STRATEGIC DILEMMAS OF A SMALL MARKET PLAYER: THE CANADIAN WINE INDUSTRY

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Abstract

This paper undertakes an analysis of the strategic situation of the Canadian wine industry. A very small player by world standards, Canadian wineries face intense and intensifying competition within the domestic market. The demand side of this market is dominated by a small number of large provincial monopoly retailers. The supply side comprises five substantial firms that account for ninety percent of total wine production and a large number of very small wineries. The Canadian competitive environment is characterized by strong historical reputations of (and consumer preferences for) Old World wines, economies of scale and technology associated with New World wines, (at best) stable per capita wine consumption patterns, rapid increases in both the number of domestic wineries and land under viticulture, and an inexorable shift within production to higher quality product. Accordingly, this paper advocates that the Canadian industry will need to accord a higher priority to exporting so as to find a destination for its increasing capacity, to reduce its vulnerability to domestic monopolistic clients, and to obtain yet greater credibility domestically. Currently, the value of imports of wine to Canada is one hundred times the value of exports. Hence, augmenting wine exports would be a significant change in strategic direction for the industry and would be especially difficult for the large number of small Canadian winery businesses. Ways of meeting the associated challenges are presented.

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Introduction

> *"The Canadian wine industry is emerging as a small, internationally-recognized cool-climate player, garnering an impressive list of awards and praise from many of the world's most influential wine critics."*
>
> (Agriculture and Agri-Food Canada 2002a: page 15).

'Twas not always so. During the 60's and 70's Canada established a deservedly lamentable domestic and international reputation as a producer of infamous "pop" wines based on native grapes. In the 1970's, beginning with Donald Ziraldo's pioneering efforts to grow vinifera varieties, Canada's approach to winemaking has undergone a revolution. More recently, the quality of some Canadian wines has become increasingly recognized, recognition often traced to the success of a 1989 Inniskillin Vidal Icewine at the 1991 Vinexpo in Bordeaux (Aspler 2000; Hochstein 2000). In particular, Canadian producers are devoting considerable efforts to the development of cool-climate oenology.

Canada, however, as a relatively new and small international wine-producing nation, faces some considerable challenges. On the one hand, many New World producers have employed technology and economies of scale to great advantage. Old World countries, on the other hand, retain their traditional reputations and enjoy the benefits of EU, national, and local sustenance. Moreover the structure of the Canadian industry and the nature of the domestic market leave many Canadian winemakers in a vulnerable position. This paper undertakes an analysis of the domestic and international competitive situation of producers in the emerging Canadian wine industry. Specifically, this study documents the nature of the domestic wine market, situates the Canadian competitive position within the international marketplace, identifies alternative strategies available to Canadian producers, and argues that, difficult though it may be, Canadian producers need to consider exporting as a higher priority.

Exporting is increasingly being recognized as important, both to individual firms and to national interests. D'Souza and McDougall (1989) avow that exporting is a key variable with respect to both the survival and growth of small firms. Westhead, Wright and Ucbasaran (2001, p. 334)) state: "the ability of a firm to export … is increasingly regarded as an important measure of competitive performance at a national level as well as a regional level."

According to Statistics Canada (2001), wine was Canada's largest agri-food import in 1999, 2000, and 2001 ($650 million; $732 million; $900 million; respectively (Statistics Canada, 2002a)). However, according to Statistics Canada (2002b) Canada exported less than $10 million in 2001. Because exports of high-margin goods and services bestow numerous benefits to both the firm and country from which they originate many governments seek to encourage exporting. However, exporting is simply not a priority for the Canadian wine industry: this paper examines why this is so.

If exporting is, indeed, essential to the vitality of both the firm and the nation, the Canadian wine industry faces a significant challenge -- and opportunity! To the extent that Canada is able to export more and to use domestic wine to substitute for imports, there is considerable

prospect to enhance Canada's balance of payments position, thereby furthering goals of national economic prosperity. This paper therefore examines the structure of the Canadian wine industry and identifies challenges it faces. The paper begins with a description of the Canadian wine industry in the context of the global market for wine. This is followed by a discussion of the theory and literature that relate to exporting by small- and medium-sized businesses in general and the wine industry in particular. On the basis of these discussions, key challenges faced by Canadian wineries are presented and discussed. A description of a fundamental dilemma faced by Canadian wine entrepreneurs follows. The penultimate section of the paper discusses strategic alternatives that might be adopted by Canadian winemakers. The paper concludes with a discussion of the issues, recommendations, and suggestions for future research.

Context for the Work: The Canadian Wine Industry

An important element of the transition to higher quality wines was the 1988 introduction of the Vintners' Quality Alliance (VQA) designation that governs the use of geographic and varietal designations, grape types and viticulture, and winemaking practices. Since then, producers have gradually but inexorably shifted their plantings to comply with VQA standards. The primary challenge identified by Canadian winemakers is to increase their domestic market share. This problem is witnessed, for example, by the fact that Ontario (the most populous province in Canada and the location of the majority of Canadian wineries) wineries hold only a 29 percent share of Ontario wine sales (Ross, 2003). This imperative is viewed by those in the industry as a much higher priority than that of building a stronger international presence through export sales. This section of the paper describes the Canadian industry and issues that face the industry both in its Canadian home market and in international wine markets.

