FINAL REPORT AS PREPARED BY THE LODI-WOODBRIDGE WINEGRAPE COMMISSION AND THE CAL POLY FOUNDATION

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FEDERAL-STATE MARKET IMPROVEMENT PROGRAM

ENHANCING MARKET OPPORTUNITIES FOR AMERICAN WINEGRAPES THROUGH VERTICAL INTEGRATION

BACKGROUND

The Lodi-Woodbridge Winegrape Commission currently represents 757 winegrape growers farming approximately 80,000 acres of winegrapes in Crush District #11. Since its inception in 1991, the Winegrape Commission has served its constituents by conducting regional marketing, grower education, and research activities. It has also created an award-winning district-wide integrated pest management program that serves as a model for other regions and commodities. This program strives to move growers towards a more sustainable form of farming that is environmentally sound, socially just, and economically viable.

The Lodi region produces about 16% of California's total winegrape production, and is the state's leading supplier of premium winegrape varieties (Cabernet Sauvignon, Merlot, Zinfandel, Chardonnay, and Sauvignon Blanc). Yet the small number of wineries does not even make California's top ten list in terms of local wineries. In contrast the Napa area, with less than half the production of the Lodi region, has nearly 230 wineries. Sonoma County with half the acreage of the Lodi region has over 170 wineries. Average grower returns in those regions are two to three times those in Lodi.

To address this situation the winegrape commission has embarked upon a two-pronged strategy: one to address the growers' marketing needs, another strategy to address their educational needs.

The marketing program has been launched and focuses on developing regional agri-tourism. The educational program, the scope of this project, was to educate grape growers about the opportunities for profit enhancement through vertical integration. Vertical integration is defined as controlling more functions of production and marketing within the firm as the product proceeds along the path to the ultimate consumer. The gap between grower returns from vertically integrated and non-vertically integrated growers is a characteristic shared by the other 47 states that have local wine industries.

PROBLEM

The California Wine Industry is coming off an unprecedented decade of growth. The demand for premium California wine has expanded rapidly driven by a booming national economy, continuing reported health benefits of moderate wine consumption, and the baby-boomer demographic embracing wine. In addition, the wine industry has experienced a remarkable shift in value, as consumers have been trading up to higher priced premium wines away from historical jug-based wines. This fundamental shift from jug to premium wines has driven many California vintners in search of greater and greater quality winegrapes.

The above conditions led to a significant shortage of premium quality winegrapes in the mid-1990s. This shortage led to significant new plantings of winegrapes across the state. In Lodi, the acreage under production nearly doubled, with many jug-based varietals being replaced with premium varieties such as Cabernet Sauvignon, Merlot, Zinfandel, Chardonnay, and Sauvignon Blanc. Vineyards sprung up across California in many regions historically thought unsuitable for quality winegrape production. This planting boom continued through 2000.

Not only did the shortage of quality grapes lead to many speculative vineyard investments; it opened the door to foreign imports. Wineries facing product shortage bolstered supply by importing bulk wines from foreign producers bottling the wine under traditional California brands. Furthermore, market-savvy foreign-based brands led by Australia and Chile have stormed US markets taking market share from California winegrape growers. Imported brands have had further advantages including subsidized farming and the exchange benefits of the strong US dollar.

The above conditions coupled with the downturn in the US economy and the events of September 11th have dramatically changed the market conditions for California winegrapes. The demand for premium wine is still present, but the growth-rate has slowed, with current supplies far outstripping demand. Thousands of acres of grapes will go unharvested in coming years. Lodi growers have already experienced a depressed market as grape prices have gradually fallen the past couple of years. New vineyards will continue to come into production over the coming years making the situation more difficult.

Furthermore, globalization has brought about consolidation in the wine industry. International wine companies have evolved consuming domestic and foreign-based producers under a few globally based organizations. This consolidation has led to reduced competition for winegrapes in Lodi and the California wine industry.

Those regions that have done best, and will continue to fair best in the coming difficult years will be those regions that have formed a regional identity. Essential to forming an identity is the number of wineries within a region. More wineries lead to more regionally labeled wines, higher quality wines, greater tourism, and greater market awareness. The increased image and quality leads to long-term economic sustainability for

winegrape growers. In fact, industry analysts have demonstrated a direct correlation between the number of wineries and the value of grapes, the more wineries within a region the higher the price of grapes, a general concept clearly applicable to other US winegrape growing regions.

One way to create more wineries is for growers to vertically integrate their operations. This would involve the grower processing their own fruit into wine and then marketing the wine directly from the farm and/or through other market channels.

GOALS OF THE PROJECT

Since its inception in 1991 the Lodi-Woodbridge Winegrape Commission has set a fundamental goal of aiding in the development of the local wine industry. These efforts have blossomed in recent years as the number of people/growers interested in establishing wineries and Lodi-based brands has increased dramatically. This expanding interest manifested itself in regular visits from constituents seeking information on how to go about establishing a winery and marketing the finished product.

The wine industry is a relatively small but complicated business. It is saddled with extensive regulatory burdens and requires a broad spectrum of skills, knowledge, and ability to succeed. The successful vintner combines farming, production, business management, marketing, promotion, and sales in a single small enterprise. This type of venture requires extensive up-front capital and a solid business plan in order to succeed in today's competitive wine market.

Therein lies the need for an extensive grower education program. More wineries will bring greater recognition and higher returns to producers, especially those who vertically integrate to create wine labels and open tasting rooms. To adequately prepare for such an expansion growers need to be familiar with quality wine production techniques, regulatory matters, and marketing, distribution and promotion strategies.

