

## **Under the Bench Cellars**

**Herbert (Herb) F. MacKenzie**

*Brock University, Canada*

[herb.mackenzie@brocku.ca](mailto:herb.mackenzie@brocku.ca)

**Carman W. Cullen\***

*Brock University, Canada*

[ccullen@brocku.ca](mailto:ccullen@brocku.ca)

**Adrienne Kolich**

*Brock University, Canada*

**Michael Marini**

*Brock University, Canada*

**\*Corresponding Author**

## **Under the Bench Cellars<sup>1</sup>**

Michael Marini and Adrienne Kolich were busy deciding whether they should launch Under the Bench Cellars (UTBC), a “virtual” winery in the Niagara region<sup>2</sup> and were under considerable pressure to make their decision. It was April 2013, and, unless they moved quickly, they would have to shelve plans for another time. In fact, the opportunity might not be as attractive in the future.

Michael, through his connections in the wine industry, was able to negotiate the purchase of grapes from a local grape grower, assuming he could sign a contract by mid-summer. The grower had agreed to supply up to 10 tonnes of Cabernet Franc grapes, 7 tonnes of Riesling grapes, and 5 tonnes of Vidal grapes.

Adrienne and Michael had a common friend who advised he would finance their business if they could convince him that he would get a good return on his investment, and he offered what was a very favourable arrangement, much better than they could expect from an angel investor. His offer was to supply funding up to \$200 000 as needed. He would expect an annual interest payment of 10% of the average annual investment outstanding, and he would let Michael and Adrienne pay off the principal as they wished, without restriction. Michael and Adrienne knew they might never be able to negotiate such an offer again.

It was Friday afternoon, and they were scheduled to meet their potential investor on Monday evening. To get the funding they needed, they would have to present him with a solid marketing plan and, even if they were able to convince him to make the investment, they would still have to decide whether they wished to proceed with the venture. Michael and Adrienne had done a lot of work on their proposed venture, but they still had some issues that they needed to resolve, particularly around market segmentation, branding and labelling, price strategy, and distribution.

## **Canada’s Wine Industry**

Canadians are beginning to love their wines, and this is having a tremendous effect on the domestic wine industry. For the decade between 1995 and 2004, sales grew an average of 11 percent per year. By 2012, sales accounted for \$6.1 billion (over 470 million litres). In volume terms, Canadian adults drank 22 bottles of wine per year, and this volume far exceeded the 13-bottle average for 1995. Compared to other alcoholic beverages, wine accounted for 30 percent of total sales in 2011, up from 23 percent as recently as 2000. Total Canadian wine consumption is expected to grow by an additional 19 percent between 2012 and 2014

Despite Canada’s enormous size, wine production is heavily concentrated in two small regions of the country. The Okanagan Valley of British Columbia has more than 8000

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<sup>2</sup> Maclean’s Magazine (2012). *Virtual wineries make some real corkers*, August 20, p. 263.

acres of grape production<sup>3</sup>, serving 122 wineries<sup>4</sup>. In the Niagara Peninsula region of Ontario, there are 13,600 acres of grape production, and 84 wineries<sup>5</sup>. The average grape farm in the Niagara Peninsula has just over 30 acres under production, and, with a few notable exceptions, wineries in the region are small-scale operations. Prices for grapes are established every two years, and vary by grape varietal and the sugar content of the grape (measured as °Brix), which, of course, cannot be determined until the grapes are ready for harvest. The sugar content can therefore vary from growing season to growing season. High-quality grapes can reach as high as 20-22 °Brix, depending on variety and the season. Sample prices for 2013 are shown in Exhibit 1.

**Exhibit 1. Sample Grape Prices, 2013<sup>6</sup>**

<b>Varietal</b>	<b>Soluble Solids (°Brix)</b>	<b>Price per Tonne</b>
Cabernet Franc	21.5	\$1676.00
Riesling	19.0	\$1431.00
Vidal	19.5	\$618.00
Vidal Icewine juice	35.0	\$9.05/ L

Ontario was the first province to introduce appellations systems for grape and wine production. Vintners’ Quality Assurance Ontario, or VQAO, was introduced in 1988, and British Columbia followed two years later with VQA BC. VQA systems guarantee regulated production practices, product quality, and labelling integrity. Approximately 98 percent of Canada’s premium-wine production occurs in southern Ontario and British Columbia, and given the small size of the average winery, competing on the basis of quality makes sense. Only the few very largest wineries could consider competing on the basis of price. In 2013, total VQA Ontario wine sales reached \$346 million as shown in Exhibit 2.