The International Setting: Export Markets

In assessing the strategic challenges facing Canadian wine producers in exporting, it is essential to examine some of the key recent developments in those international markets. In international terms, Canada is a very small player, producing approximately 0.13 percent of the total world wine production in 1998, an amount that compares with that of Algeria or Tunisia (based on data presented in Johnson and Robinson, 2001, p. 10).

As noted earlier, wine imports far exceed wine exports for Canada. While export growth has stalled at about $10 million since 1997, exports of related products (such as cider, fruit wines, perry, mead and hard lemonade) have increased from $10.7 million in 1998 to $80.2 million in 2000 (Agriculture and Agri-Food Canada 2002a). These increases in exports of related products beg the question of why exports of wine remain stagnant.

Until early in 2001, Canada's primary wine export, Icewine, had been barred from the EU (Tromans 2000) and, until recently, the EU also limited access of Canadian table wines to 100,000 hectolitres. These restrictions have now been dropped for those Canadian wines that meet the same winemaking standards as EU wines. Both Ontario and BC are mandated to certify table wines and Icewines for EU access (Agriculture and Agri-Food Canada 2002a; Agriculture and Agri-Food Canada 2002b). However, hurdles continue to limit access to the EU market because of production and labeling entry regulations.

As Johnson and Robinson (2001, p. 10) note, "the general trend has been for the major wine-producing countries to be drinking less while some notable importers … are drinking more". On a per capita basis, Canada consumes less than most other developed countries at 8.28 litres per person. By comparison, France still consumes 61 litres per person and Australia almost 20 (19.89) litres per person. Notably, the United States consumes less than Canada at 7.88 litres per capita (Johnson and Robinson 2001). Overall, the world still produces more wine than is consumed.

One of the important trends in the international scene is consolidation among major players (Hochstein 2000b). Consolidation has taken a number of forms including mergers, acquisitions, and strategic partnerships. Alcoholic beverage (spirits and beer) companies have been especially active in acquiring wineries around the world (Goldman 2000). Such firms have developed effective distribution channels for their traditional products and recognized that distribution channels for wine are largely the same as those for beer and spirits. Hughes (2002) has also identified partnerships as a form of consolidation that has been increasingly used to compete internationally.

From a wider perspective, the wine business is inherently international. Global wine markets are becoming increasingly competitive: for example, Australia and the US have both doubled their exports to Canada between 1995 and 2000 (Agriculture and Agri-Food Canada, 2002a). Given the Canadian setting, it would seem that Canadian vintners must explore export markets if they wish to reduce their vulnerability to the combination of a single customer and intensifying domestic competition. Moreover, exporting provides a means by which Canadian producers might further enhance their domestic reputations. However, the development of export markets is not straightforward for small and medium-sized enterprises.

The Canadian Industry

Data from Agriculture and Agri-Food Canada (2002a) show that the total Canadian wine market amounts to about $1,140 ($Cdn) million. Of this, imported wine accounts for a 65% share, leaving approximately 35% for domestic producers. Canada imports primarily from France (about 33% of imports), the US (19.5% of imports) and Italy (16.8% of imports). Canadian wine exports are minimal, averaging between $6 to $10 million annually. With about 7,500 hectares of vineyards, Canada is a small producer compared with the EU which has 3.5 million hectares, of which 2.5 million are in France (Agriculture and Agri-Food Canada 2002a)).

Canada's production potential is limited by climactic conditions; however several cool-climate varieties have thrived in the micro-climate regions in which the industry is centred. Within Canada, wine is produced in four zones where microclimates provide respite from harsh winters (Canadian Vintners Association, 2002). The province of Ontario produces about 80% of the country's wine in three designated viticulture areas in the southern regions of the province (Niagara Peninsula, Lake Erie North Shore and Pelee Island). Most of the remainder (18%) is produced primarily in the Okanogan Valley in the province of British Columbia. The Provinces of Quebec and Nova Scotia contribute a small amount of additional production (Canadian Vintners Association, 2002). Canada's primary export product, Icewine, is one very positive result of the relatively harsh climate. Canada's Icewine total sales in 1998 were over $30 million. This ranks Canada among countries such as Austria and Germany as a leader among the world's producers of Icewine. Icewine has

also become Canada's major success internationally, with exports going primarily to Asia (Agriculture and Agri-Food Canada 2002a).

There are about 170 wineries across Canada (Ontario has more than 90 of these (Getz, 2002), with a majority on the Niagara Peninsula). Yet, wine making in Canada is relatively concentrated. The leading five firms account for close to 90% of total wine production (Agriculture and Agri-Food Canada 2002a). Two particularly large wine companies have emerged: Vincor and Andrés Wines.

With annual sales of more than $376 million (for the year ending March 31,2002), Vincor ranks fourth among North American wineries in terms of volume and 22nd internationally in terms of revenues. Vincor owns nine Canadian wineries (including Jackson-Triggs and Inniskillin). Vincor accounts for about 25% of all wine sold in Canada making it the Canadian market leader. Vincor's success can be attributed to three key factors: ownership of top wine brands; control of much of its own distribution network; and a series of strategic US and international acquisitions (e.g., Hogue and R.H. Phillips (Lechmere, 2002)). It owns 165 Wine Rack stores in Canada in which it can place its 270 brands directly before the consumer and, through its acquisitions Vincor obtained an extensive distribution network within the US.