The Lodi-Woodbridge Winegrape Commission sought grant funding through the Federal-State Market Improvement Program of United States Department of Agriculture. Grant funds were to be used to develop an educational curriculum designed to teach winegrape growers about vertically integrating their farming operation by establish a winery and/or brand. In order to benefit the largest number of growers, the curriculum was to be developed in a format that can be easily customized of other grape growing regions throughout the country.

METHODOLOGY

Through extensive discussions and consultations with growers the Lodi-Woodbridge Winegrape Commission developed a clear understanding of what type of information constituents were looking for to aid in establishing wineries. Those discussions combined with staff experience and consultation with Dr. Bob Noyes of Cal Poly San Luis Obispo and other leading industry experts led to the development of the course curriculum. The subjects were to be covered through a series of classes and instruction. The class schedule is attached.

A series of fourteen three-hour classes were developed to address the subject matter. Instruction was to be provided by Cal Poly State University Faculty, state and local industry experts, regulatory experts, and other related professionals. All instructors provided extensive handouts and offered detailed perspectives on their related fields. All classes were videotaped for those that could not attend, or those that may be interested in establishing a winery in the future. A business plan textbook was also provided. Many of the instructors also provide outside consulting services in their field of expertise and offered their services to those interested. The following individuals were responsible for the curriculum development and execution:

Mark Chandler
Executive Director
Lodi-Woodbridge Winegrape Commission

Stuart Spencer
Program Manager
Lodi-Woodbridge Winegrape Commission

Dr. Bob Noyes
Professor Emeritus
Food Science and Nutrition Department
Cal Poly State University

The following subjects were covered during the 3-month course curriculum:

The State of the Wine Industry – Today, Tomorrow, and the Future

- The wine industry is an extremely competitive market. Understanding broad market conditions will aid in establishing a viable business plan. Identifying industry trends, segmentation, and opportunities are keys to success.

Winery Business and Operations – What do I need and what is it going to cost?

- The production of wine is a capital-intensive business; it requires a significant investment well in advance of any returns. Understanding your true cost of goods is critical to long-term profitability. Furthermore, quality wine production is essential to being competitive. Understanding how quality wine is made and what it will cost is critical. Determining the scale of the operation (small, medium, large) is critical.

Regulatory Issues – Federal, State, County, and Local

- Getting through the red tape – requirements for a new winery. The production and sale of wine is an extremely regulated activity requiring interaction with multiple federal, state, and local agencies. Navigating the myriad of regulatory burdens requires extensive patience, time, and knowledge.

Sales, Marketing, and Distribution

- The scale of the operation may dictate how the product is sold. A small winery may choose to sell all their wine directly to consumers through their tasting room retaining the highest margins. Larger operations will require navigating the three-tier distribution system. Understanding and establishing a clear plan of sales and distribution is critical to creating a viable marketing plan.

Promotion and Packaging

- The wine shelves are filled with thousands of different brands and labels. Distinguishing your brand through quality packaging, effective promotion, and successful public relations is critical to selling through your product.

Business Plan Development

- Fundamental to the success of any business venture is a thoughtful and thorough business plan. It is necessary to obtain financing, and serves as a critical working document to guide the process of establishing a profitable winery. It will require a grower to carefully examine the marketplace to determine the scale and viability of their proposed operation.

PROJECT RESULTS

Through funding provided by the Federal-State Market Improvement Program of the United States Department of Agriculture the Lodi-Woodbridge Winegrape Commission was able to develop an extensive curriculum designed to assist Lodi winegrowers in vertically integrating their farming operation by establishing wineries and/or brands. This program came at a critical time in the California wine industry as decreasing vineyard returns are forcing many growers to explore other avenues of adding value to their winegrapes.

Over 50 people representing approximately 30 different business entities participated in the program. Many of the participants had already begun the process of establishing a winery and found the course curriculum of immense assistance in further defining their plans. Other participants have since begun the process of starting a winery, and have stated the classes have fundamentally altered their business plans. Still others after careful consideration have placed their winery plans on hold, realizing the wine industry is much more complicated and competitive than they had originally thought. All Lodi winegrower participants came away with a greater understanding of the wine business

and now have a better view of the market for California winegrapes, and the importance of regional identity.

See the attached "Final Report" as prepared by Dr. Noyes. This Report summarizes the responses of class participants. A copy of all course materials is also included.

The Lodi-Woodbridge Winegrape Commission is extremely happy with the results of the program. It has provided many of our growers with valuable information, insights, and instruction to properly guide them down the path of vertical integration. More wineries, buying more grapes, producing higher quality products, raising the image and awareness of Lodi wines is fundamental to the long-term economic sustainability of grape growing in the Lodi region. Not only will more wineries benefit those that choose to vertically integrate through increased returns, but also the entire district stands to gain as the reputation of Lodi wines rises driving more brands and wineries to Lodi in search of high quality winegrapes.

The project has provided key documents, instruction, and contacts that have energized local growers as they begin their new business ventures. We anticipate other states utilizing the curriculum will have similar positive results.

INDUSTRY BENEFITS

This program was designed with the thought in mind that just as in the case of our growing region, most of the farmers in other winegrape growing areas throughout the country are small farmers. As a result, this project also addresses many of the concerns targeted by national initiatives for small farm development and empowering of farmers through direct marketing opportunities.

The California and American winegrape industry stands to gain from this program. Federal-State Market Improvement grant funds produced a series of classes fundamental to vertically integrating from grower to winery. All of the classes were videotaped and are available for viewing. The majority of the classes had extensive handouts on the relevant subject matter. These handouts are also available. A key list of industry contacts, consultants, and experts was utilized, and is available for further consultation should growers so desire.

The Lodi-Woodbridge Winegrape Commission has already disseminated this information to constituents who were not able to participate in the original series of classes. The Commission continues to stress the importance of understanding the wine business before embarking on such a complicated business venture.

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