazon, but it is the digital environment that has enabled these tech giants to access the data that drives so much of their decision-making.

A great example comes from the DTC wine channel. Whether through tasting rooms, clubs, or e-commerce, wineries' DTC programs offer extremely valuable consumer data (emails and associated social media accounts, wine preferences, travel behavior, home addresses, etc.). This data can be used to support a winery's brands sold through traditional retail distribution. For example, if a winery decides to launch a brand into a new geography, they could use the email addresses from their tasting room visitors to build a look-alike audience and use geofencing to target that audience with social media ads to drive sales in that new market.

A robust DTC business also offers wineries a focus group of core wine consumers who, instead of answering hypothetical questions about their preferences, reveal their true preferences through their purchasing decisions. We heard one e-commerce professional speculate that the DTC channel would lead to the "death of the focus group." This channel can be used a laboratory for product innovation and learning more about how consumers interact with wine brands in a digital environment. Besides shortening and strengthening the innovation pipeline, it is also a very good tool for building knowledge and narratives that will help give brands an advantage over their competitors in conversations with retailers.

A Guiding Principal

While e-commerce is changing some aspects of how wineries do business, it should not distract companies from their true raison d'être: their consumer. A laser focus on the consumer (what they need, why they need it, how they want to get it) is both the purpose for creating an e-commerce team and the guiding principal at the center of a robust e-commerce strategy. The move towards e-commerce can be intimidating, but it does not require an advanced degree in computer science to build a great e-commerce team. If you never stop being a consumer-focused company, you should do just fine.

M&A Trends in Wine

Given the disruption from the global pandemic, M&A trends have been fairly subdued in the first half of 2020, though interesting deals continue to be made (e.g. the Foley Family Wines acquisition of Ferrari-Carano Vineyards and Winery or Precept Wine's acquisition of Pampelonne). Among the various deals that have been done in the wine space, we see the emergence of some important strategic trends.

E-Commerce Investments Accelerate

Beverage companies in general, and wine companies in particular, are waking up to the fact that they need to invest more heavily in e-commerce. For example, Constellation Brands recently announced their acquisition of Empathy Wines, the e-commerce-centric wine company cofounded by entrepreneur Gary Vaynerchuk. Constellation has been one of the more forward-thinking companies in terms of investing in e-commerce, and CEO Bill Newlands noted that the acquisition would "expedite their ability to more deeply connect with their consumers, and build the strongest direct-to-consumer and digital commerce business in the category."

It's also interesting to note that Campari – the Italian spirits company – acquired a 49% stake in wine e-commerce platform Tannico for EUR 23.4m in June. This deal follows Pernod Ricard's acquisitions of wine e-commerce platforms Uvinum and Bodeboca in 2018, and though a smaller piece of Pernod's operations, wine remains meaningful. The Campari acquisition is perhaps most notable for the fact that, in recent years, the company has divested nearly all of its wine assets. Given the greater limitations that spirits face in e-commerce, spirits companies appear to be investing in wine e-commerce platforms in order to learn more about consumers and consumer behavior in this space.

Spirits Companies Invest in Champagne

The first half of 2020 saw Campari announce plans to take an 80% stake in Champagne Lallier for EUR 21.8m and Rémy Cointreau announce plans to take a majority stake in Champagne J. de Telmont. Spirits companies have been actively reducing their investments in the wine industry in recent years, but often note that sparkling wine – and particularly champagne – are more similar to spirits than the rest of the wine category. Given the challenges facing the champagne category in the current pandemic, we would not be surprised to see additional activity in this space.

European Wineries Investing in California

In March, Louis Roederer announced the acquisition of celebrated Napa Valley winery, Diamond Creek Vineyards. The deal adds to Roederer's impressive portfolio of California wineries but also highlights a broader trend. We continue to hear more European wineries express renewed interest in acquiring California wineries, both to strengthen their distribution in this market and as a means to internalize some of the DTC strategies that California wineries use and take them back to their home markets. Given the prolonged challenges in the on premise that we discussed in the last quarterly report and the challenges this will create for many premium California wineries, interested European buyers will likely begin to find more attractive opportunities in the coming months.

Export Trends of Major Producers

Trade agreements and trade 'disagreements' (think US and China, US and EU) had a big influence on the 2019 export landscape, but in many ways, these have taken a back seat to Covid-19 in 2020.

While we do not underplay the importance of trade agreements, Covid-19 further complicates the outlook for 2020. Already slowing Chinese import demand has been magnified under Covid-19, with year-on-year total import volumes from all suppliers for the period January to April 2020 down by over a quarter. Brexit continues to retain the potential to disrupt trade at the back end of 2020, and while currently playing second fiddle to Covid-19, a hard Brexit would extend recovery from the current recession in the UK.