Andrés Wines, which recorded sales of $139 million for the year ended March 31, 2002, operates wineries in British Columbia, Ontario and Nova Scotia. Andrés bi-focal strategy appears to be focused on domestic marketing of high-end wines complemented by mainstay popular priced products (Hochtaler, Domaine D'Or). Andrés also owns Vineyard/The Wine Shoppe, a wine retailer in Ontario with more than 100 stores and produces and markets wine kit products.

Vincor and Andrés together account for about 75% of the Canadian wine sold through provincial liquor board outlets in Ontario (Agriculture and Agri-Food Canada 2002a). The third largest winery, Magnotta (annual sales of $18 million) manufactures and sells grape wine, fruit wines, beer, juice, and related products primarily from seven company-owned retail outlets in Ontario. Most of the remaining establishments are comprised of much smaller "estate" wineries where grapes are cultivated in vineyards owned by the winery.

The implications of the existence of only two large players and many small players are considerable. By international standards, Canada has few wineries with the capacity to be medium-to-large players by international standards. Vincor has internationalized through foreign direct investment, buying wineries in both the United States and Australia (Getz 2002). These larger companies can take advantage of economies of scale in the production of lower-priced wines, while smaller operations face relatively greater challenges in this market. However, many wineries have drawn effectively on wine tourism as one means of enhancing sales.

Key to understanding the Canadian wine market is an awareness of the distribution system for wine and other alcoholic beverages. Given that Canada is such a large country geographically, access to distribution systems is critical for wineries that wish to pursue growth domestically. However, the sale of alcoholic beverages in Canada is largely controlled by provincial monopolies. (Exceptions are the province of Alberta, where wine distribution has been privatized, and the Province of Quebec where wine bottled in the province can be sold in grocery stores. In the latter case, this has led to establishment of firms that import wine in bulk and bottle it for Quebec resale.) Consequently, domestic wine

prices carry heavy mark ups set by the monopoly, as well as substantial excise and sales taxes. Generally speaking, therefore, producers must deal with provincial monopolies to get their wines distributed and sold. On the other hand, these monopolies are large buyers.

The most important of these government monopolies is the Liquor Control Board of Ontario (LCBO). The LCBO is among the largest purchasers of wine and other beverage alcohol in the world. It controls pricing and distribution in Ontario. Canadian wineries have expressed considerable dissatisfaction about LCBO practices (Menzies 2000). First, prices set by the LCBO do not necessarily translate into high margins for wineries (Menzies 2000). Second, the LCBO utilizes a shelf management system that weeds out brands that do not sell "well enough". Third, it is not unusual for the LCBO to undertake special promotions of foreign-produced wines. Fourth, as one of the largest purchasers of beverage alcohol in the world, the LCBO's purchasing power allows it to obtain quantity discounts in its purchases of foreign wines. For example, certain French wines are priced at least as attractively in Ontario as at the French winery cellar door. Fifth, the buying policies of the LCBO (and those of the other monopolies) may be subject to the vagaries of political and senior management leadership. These factors leave many smaller producers in a potentially vulnerable position.

In particular, small domestic producers face challenges getting listed in government monopoly retail stores. Low-sales volumes can lead to failure to obtain a listing or result in a delisting. As noted, Vincor, Andrés, and a few other wineries also maintain retail wine stores. However, the number of licenses (at least in the Mainstay Ontario market) has been capped. Therefore, this distribution channel is not available to the vast majority of wine producers. This leaves such wineries with limited options: exporting, selling through their own on-site estate wine stores and wine tourism activities, or the restaurant trade. As noted above, only the two largest wineries in Canada have been successful in developing their own distribution systems outside the government monopolies.

Several results of this system are worthy of note. First, it is extremely difficult to purchase Canadian wines outside of the province that produces them (government-operated monopolies treat wine made in other provinces as imports). Second, competition for shelf space is fierce. Third, the majority of Canadian wineries have little experience in marketing their wines in freely competitive markets, experience that might arguably better prepare them to compete internationally. Also, smaller firms are less likely to possess the resources, including in-house marketing and business acumen, to undertake extensive market development.

The Canadian wine market

Not surprisingly, the domestic market is the most important market for Canadian wines, accounting for sales of almost all production. Nonetheless, it is critical to recognize that domestic share held by Canadian producers is low compared to that of major wine producing countries. For example, Ontario-produced wines accounted for 25 to 40% of Ontario wine consumption (Agriculture and Agri-Food Canada 2002a; Getz 2002). Conversely, the US, France, Australia, and Italy each supply more than 85% of their respective home markets (Agriculture and Agri-Food Canada 2002a). Furthermore, the share of imports has increased from 58% in 1990 to 65% in 1998.