**Exhibit 2. Ontario Retail Value of VQA Sales by Channel**

<b>Sales Channel</b>	<b>Sales (\$ millions)</b>
LCBO (Liquor Control Board of Ontario)	\$116.5
Winery retail stores	\$115.8
Inter-provincial and export	\$ 60.0
Wine delivered to licensees (restaurants/bars)	\$ 53.7

Because of the volume of its wine sales and the influence it has on wine consumers, the LCBO has a tremendous impact on the competitiveness of Ontario wineries. In recognition of its dominance as a distribution channel and its subsequent influence over the success of many Ontario wineries, the LCBO demands significant margins on the

<sup>3</sup> <http://www.winebc.com/discover-bc/okanagan-valley>

<sup>4</sup> *ibid*

<sup>5</sup> <http://www.vqaontario.com>

<sup>6</sup> <http://www.grapegrowersofontario.com>

wine products it sells. For this reason, many smaller wineries focus their distribution on cellar door sales; i.e., sales to winery visitors. Many wineries have the advantage of location: near Niagara Falls or on what has become the “Wine Route” for tourists who want to visit the region’s many wineries. The risks, however, for wineries that follow this strategy are the common ones related to the tourism industry: seasonality, few repeat sales, and the fluctuating strength of the Canadian dollar.

## **Wine Consumers**

Experts attribute the growth in the premium wine market to the aging baby boomers. Baby boomers are entering their prime drinking age and this group of consumers is expected to increase premium-wine consumption for a number of years. Older individuals are key consumers of wine; they tend to have the income and inclination to purchase more, and higher-priced, bottles of wine. Niagara has a large population of people over age 55, the reason it has sometimes been referred to as the Viagra Peninsula. There are about 3.5 million people over age 55 in Ontario, and 145,000 of them live in the Niagara region. Adrienne wanted to target this segment, expecting them to be more responsive to wines that Under the Bench Cellars would produce, and probably they would be more loyal than younger wine consumers.

Michael thought the 19-34-year-old age group should be the primary target market. There were normally 80,000 people in this age group in the Niagara region, and this was supplemented by an additional 20,000 people who attended university or college there during the fall and winter. Across Ontario, there were 2.65 million people in this age segment. Michael wanted to target this segment because, as he said, “I understand this segment much better. They are more adventurous and although they may not want to spend as much for a bottle of wine, they are more willing to experiment and try new things. If we can establish ourselves with this segment, we will have a tremendous advantage when we are able to produce wines from Moscato grapes three years from now.”

## **Under the Bench Cellars**

Both Michael and Adrienne believe they have a tremendous opportunity to succeed in this very competitive industry. They have been studying the industry for several years and, at one time, were planning to open a regular winery in the region. Their first proposal would require an investment of nearly \$1 million, and the risks they deemed to be quite high. They were aware of the popular wine industry saying, that the best way to make a small fortune in the wine industry is to start with a large one. The risks and the financial demands eventually dissuaded them from proceeding with their plan. Then they heard about “virtual” wineries, and this again sparked their interest. Virtual wineries had the advantage of low overhead because they owned almost no physical assets. They took advantage of the excess capacity of existing wineries, renting whatever space and equipment they needed.

As a virtual winery, Under the Bench Cellars planned to purchase all the grapes it needed for wine production in the early years, but it also had available seven acres of land that it could lease from a family friend for 25 years and on which it could plant grape vines. The price to lease the land was established at \$1,000 per acre, subject to review after 10 years. The land is near Niagara-on-the-Lake close to an area known as the St. David's bench area. In fact, the property is just below this area, suggesting to Michael and Adrienne the name for their winery: Under the Bench Cellars.