With the timeline of a full and sustained reopening of foodservice channels across many countries still uncertain and dependent on a health recovery followed by an economic one, visibility on future consumer demand remains problematic. These factors will bring an air of caution from importers and distributors across the next two quarters of 2020.

France

French wine exports during the first five months of the year reached EUR 3bn, or 22% less than the same period of the previous year. Volumes were down by around 13%, pointing to a 10% decline in average prices. In May alone, sales remained sluggish, with value down by 36% and volumes down by 22%. For the five-month period, sales to the US were down by 30% and sales to China were down by just over 40% in value terms. The UK also saw a weak performance, with exports for the five months down by 29%.

Spain

During the first four months of 2020, Spanish wine exports declined by 6.5% in value, to EUR 795.14m, and by 11.5% in volume terms, to 625.2m liters. Bottled wines saw a decline in both volume and value. Bulk wine exports were down 8.8% in value and 16% in volume, showing an increase in the average price per liter. Exports to Canada, Sweden, and Norway increased, but they couldn't offset lower sales to countries such as Russia, China, Japan, Italy, and France. The trend in April was worse than in the previous three months, due to the full effect of Covid-19 in that month. It is worth highlighting the good performance of bag-in-box wines (+3.7% in value and +11.2% in volume), where the already positive trend of previous months accelerated. Exports of Spanish sparkling cava were down by 6.6% in value and 4.7% in volume.

Italy

When compared to Q1 2019, Italian wine exports in Q1 2020 increased by 5.1% in value, to EUR 1.509bn, and 5.4% in volume, to 515.7m liters. The numbers reflect a strong January (+13% in value), as sales were virtually stagnant in February and March at +1% and +2%, respectively. It is worth noting that the full impact of the Covid-19 crisis will become visible from April onwards. Among products, bottled still wine saw a 5.8% increase in value and 1.7% increase in volume, with a 4% rise in average price per liter. Bulk wines were up by 5.5% in value and 6.2% in volume, and sparkling sales were up by 2.8% in value and 17% in volume, pointing to a clear decline in the average price per liter. Sales to China were down by roughly 50% during the period. Lower sales to Switzerland and the UK were more than offset by higher demand from the US, Germany, Canada, Benelux, and Scandinavia, although the numbers are unlikely to be sustained in the near future.

US

In the first two months of 2020, US wine exports declined by 11% in volume and value. Bottled wine exports declined by 12% in volume and value, respectively, during the same period. The numbers reflect a significant contraction in sales to Europe (-28%), China (-66%), Japan (-19%), and Hong Kong (-26%). Overall bulk wine sales also contracted, despite an increase in sales to some markets, such as the EU and Canada, but these were not enough to offset a significant decline in exports to the UK (-15%).

Table 2: Change in wine exports for selected countries

Country	*Volume change (%)*	*Value change* (%)*	*Period of measure*
France	-13.0	-22.0	Jan-May 20
Spain	-11.5	-6.5	Jan-April 20
Italy	+5.4	+5.1	Jan-Mar 20
US	-11.0	-11.0	Jan-Feb 20
Argentina	+59.4	-0.9	Jan 20-Apr 20
Chile	-4.4	-9.8	Jun 19-May 20
South Africa	-19.8	n.a.	Jun 19-Jul 20
Australia	+11.0	+3.0	Apr 19-Mar 20
New Zealand	+6.0	+6.0	Jun 19-May 20

* Value changes in local currencies, Argentina and Chile in USD
Source: ISTAT, I numeri del vino, OEMV, lekiosque.finances.gouv.fr, Wine Australia, SAWIS, ODEPA, Stats NZ, Observatorio Vitivinícola Argentino, the Gomberg Fredrikson Report, Rabobank 2020

Argentina

Argentine wine exports in the four months of 2020 saw a massive 59.4% increase in volume, with value declining by 1% when compared to the same period of 2019. Both bulk wine and packaged wine exports rose during the period (up 167.6% and 1.1%, respectively), and both saw declines in average prices, but the outsized growth of bulk wine exports played a key role in the difference in growth rates between volumes and values.

Chile

In the 12 months to May 2020, Chilean wine exports decreased by 4.4% YOY in volume terms and by 9.8% in value (USD). The decline in the average price per liter is a combination of lower prices for virtually all products. Bulk wine suffered the largest decline in price per liter, with a 19% drop in export volumes combined with a sharp 33% reduction in export value.

For the first four months of 2020, bulk exports to China declined 66% by volume and 73% by value, as Covid-19 continued to disrupt that market. Sales to the UK rose 2% by volume, and total value was unchanged but declined slightly for bulk exports (-3.8%). Exports to the US rose by 58% in volume, led by an increase in sparkling exports (+42m liters).