Moreover, even though many wine writers comment on the major efforts to increase quality (through large scale growing of viniferous grapes and the development and adoption of the VQA standards), the marketing effort of the Canadian industry continues to be inhibited by

perceptions of low quality (Johnson and Robinson, 2001; Agriculture and Agri-Food Canada 2002a; Aspler 2000). The effect of reputation in the wine industry context cannot be overstated. Landon and Smith (1997) examined the effects of reputation on consumer preferences with respect to Bordeaux wines. They conclude (p. 289):

> "… that a model of consumer decision making which incorporates information on reputation (past quality) and collective reputation (average group quality) rejects alternative models that include current quality. … [R]eputation has a large impact on the willingness to pay of consumers, that long-term reputation is considerably more important than short-term quality movements and that consumers react slowly to changes in product quality. Collective reputation is shown to have an impact on consumer willingness to pay that is as large as that of individual firm reputation. If reputation and collective reputation effects are ignored, the estimated impact of current quality and short-term changes in quality on consumer behaviour are overstated."

Overall, there are reasons to believe that exclusive reliance on the domestic market may pose significant future strategic difficulties for Canadian producers. There has been a decline in the domestic consumption of wine - annual per capita consumption declined from 9.5 litres to 8.8 litres between 1988 and 1999 (Agriculture and Agri-Food Canada 2002a). At the same time, domestic production of wine has increased. The number of commercial wineries increased from 30 in 1990 to more than 170 by 2002. In the face of this decline in consumption and increase in domestic production, competition is intensifying. New World producers, especially the US and Australia, have made significant inroads in the Canadian market by virtue of economies of scale, application of technology, and high levels of product consistency. Old World producers have also increased their presence in the Canadian market by virtue of their established reputations and aggressive pricing and production policies.

Moreover, increased competition from imports has followed changes in tariff agreements. For example, the Canada-US Free Trade Agreement eliminated tariffs on US wine. Since the last round of WTO negotiations, tariffs on imports of EU wines were also reduced. In addition, agreements with the EU and the US have phased out differences in mark-ups between Canadian and foreign wines (Agriculture and Agri-Food Canada 2002a). These directions have meant that government monopolies such as the LCBO must be in compliance with GATT and WTO agreements in terms of pricing and buying practices.

Several additional explanations for the Canadian anomaly of relatively low domestic market share exist. In addition, the domestic industry faces a historical consumer preference for European imports; the legacy of historically inferior Canadian wines; as well as the relative inexperience of management and marketing teams in many Canadian producers. Two implications follow. First, increasing the domestic share of the wine market will be challenge for many Canadian establishments. Second, a strong domestic base is a traditional advantage in moving into export markets and the Canadian industry does not currently enjoy this advantage.

Summary

In summary, the Canadian wine industry is one that is increasingly producing a range of high quality wines; yet it faces several significant challenges.

- Canadian wine producers have set as a priority the task of regaining domestic market share. They currently hold very low (by world standards) share of their domestic market. Low domestic share stems in part from
    - the legacy of poor quality wines that once characterized the industry; and,
    - the absence of external credibility resulting from low penetration of export markets (in part, Canadian winemakers have tries to address these issues through active participation – and success – in international competitions).
- Competition is increasingly intense for the domestic market share because:
    - Old World producers have retained their reputations, have increased capacity, and have benefited from EU and local assistance.
    - New World producers have enjoyed economies of scale and have deployed technology advantageously. As Heien and Sims (2000, p.181) conclude "the removal on non-tariff barriers, especially those related to the lisitng of US wines, was the main factor accounting for the substantial increases in both value and volume of US wine exports to Canada [since 1988]."
    - The LCBO and other provincial monopolies have sufficient buying power to import foreign wines at relatively attractive prices.
    - Canadian producers are increasing in number and in terms of overall capacity in an industry structure characterized by a relatively large number of small firms.
- As yet, there is no national wine standard.
- Winemakers are vulnerable to the buying practices of provincial government monopolies and to the political vagaries of governments with respect to taxation, labeling, food and drug regulations with respect to additives, and monopoly priorities.

Given that most Canadian wineries do not sell out and that additional high quality wine capacity is coming on stream, it seems that Canadian winemakers will need alternative markets. Exports are one alternative; however, exporting is not straightforward in this setting. It is therefore useful to review what is known about SME exporting.

Previous Research: SME Exporting

Given that the Canadian wine industry (like many others) is characterized by a large number of small firms, the relationship between firm size and exporting propensity needs to be explored as does the process by which businesses in various sectors become exporters. As Prasad (1999, p. 1) remarked:

> "Reduced barriers to international trade and investment coupled with advances in information technology have accorded opportunities for smaller firms … to emerge as multinational".

SME Exporting Activity in Canada

As of December 2001, there were approximately 2.2 million businesses in Canada (Industry Canada, 2003a). Of these, 10.6 percent were engaged in some form of direct exporting (Industry Canada, 2003b). Exporter firms tend to be:

- *larger* (exporters accounted for less than ten percent of firms with fewer than 5 employees; however, almost one-half of firms with more than 100 employees were direct exporters);
- concentrated in the *manufacturing* (28.6 percent of firms were exporters) and *knowledge-based* sectors (22.3 percent of firms were exporters); and,
- more likely to be situated in *urban* settings (11.8.6 percent of firms in urban locations were exporters, compared with 7.3 percent of firms located in rural settings).
-

A 1997 survey of the members of the Canadian Federation of Independent Business (CFIB, 1997) found that:

- The vast majority of non-exporters did not export because the principal owner(s) had "no desire to enter export markets", usually citing "the nature of their business/product as the most common reason".
- New firms were just as likely to be exporters as old firms and that firms were more likely to become exporters at birth than to evolve to export as established firms.
- Among exporter firms, high costs of exporting and difficult customs processes were cited as the biggest export challenges.