Adrienne found a government study that reported the average cost for planting an acre of vineyard at \$16,874.00, taking into account labour and wage rates in Canada. Working with this study, she was able to lower the estimated cost of planting to \$12,857.57 per acre for UTBC. This would require some contribution of labour by herself and Michael, and possibly by a few family members and friends. She also had a contractor friend who she thought might help with the tile drainage, possibly lowering the cost a bit more.

Grapes would be available by the third growing season, and in increasing quantities after that until full production would be reached after year five. An important consideration was that there was a solid building that had been recently constructed on the property. Unfortunately, to prepare it for retail sales, UTBC would need to make considerable leasehold improvements: a new façade, inside renovations to make tasting and display areas, a parking area and picnic tables, and some additional landscaping. Adrienne estimated the changes would cost somewhere over \$50,000, possibly as high as \$60,000.

Michael and Adrienne would share management responsibilities for the winery, Michael as CEO and Adrienne as CFO. Michael has a university science and business background and has five years of customer service experience, and four years of labour experience. Michael is a wine enthusiast and has spent many years with his father, Dr. Zopito Marini, making wine for the family. Adrienne has a university business background and has worked with a number of companies doing bookkeeping and accounting. She is currently a third-level Certified General Accountant (CGA) and has completed all of the required courses to earn her full CGA designation. Michael and Adrienne plan to be equal shareholders in the company.

Michael's father, Dr. Zopito Marini, has a Ph.D. in developmental psychology and is a WSET (Wine, Spirits, Education Trust) Sommelier. He will serve as the company's sommelier and educational consultant. Adrienne's cousin, a certified Chef de Cuisines and a culinary arts instructor owns two upscale restaurants in the Niagara region, one in Niagara Falls and one in Niagara-on-the-Lake. He has promised to introduce UTBC wines in his restaurants, and will eventually serve as a wine and food consultant for the winery. A family friend and colleague of Dr. Marini is an expert in applied climatology and meteorology, viticulture, and vineyard site selection. He has done extensive research for the Ontario VQA board and is very knowledgeable about the Niagara wine industry. He has indicated that the company's planned growing property near the St. David's bench is very suitable for growing the grape varieties that UTBC is planning to grow. Another family friend has considerable experience replicating plants and grafting vines. He also has expertise in plant diseases that can affect fruit and grape vines in the Niagara region.

There were many people who wanted to see UTBC succeed, and their skills and expertise provided the winery with important production, marketing, and knowledge resources.

Under the Bench Cellars does not plan to hire any staff as it begins operations. The one critical person needed by the winery is an experienced wine maker, and Michael and Adrienne plan to hire one on a part-time basis. Through Dr. Marini, they have identified several who they believe are qualified to execute the company's trade secret recipes and vision for each wine that they will produce. Winemakers can be contracted for a reasonable cost on a part-time basis. The going rate for the highest quality winemakers is approximately \$30,000 per year.

## **Product**

Under the Bench Cellars intends to offer high quality wines from Vinifera grape varieties, including Cabernet Franc, Riesling, and Vidal (for icewine production). These are all popular grapes in the Niagara region. Since 100 percent of the grapes used in its winemaking will be grown in Ontario, it plans to produce only VQA wines. Exhibit 3 shows the company's estimated sales mix, by volume, based on its planned production. Riesling and Cabernet Franc will be produced in the traditional 750mL bottles, and the Vidal icewine will be produced in the standard 375mL ice-wine bottle.

### **Exhibit 3. Estimated Sales Mix (by volume)**

<b>Estimated Sales Mix (by volume)*</b>	
Cabernet Franc	53.20 percent – 64.21 percent
Riesling	35.14 percent – 28.75 percent
Vidal	11.66 percent – 7.04 percent
*estimate on left based on competitive intelligence; estimate on right based on UTBC planned production volumes	

Eventually, UTBC plans to introduce wine produced from the Moscato grape, one not yet grown in Canada. Moscato Canelli is one of the world's fastest growing grape varieties. It is originally from Piedmont, Italy and UTBC believes it should grow well in the Niagara macroclimate<sup>7</sup>. World-wide sales for wines from this grape have doubled in the past year, exceeding 10 million nine-litre cases (120 million bottles), moving it ahead of such well-established varieties as Shiraz and Riesling. The wine has turned into a hit in hip hop circles, with rappers Kanye West and Drake both singing the praises of the wine. In fact, Kanye West has recently been dubbed the "Maestro of Moscato." This trend has made Moscato popular with the 19-34 age group, but there has also been a sales increase among the 55+ age group. UTBC attributes the large increase in sales to the fact that some sommeliers are proposing that North American wine tastes are moving toward the sweeter wines produced from this grape and away from the more traditional dry wines. UTBC plans to make this its signature grape.