South Africa

South African wine export volumes declined by 19.8% in the 12 months to July 2020. Bulk wine exports were down 21%, and bottled wine exports were down 18%.

Exports to the UK, the largest buyer of South African wine, declined 22% by volume for bulk wine and 21% for bottled wine sales. Exports to Germany, the second-largest destination, also declined. Continuing recent trends, countries within Africa were the main countries buying more South African wine year on year (Kenya, Tanzania, and Nigeria) – but volumes were not enough to offset overall reductions. Among the top ten export destinations (accounting for 80% of export by volume), total volumes were down by 18.8% YOY.

Australia

In the 12 months to March 2020, the value of Australian exports rose by 11% YOY, with volumes declining by 11%. Underlying this volume change was a focus on more premium packaged wine exports, which supported a lift in price per liter to around AUD 3.95 (FOB) – the highest value for year end March since 2005. Bulk wine exports declined by 9% in value and 14% in volume for the period.

At around 44% of total sales value but only around 18% of volume, China remains Australia's highest value and most important export market. Sales to China increased by 13% in value, despite an 11% decline in volumes. Subsequently, average price per liter rose by around 30%. Exports to the US declined by 2% in value and 13% in volume, with a focus on premium segments and less bulk wine pushing up the average price per liter to the US. The UK remains the largest market for Australian wine in volume terms, with sales to this market dropping 10% by value and 9% by volume.

We expect to see a continued deceleration in exports across the next quarter, reflecting the impact of the coronavirus in Australia's three largest markets, the US, the UK, and China (67% of export volumes and value for the year ending in March).

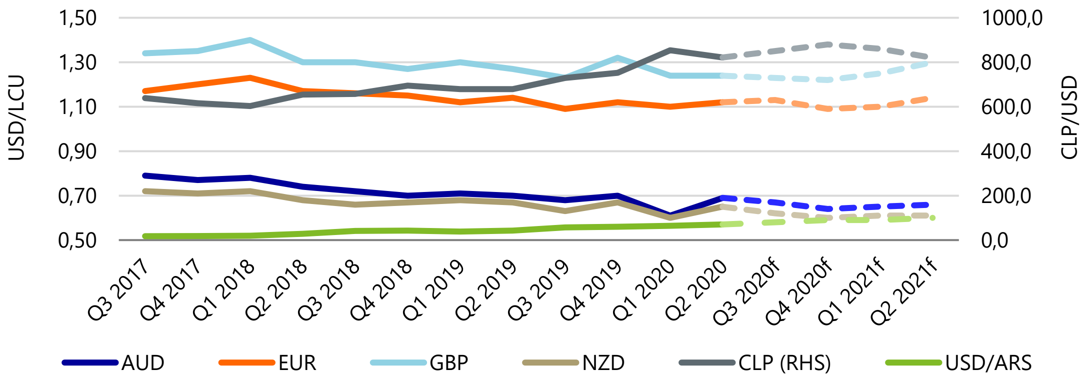
New Zealand

Despite the Covid-19 environment across late Q1 and into Q2 2020, New Zealand wine exports rose by 6% for both volume and value (local currency), when compared to the previous year in the 12 months to May 2020. For volume, exports rose by 16% YOY, with packed exports dropping slightly by 1%. Exports to the US, the UK, and Australia (which collectively account for around 78% of total volume) rose by 8%, 1%, and 8%, respectively. Of the total volume exported, sauvignon blanc was 248.5m liters (up 8% YOY and 88% of total exports). In the month of May, shipments of the 2020 vintage sauvignon blanc commenced, with an expected increase in 2020 sauvignon blanc wine of around 8%.

Currency Outlook

For most currency pairs, quarterly data fails to capture the huge volatility in prices in recent months. Emerging market currencies were battered in March, but most have staged decent recoveries vs. the safe haven USD, which reflects the broad-based bounceback in risk appetite. There are exception to this. The Argentine peso remains under significant pressure, as the government attempts to restructure debt and investors are forced to continue waiting for structural reforms amid an extended lockdown (*see Figure 2*). In the UK, politics is also on the agenda in the shape of ongoing talks between the EU and the UK on the terms of a Brexit trade deal. If the UK walks away without an agreement, the British pound will suffer a setback. The Australian dollar has been a fairly reliable litmus test of investor appetite in recent months, with the country's relative success in dealing with Covid-19 also supportive. That said, the relationship between Canberra and Beijing has deteriorated, and this may impact exports of some Australian goods. (There have been whispers that wine could be affected.) New Zealand has all but wiped out Covid-19, but the tight lockdown and border closures have come with heavy costs, particularly to tourism. As a result, the economy is set to pay a high price, which could leave the New Zealand dollar vulnerable.

Figure 2: Wine currency movements and forecasts, Q3 2017-Q2 2021f



Source: Bloomberg, Rabobank 2020

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