The processes by which SMEs become exporters has been the subject of considerable study.

Theories of Internationalization.

Reid (1981), Johanson and Wiedersheim-Paul (1975), Ogbuehi and Longfellow (1994), and Moini (1995) postulate that businesses start small and develop exports as they grow and mature over time. According to these models, businesses evolve through sequential stages in which interest in international trade increases from no exports to indirect exporting to some direct exporting and eventually to substantial direct exporting (and thence to foreign direct investment and production abroad). Empirical evidence consistent with the stage model has been advanced by Calof and Viviers (1995) and by Karagozoglu and Lindell (1998).

This stage model has been the basis of considerable public policy. For example, partial funding to firms that are seeking to develop export markets may be provided by the Canadian Program for Export Market Development (PEMD, http://www.dfait-maeci.gc.ca/pemd/). The program helps firms finance export plans, participate in trade shows, etc. However, the firm must meet particular eligibility requirements, including minimum levels of sales volume, a requirement that may exclude firms that are "born exporters".

The so-called "stage model" is not universally supported. While Calof (1993) noted significant correlation between firm size and degree of internationalization, he also documented – contrary to the stage model paradigm – that firm size was not necessarily a

barrier to exporting. According to Calof (p.67), "large firms appeared to have lower levels of international sales intensity than did small and medium-sized firms". Moreover, Kirpalani and MacIntosh (1980) found that age was associated with export performance, but that the association was negative: that "Newer firms … do better than older ones … that newer firms are more anxious to expand and thus seek growth through international markets (p. 83)".

The staging model also supposes that exporting is the consequence of a well-thought-out developmental strategy. Yet, Beamish and his colleagues (1986) concluded that "the vast majority of exporters did not have a set "system" for finding representation and that the major lesson they had learned in selecting foreign representation was to double check everything". Yeoh (2000, p.52) also supports this finding: "…global start-ups position themselves to opportunities in the international marketplace by being avid information seekers".

Accordingly, additional theories of internationalization have emerged in the recent literature. Two such models are the organizational life cycle theory (Kimberly and Miles, 1980) and resource-based views (for example, Westhead, Wright, Ucbasaran, 2001). The organizational life cycle hypothesis shares with stage theory the concepts of incremental steps and sequencing. However, organizational life cycle also recognizes that many firms never export and that most small firms fail. It imbeds the chaotic nature of the small business landscape thereby redressing some of the rigidities inherent in the stage theory approach.

Resource-based theories develop the implicit assumption of both stage and organizational life cycle theories that export development is subject to constraints imposed by availability of financial and knowledge resources. It postulates that such resources are the key factors that lead to export activity. To the extent that firms gain export-related expertise and are better able to marshal financing as they grow, an association between enterprise development steps and exporting might be apparent. However, the resource paradigm posits that this association is not so much causal as much as a correlate of its ability to command the necessary resources. This model is consistent with the relatively recent findings of many firms that are "born exporting"(CFIB, 1997; Moen and Servais, 2002).

Reuber and Fischer (1998) found that SMEs in a small domestic market (the Canadian software products industry) exhibited a greater degree of international business competency, were more innovative, and adapted their products less for foreign markets than did SMEs operating in a large domestic marketplace. Perhaps firms that compete in large domestic markets are more likely to have the resources that allow them to better adapt their products for foreign markets.

Moini (1995, 1998) added to this debate by noting that export success among small firms depended on two key factors. The first was the competitive advantages demonstrated by the firm's products/services. Significantly, the second key factor was the owner(s)' intent to develop foreign trade. In this context, Orser (1998) has shown that owners' decisions to expand their firms depend critically on their sense that business expansion is feasible. These two factors are key in the context of the Canadian wine industry.

Developing Export Markets

There is little research about how SMEs undertake exporting. However, in one particularly relevant study, the Canadian Department of Foreign Affairs and International Trade (DFAIT, 1999) undertook extensive surveys and interviews of Canadian women SME owners to

identify their experiences with respect to export market development. Virtually all respondents identified one or more of the following as stimuli of their export decisions:

- The wish to expand the markets for goods or services sold by their firms, a finding consistent with that of Moini and Orser.
- An unsolicited bid.
- Familiarity with the target market.

Unsolicited bids were identified as the primary *stimulus* to export by 23% of respondents. These elements (market expansion and unsolicited bids) are linked. One or more unsolicited requests demonstrate that exporting is feasible and provides an immediate means of achieving the financial success business owners seek. Sixty-five percent of business owners surveyed identified the desire to expand their markets as the primary *motive* for exporting. The decision process was both deliberate and intentional. These results are consistent with previous research on export stimuli (Albaum, et. al, 1989, p.35, cited in Bagchi-Sen, 1999) and are summarized in Table 1.