<sup>7</sup> <http://www.wine-searcher.com/technical-wine-terms-m-n.lml>

## **Price**

A check of wine prices in Ontario revealed that VQA wines averaged, at retail, \$15.50 per bottle, non-VQA averaged \$8.50 per bottle, and icewines averaged \$45.00 per bottle. However, there was considerable variability. Riesling VQA wines sold for as little as \$14.00 and could cost as much as \$23.00 per bottle. Cabernet Franc ranged from \$15.00 to \$28.00 per bottle. Vidal icewines sold for \$40.00 to \$55.00 per 375mL bottle. Given the segment he wished to target, Michael preferred prices lower than the average; Adrienne, thinking about how price might affect the quality image of the wine among older consumers, favoured prices higher than the average.

## **Promotion**

Social media sites have become effective marketing tools for promotion of new businesses as most are free. Under the Bench Cellars plans to begin using social media as soon as the company is started. Adrienne plans to start with a Facebook page and a Twitter page, explaining the company vision and location. As the production process proceeds, UTBC will use these media to explain where the winery is in the process of winemaking. These sites will also promote product availability, including availability release dates and locations where the wines can be purchased.

Eventually, on a monthly basis, Dr. Zopito Marini, as sommelier, will produce a short video blog for UTBC. Each month he will highlight one of the newly released wines or some aspect of the growing process. He will discuss these issues and educate customers so they develop a greater understanding of the wine industry and the wine-making process. Plans are for the company's culinary consultant to discuss pairings with food and show how tasting notes are made. These blogs will be released on the UTBC website and on other social media forums the company will use for promotion. Adrienne believes this will be a great marketing tool as both people are well-established educators in the region.

As part of the company's education program, UTBC plans to offer "vineyard to glass" tours. This will be the cornerstone of the company's education program, where customers would visit the winery at four different times during the growing season. Each visit would last one hour and would coincide with a different phase of production: the Budding phase, the Pruning phase, during Harvest, and, finally, during actual Winemaking. This would give customers insight into the everyday operations, how to prune the vines and the characteristics of the grapes, and what makes them into good wine. During the tours, the company's sommelier, chef, and grape grower will be on hand to educate customers in the process of winemaking. To increase consumer engagement, Michael plans to name a few vines after each of the customers in the program every year. This will hopefully increase customers' attachment to the winery as well as enhance their education. Following the four visits, customers will receive a 12-bottle case of red (Cabernet Franc) or white (Riesling) wine, depending on their choice. Michael is planning to offer the program at a price of \$250 per person. He is hoping to attract between six and 10 customers in the first year, with the program becoming increasingly popular in succeeding years.

An important local venue for promoting Niagara wines is the Niagara Grape and Wine Festival that takes place each September at Montebello Park in St. Catharines. It is a showcase for wineries and new wines in the region and gives a grand opportunity for a new winery to gain recognition and customers. The festival runs over two weekends; tents are set up on-site where people can buy tokens to sample some of the wines from the region. Companies gain a spot in the tents by making a donation to the festival, and how much product they can bring to the festival depends on the amount they donate. UTBC plans to donate \$2000 to the festival, and this will allow the company to have two wines in booth for people to sample. This is an excellent marketing and promotion opportunity that can lead to other festivals in the region, such as the New Vintage Festival and the January Icewine Festival.

If UTBC decides to sell through the LCBO, it will be able to promote its wines through the LCBO Go Local website, [www.lcbogolocal.com](http://www.lcbogolocal.com). This site posts various Twitter and social media posts about local wineries, including pictures, videos, and testimonials, all aimed at getting customers at the LCBO to buy more VQA and local wines.