Table 1: Summary of Research on Export Stimuli

International Research Findings		Canadian Women Business Owners	
Internal Stimuli	**External Stimuli**	**Internal Stimuli**	**External Stimuli**
• Excess capacity • A unique product • Firm's competitive advantage (e.g., technology, marketing)	• Unsolicited order • Saturated home market • Better opportunities in the export market • Competitive pressure	• Wish to expand the markets for goods or services sold by their firms • Familiarity with the target market	• Unsolicited bids • Unfulfilled demand • Government programs

According to the DFAIT (1999) study, the first steps in exporting for Canadian women business owners involve two categories of activity:

- Gathering information and/or
- Increasing exposure of their products or services.

Much of the focus of information gathering was in determining an appropriate channel of distribution and/or agent(s) or broker relationship. Business owners who export gathered two types of information. First, they sought market intelligence. To do so they used market surveys, secondary market analysis, and followed-up leads from trade shows and personal visits. Typically, owners sought to increase exposure of their product or service by using external sources such as the Internet, attending trade shows, or engaging first-hand information through agents or representatives. The second type of sought-for information related to the export process: customs procedures, labeling regulations, agents, brokers, etc.

Seringhaus (1993) identified the level of marketing expertise as a critical factor in a firms' involvement with exporting. The process of information gathering is linked to export performance. Firms with successful products tend to do more market research, engage in greater market planning, market monitoring and market testing. Furthermore, different kinds of information are sought at different stages of the exporting process: newer exporters seek export information more aggressively than older companies and that gathering such

information may differ from domestic market intelligence. According to Seringhaus, the process of gathering information includes objective (e.g. published statistical facts) and experiential (e.g. obtained through experience on visits, trade fairs and missions) learning. Yeoh (2000, p.52) reports "personal and quasi-governmental sources were relied on to a greater extent (than documented sources) by global start-ups".

Does size matter?

Arguably, firm size can both enable and inhibit exporting success. Bagchi-Sen (1999, p.238) reports, in a study of Canadian firms located in the Niagara wine-growing region:

> "a clearcut relationship between size and exporting even within SMEs – all firms with low export orientation are relatively small in size as measured using sales volume. However, the relationship between size and exporting is less clearcut for the firms with high export orientation; it seems that other factors (i.e., product development, process innovation) beyond their relative size influence SMEs to become exporters."

On the one hand, small and young firms are said to have flexibility and greater attention to customer needs (McDougall, Shane & Oviatt, 1994; Reuber and Fischer, 1997b; UNCTAD, 1994). Conversely, large firms are able to marshal more resources. Wagner (2001, p. 229) argues:

> "… the importance of firm size for direct exports follows from economies of scale in production, a more fully utilization of (specialized) executives, the opportunity to raise financing at a lower cost, benefits from bulk purchasing, own marketing department plus own sales force, and a higher capacity for taking risks … due to internal diversification. Furthermore, at least some of the costs related to direct exporting activities … are fixed costs. Hence a positive relationship between direct imports and firm size is expected."

According to Wagner (2001), however, size "may not be an obstacle to exporting that is hard to overcome in every industry". He also found that factors such as human capital, the presence of innovative products, and technological advantages are also factors in exporting success. In this regard, the Canadian wine industry is as technologically advanced as any. However, as Bagchi-Sen (1999) noted, export orientation of the owner of the small business had a substantial effect upon export behaviour. This emphasizes the critical importance of the owners' intentions, competencies, and knowledge with respect to success in the development of export markets in their goals for business performance. In turn, this suggests that a critical element of the low level of Canadian wine exports may be the attitudes towards exporting, and export-related expertise, of Canadian winery owners. The next section explores these potential barriers in more detail.

Challenges to Canadian Wine Exporting

The above analysis has revealed several challenges that Canadian wineries might face if they seek to increase exports.

Lack of Capacity

Historically, climatic conditions have limited the production capacity as well as the choice of climate-hardy varietals of the Canadian industry. This has been exacerbated by the historical use of native vines. While these have largely been replaced, the capacity of the new plantings has not yet been realized. While it doesn't seem likely that Canada will ever be among the major exporter nations, the recent increases in wine production and the application of technology does promise to further expand capacity, especially among cool-climate varietals. The current situation is that most producers do not sell all their production. Because the wineries are mostly small, the excess is not generally large enough for any winery alone to be able to service significant export sales. This suggests the need to agglomerate surpluses across small wineries for export purposes.

Lack of Marketing Expertise

With all due respect to a minority of firms that have established export markets, most Canadian wineries are product-centred. For some, wine is perceived perhaps too often as a "craft" and not frequently enough as a "business". To some extent, the young age of the industry is correlated with a lack of marketing expertise and experience, not unusual in a sector that is relatively young and geographically isolated from competitors. This situation is aggravated by lack of domestic opportunities to hone marketing strategies and skills. Consequently, smaller firms may not emphasize the need for branding and reputation development.

Not only is domestic business knowledge limited, international business experience is particularly inadequate. In part, this is attributable to the historical lack of access to traditional European and US markets. This lack of experience is the more important in the highly competitive international wine environment.