Both Michael and Adrienne are aware of the role that their wine label can fill when promoting their wine, particularly if they use the LCBO in their distribution strategy. Research has continued to demonstrate the importance of an appealing and distinctive wine label to consumer choice in a retail setting. Fortunately, UTBC has had some professional help from Adrienne's sister, a professional graphics designer. She has presented two ideas to them, but they have so far been unable to decide between them, or indeed, if they would like either or both of them. Also, Michael and Adrienne continued to debate colours for the copy and the graphics on the labels. These designs are shown in Exhibit 4.

## **Distribution**

Under the Bench Cellars plans to sell through a number of distribution channels to meet consumer needs. The most important question to be resolved is whether to include the LCBO as a distribution channel. Michael was confident they would get an LCBO listing if they desired one because UTBC would be closely following all of the LCBO requirements throughout its production process. The LCBO is the largest retailer of alcohol in Ontario. According to Michael, "It is essential we sell through the LCBO because it is one of the largest purchasers of alcoholic beverages in the world, and it can give us the market exposure and credibility that we need to establish our brand." Adrienne, on the other hand, held an opposing view: "We may get exposure, but the cost is far too high. The margins we must sacrifice could be the difference between making a profit, or operating at a loss. Not only that, once customers find they can buy our product at the LCBO, they will simply return there if they wish to buy more. We will be spending a lot of effort and money to build brand awareness and loyalty, and then we lose much of our margin to the LCBO." An important issue for wineries that sold through the LCBO was the need to guarantee both production and sales. They had to be able to supply the LCBO in reasonable volume (somewhat lower for new wineries), but also must be able to



sell sufficient volume to remain listed as one of the LCBO's products. Michael was certain they could meet the LCBO requirements, but the issue of whether to sell through the LCBO remained unresolved.

**Exhibit 4. Sample Wine Labels (© 2013, Under the Bench Cellars)**



Other distribution channels included sales to licensees (restaurants and bars), cellar door sales, “vineyard to glass” sales, and online sales. Adrienne planned to sell wines through licensed establishments, and planned to do the selling to these establishments herself. The customary discount to such establishments was 15%. UTBC had a small advantage here as it was assured two restaurants that would feature its wines as soon as they are released. At the cellar door, UTBC would get to keep the highest margins. There is a requirement that, if wines were sold through the LCBO, prices at the cellar door could not be lower than the prices that the LCBO charged its customers. Vineyard to glass sales would be similar to sales through the cellar door; i.e., full price with the entire margin remaining with the winery. Adrienne plans to charge a premium, though, to cover the cost of the valued added through the four winery tours associated with this program. However, in

terms of overall sales, the vineyard to glass program is expected to account for considerably less than 1% of sales.

With respect to online sales, Adrienne expects to sell through the company's own website, but also through a number of websites that specialize in selling wines throughout Canada and the United States. For example, Toronto-based Winery to Home Inc. ([www.winerytohome.com](http://www.winerytohome.com)) sells wines over the Internet to consumers in Nova Scotia, Ontario, Manitoba, and British Columbia. When sales come through the UTBC website, Adrienne expects the margins will likely be similar to those the company would get if the sales had been made to licensees as there would be transportation costs that would need to be absorbed when customers ordered six or more bottles. She was uncertain what margins she would be able to realize when sales were made through third-party websites as she was not certain what margin these sellers would seek. In any event, Adrienne believes that online sales will account for a small percentage of overall sales.

Exhibit 5 shows the impact on the selling price that the winery would realize based on the channel through which the wine is sold. For illustrative purposes, a basic price of \$15.00 from the winery was chosen.

**Exhibit 5. Examples of the Selling Price that UTBC Would Realize Based on the Channel through Which Its Wine Is Sold**

<b>Sales through the LCBO</b>	
Price paid by buyer	\$17.15
Bottle deposit	0.20
Retail price at LCBO	\$16.95
HST @13%	1.95
<b>Basic price from winery</b>	<b>\$15.00</b>
Environmental fee (0.0893 per bottle)	0.0893
Bottle levy (0.29 per litre)	0.2175
Wine levy (\$1.62 per litre)	1.2150
LCBO markup	5.3343
<b>Revenue to winery</b>	<b>\$ 8.1439</b>

<b>Sales through Licensees</b>	
Price paid by licensee	\$16.37
Bottle deposit	0.20
HST @13% (on \$14.31)	1.86
Net licensee price	\$14.31
Discount to licensee 10% on \$15.00	1.50
Markup on licensee sales 6% on \$13.50	.81
<b>Basic price from winery</b>	<b>\$15.00</b>
LCBO admin. fee 6.1%	0.84748
Environmental fee (0.0893 per bottle)	0.0893
Bottle levy (0.29 per litre)	0.2175
<b>Revenue to winery</b>	<b>\$13.8457</b>

**Exhibit 5. Examples of the Selling Price that UTBC Would Realize Based on the Channel through Which Its Wine Is Sold (continued)**

<b>Sales through the Cellar Door</b>	
Price paid customer	\$17.15
Bottle deposit	0.20
HST @13% (on \$14.31)	1.95
<b>Basic price from winery</b>	<b>\$15.00</b>
Basic tax 6.1%	0.84748
Environmental fee (0.0893 per bottle)	0.0893
Bottle levy (0.29 per litre)	0.2175
<b>Revenue to winery</b>	<b>\$13.8457</b>

**Wine Production**

Wineries in the Niagara region grow their own grapes, or purchase grapes on contract from grape growers, or they do both. Under the Bench Cellars, as a virtual winery, plans to purchase all of its grapes for the first two years; but with its own property for growing grapes, it plans to plant vines to supply its future demand beginning with a smaller quantity in year three and increasing to meet its entire demand in later years. In particular, it hoped to plant Moscato grape vines immediately, and to produce some wine from this grape in its third year. Wine production varies depending on grape varietal as shown in Exhibit 6.

**Exhibit 6. Wine Production per Grape Varietal**

<b>Grape Varietal</b>	<b>Tonnage</b>	<b>Yield per tonne (L)</b>	<b>Production Volume (litres per tonne)*!</b>	<b>Cases per tonne</b>
Cabernet Franc	10	650	6500	722
Riesling	7	600	4200	467
Vidal	5	150 (icewine)	750	167
*Volume represents original liquid volume, but wineries can expect a loss of 4% to 6% due to evaporation, transfer loss, spillage, etc. !UTBC will withhold 5% of total production as a reserve: for tastings, gifts, cellaring, etc.				

In addition to the cost of grapes and the winemaker, Adrienne estimated additional costs as shown in Exhibit 7.

### Exhibit 7. Estimated Costs for UTBC

Materials and processing costs, including labour	\$15,200.00
Computer and software	1,070.00
Registration and licensing, including incorporation	2,300.00
Website design	1,500.00 + \$300.00 annually for maintenance
Telephone and Internet expenses	900.00 (annually)
Promotion (budgeted)	50,000.00 (includes the Niagara Grape and Wine Festival)
Leasehold improvements to property and building (one time)	50,000.00 total (highest estimate)
Management fees for Michael and Adrienne (annual)	25,000.00 each
Land lease (annual)	1,000.00 per acre
Yeast	0.03 per bottle
Nutrients	0.01 per bottle
Tannins	0.08 per bottle (for Cabernet Franc only)
Sulphites	0.07 per bottle
Corks	0.12 each
Bottles	0.18 each
Labels	0.32 each
12-bottle cartons	0.36 each

### Plans for the Weekend

Over their Friday evening dinner, Michael and Adrienne made their weekend plans. They realized that they had a number of decisions to make and they needed to present a realistic and final marketing plan to their potential investor. Gaining his support was important. Aside from the financial backing, his support would raise their confidence that they should proceed. From their immediate family and their own resources, they estimated that they could easily invest the first \$20,000, but they also knew they should be able to provide their investor with a realistic estimate of their additional needs, and their plans to pay back the investment. Over a glass of wine, Michael turned to Adrienne and said, "Let's relax and enjoy the evening. We should plan to get an early start in the morning as we have a lot to discuss and a lot of decisions to make."

Adrienne smiled as they clinked their glasses. "Maybe someday we'll own that "destination" winery that we've been dreaming of, complete with hotel. Who knows?"