Lack of Financial Resources

As noted, the majority of Canadian wineries are small, young businesses. It is well-known (e.g., BDC, 2000) that such firms face particular difficulties accessing financial capital. Moreover, the capital-intensive nature of the wine business requires investment in land, vines, equipment, barrels, etc., expenditures that can divert financial resources from market development. Larger firms are arguably better able to undertake market development because they can take advantage of economies of scale in the production process, freeing capital for alternative uses. However, most small firms are likely to lack the financing necessary to undertake substantive market development activities. The problem is worse for new firms, whose capital may be tied up in young vines and inventories.

The Nature of Current Export Product Success

The relative success of Icewine exports may present both an opportunity and curse. On the one hand, Canadian Icewine exports have established channels of distribution as well as a quality image in particular countries. On the other hand, Icewine may create an unwanted image of Canada as an icy wasteland.

Strategic Dilemmas Faced by Canadian Winemakers

The major options involve focusing upon the domestic market or upon international markets. The key strategic considerations surrounding each of these markets are discussed below.

A Focus on the Domestic Market

Canadian winemakers current strategic priority is to increase their share of the domestic market. Because of the resource implications, most wineries avoid export market development and concentrate upon the domestic market. Such a strategy may indeed be very attractive to small Canadian estate wineries that may believe they do not possess the requisite resources to pursue international markets. The advantages and disadvantages of such a strategy require consideration.

A key advantage of pursuing such a strategy is the wine entrepreneur's knowledge of the Canadian market – its buyer's, distribution channels, and regulations. Such knowledge must be developed when new wineries are started, and limited resources may prevent the firm's development of equivalent knowledge concerning foreign markets. Further, compared to the production capabilities of most Canadian wineries, the Canadian market offers considerable scope for growth. Because the market is currently dominated by imports, Canadian wineries could attempt to wrestle share from the imports and grow their own share of the market. As well, the wineries' development of wine tourism on and around their premises offers potential for growth of the winery on the domestic front.

A second key advantage of focusing on the domestic market is the relatively low costs associated with nurturing a small number of large clients.

A focus on domestic markets may result in some critical disadvantages. First, competing for share against imports may not be successful. Canadians have demonstrated historical preferences for imported wines and altering these preferences will take time, particularly in the face of strong marketing strategies by these importing countries and companies. As noted, reputation is a key variable and changes in reputation are slow. Australians and Americans have both mounted strong recent marketing campaigns in Canada. Further, the government monopoly distributors such as the LCBO have been partners to these promotions.

Somewhat ironically, in the face of lingering Canadian consumer concerns about the quality of domestically produced products, success of domestic wines on the international stage may be necessary for success in the domestic market. This phenomenon can be observed in other Canadian industries such as art and entertainment, where international acceptance has often been necessary for domestic acceptance.

From an industry, regional or national perspective, the strategy of focusing upon domestic markets offers several additional disadvantages. First, as noted above, to the extent that Canadian consumers' preferences for imports do not change, individual Canadian wineries may end up competing primarily with each other for market share. This scenario would stall the growth of the fledgling Canadian wine industry at a time when overall growth of the industry is what is desirable. Second, the well-documented advantages of exporting (noted earlier) are foregone.

It is understandable that Canadian producers have generally opted to focus on regaining a larger share of the domestic market. There is much to be said, however, for greater

consideration of exports as a means to business expansion and as a way to reduce vulnerability. In summary, exclusive reliance upon the domestic market is probably not the best strategy for the Canadian wine industry to pursue in the long run. In principle, and in this context, Rugman and Verbeke (1990, pp. 1-2) assert:

> "… for businesses located in small open economies, like Canada, … it is of paramount importance to secure access to the market of at least one of the triad powers [NAFTA, EU, Japan]. This is essential for the long-term survival, profitability, and growth of the corporation and thus for the nation."

Recently, coordinated attempts to reposition the Canadian product have been undertaken, with some success. To the extent that credibility is a factor in the purchases by Canadian wine consumers, external validation through successful penetration of international markets would carry significant benefits. To be listed in provincial monopolies, producers must be able to drive demand. In the long run, Canadian wines must ultimately be able to compete head-to-head with international competition, domestically or abroad.

Development of Export Markets

Internationally, large multinational high-volume suppliers increasingly dominate the wine business. This dominance raises the questions of how small newcomer Canadian wineries can export and, indeed, survive. As Stewart and McAuley (2000) show, the export strategies used successfully by many SME exporters often mirror those used domestically. For example, producers that have adopted a domestic approach that emphasizes niche marketing of premium-priced high-quality wines might also use such a strategy to be successful in venturing into international markets. Exporting, however, is a major step for most firms. In assessing whether this step is appropriate for Canadian wine producers, it is worth reflecting on the stimuli summarized in Table 1.

Export stimuli internal to the firm include excess capacity, a unique product, a competitive advantage, a desire to expand markets, and familiarity with target markets. There is some evidence that the Canadian wine industry as a whole has excess capacity and that capacity is increasing. Because most Canadian winemakers are so small, each firm's surplus production is minimal. Canada's competitive advantage may be found in quality wines from cool-climate grapes varieties, in particular Icewine, Riesling, and Cabernet Franc. While Canadian wine producers have been seeking ways to expand markets, there does not appear to be an individual or collective will to export. Finally, there may well be sufficient knowledge of target markets collectively across the industry. However, to the extent such knowledge might exist, it, too, is dispersed across a fragmented industry structure. Further research is required to better document the state of these factors.

Stimuli external to the firm that encourages exporting include: unsolicited orders, saturated home markets, better opportunities in export markets, competitive pressures, and government support. There is little public information with respect to unsolicited orders. It can be argued that home markets (as well as foreign markets) are saturated and that competitive pressures abound. The export market does offer the opportunity to enjoy higher markups because of the domestic monopoly pricing structures and, perhaps, tax relief. While there are several government initiatives that encourage and support SME exporters, Francis and Collins-Dodd (2001) present data that question the efficacy of these measures..

Export-related challenges particular to the Canadian Wine industry relate to international credibility, and the potential use of existing channels of distribution for Icewine for other wine products. The recognition of the excellence of Icewine may itself be a problem because foreign customers may then associate Canadian wines as sweet and the climate as frigid. However, the quality of Canadian wine, which is now quite good, may prove to be an opportunity. Finally, the potentially higher margins available through exporting may prove to be an inducement for Canadian wineries to take the plunge into export activity.

Companies engaged in, or planning to, export must also decide whether certain essential tasks are to be handled by its own staff or by contracts with other firms. The following functions are usually specified (Daniels, Ogram, and Radebaugh, 1976, p.372): "stimulate sales, obtain orders ,and do market research; make credit investigations and perform collection activities; carry out foreign traffic and shipping functions; and, function as support for the overall sales , distribution, and advertising staff of the firm."

For small firms that lack in-house expertise, it is common to use the services of an intermediary. According to Daniels, Ogram and Radebaugh (1976), such organizations may be grouped into four major classifications:

(1) agents acting for the exporter who is the principal;
(2) agents purchasing for themselves as principals;
(3) agents undertaking a specialized aspect of the export cycle; and,
(4) agents acting for buyers as principals.

As they grow and succeed it is common for companies to increasingly internalize export-related tasks. However, the use of external agents and specialists by relatively small players poses its own set of potential difficulties. Some of these are illustrated by the following excerpt from the Vincor prospectus (2002)

> **"Reliance on Distributors.** …[In the US] Distribution channels for beverage alcohol products have been characterized in recent years by rapid change, including consolidation of certain wholesalers. Accordingly, as a relatively small competitor, there is a risk that these wholesalers may not give necessary priority to the Company's products. To address this, the Company has developed and is expanding its own sales force to support and complement the efforts of the wholesalers."

Discussion and Conclusions

This paper has argued that exporting presents a potentially important strategic direction for the Canadian wine industry. Exporting is not, however, a current priority for wine producers in Canada: gaining domestic share is. By analogy, competition by firms in the Canadian wine industry with large international producers is akin to mice among elephants. Even though there has been a net deconcentration in some major European countries, and even though there is no dominant firm in the still wine business within France, Italy or Spain (major wine exporting countries), the average size of wineries in these countries is much larger than the average size of Canadian producers. For the most part, the international

elephants don't even know there are Canadian mice. However, the Canadian mice are quite aware of the international elephants.

How do mice play among the elephants in the international wine market? First, the mice have to be willing to play at all. Canadian mice may think they can stay at home and play with the other mice, but the elephants have arrived. Second, those that participate in the game will need to nibble around the edges in niche markets. Third, the mice would do better if they shared a coherent strategy and provided each other with mutual support. Expressed differently, the mice need to form packs and pacts. Owners of small Canadian wineries need to work together to:

- pool what is otherwise fragmented expertise;
- learn from the exporting strategies employed in other wine-producing countries;
- agree on an national or provincial exporting strategy. Elements of such a strategy might include, among others:
    - building on Canadian strengths in the wine business;
    - setting the stage for successful future development of export markets.
    - identification the quality and quantity of products to be exported;
    - selection of well-considered target markets.

To accomplish these goals will require the establishment of some form of mechanism through which a coherent export strategy can be formulated. This will require resources that include the time and talents of Canadian winery operators as well as the further development export-related expertise particular to this business. Canadian wines must ultimately hold their own in international competition if they are to hold their own at home. To surmount the challenges of adopting a more export-oriented strategy, the Canadian wine industry will need to either consolidate or work in concert, perhaps by establishing an industry-wide export development organization. This would centralize the requisite knowledge and be in a position to implement a Canadian marketing strategy.

The alternative is the luxury of staying at home and playing with the other mice. We argue that this is an increasingly untenable approach. This is because of the essential dilemma that domestic success requires success in markets abroad. Such success brings additional economies of scale and scope and addresses the reputation-related challenges highlighted above.

This research paper has attempted to document challenges that Canadian wineries are facing. This paper has advocated a position that is radical with respect to current thinking and practice in the Canadian wine sector. The purpose is to generate further debate and discussion about future directions for the industry. Clearly, additional research is required to verify and expand on many of the ideas offered here.

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