A BUSINESS PLAN FOR IMPORTING BC WINE INTO HONG KONG

by

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ABSTRACT

Table wine consumption is growing briskly in Hong Kong, especially after the abolishment of the 80% import duty. Hong Kong consumers are sophisticated and readily buy into the wine culture. Although the marketplace for table wine is crowded, there are virtually no BC products for sale. A marketing opportunity may exist.

This analysis examines the viability of a business plan to export premium BC table wine into Hong Kong. Based on an augmented Porter’s Five Forces analysis, the competitive landscape is found to be less than ideal. However, a Blue Ocean Strategy may lead to new market space for the BC table wine by creating a unique, premium, single-serve product. A marketing plan and financial analysis are specified.

Keywords: wine; table wine; wine exports; wine imports; BC wine; Hong Kong table wine market; Hong Kong wine duty
EXECUTIVE SUMMARY

This project is a complete analysis of the feasibility of establishing a small business solely focused on exporting premium BC table wine into Hong Kong. The drivers for this analysis are threefold. First, the Hong Kong government lifted the 80% duty on table wine imports in 2008. Second, a trend of table wine consumption is growing strongly in Hong Kong. And third, BC products are virtually absent from the Hong Kong market.

A top-down approach is chosen in this analysis. An external analysis is conducted by first examining the macro-environment with the “PESTLE” model. Essentially, this analysis showed that Hong Kong has: long-standing liberal trade policies, a robust economy, sophisticated consumers readily adopting the wine culture, technological innovation centred around customer experience, a reliable legal system, strengthened drinking and driving laws, and a negligible recycling program in the beverage industry.

In the Hong Kong table wine market, there are five strategic groups defined by distribution. They are:

- Auction
- Conglomerate Off-Trade (i.e., grocery and food retail chains)
- Independent Importer
• On-Trade (i.e., restaurants, bars and weddings)

• Re-Exportation (i.e., to China)

With the exception of the Auction Strategic Group, where rare wines worth tens of thousands of HKD are traded, an independent importer can market BC products in all other strategic groups. Each group offers a different balance in margins and volume.

When analyzing the industry using the augmented Porter’s Five Forces model, it is determined that the competitive landscape is less than ideal. Supplier power is favourable due to BC wineries’ concerns of saturation, overcapacity, and foreign competition in their home market. The substitute factor is favourable due to the popularity of table wine in Hong Kong outpacing that of beer, currently the most consumed alcoholic beverage. On the other hand, buyers hold significant power due to their control of end-customers and the abundance of choices. Fierce internal rivalries already exist, and government policies like the lifting of the wine duty benefit rivals and new entrants alike.

A Blue Ocean Strategy may be able to create new market space for BC premium wine. The strategy focuses on three pain points for the general consumer. First, general consumers are intimidated by the perceived knowledge required for wine appreciation. Second, casual drinkers, especially beer drinkers, are accustomed to serving sizes of a pint or less. And third, wine has higher alcoholic content than beer, which deters consumers from ordering a full bottle of wine. In addressing these pain points and increasing the spread between cost and price, eight elements were identified in the
strategy. Essentially, expensive marketing methods such as an extensive variety selection and tasting events will be eliminated or reduced. Instead, more cost-effective marketing methods, such as leveraging awards and label design, will be raised. In particular, a new single-serving sized product can be created to address the sizing pain point for casual wine drinkers. The single-serving sized bottle can become a unique trait of BC premium wine. If successful, it can become part of the customer experience and visual display in on-trade settings. The risk is that single-serve bottles are typically associated with low-end wines. However, a consolidated effort of the entire Blue Ocean Strategy can increase the likelihood of success.

A successful business plan will need the cooperation of a small to medium-sized winery in BC as well as uptake by high-end, on-trade establishments in Hong Kong. Financial analysis shows that a modest investment of HKD $327,000 (CAD $42,400) will be required in the first year of the business plan, with annual profits starting in the second year. Successful market penetration can yield an internal rate of 22% over a five year project life. Moreover, it can also create the groundwork for re-exportation into the vast Mainland China.
DEDICATION

To my wife, Betty.
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# GLOSSARY

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CAD</td>
<td>Canadian Dollar</td>
</tr>
<tr>
<td>HKD</td>
<td>Hong Kong Dollar</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Officially the Hong Kong Special Administrative Region, it is part of People’s Republic of China but has retained most of its British colonial governments and systems. Has a restricted border with the rest of China.</td>
</tr>
<tr>
<td>Mainland China</td>
<td>China, excluding special administrative regions such as Hong Kong, is colloquially referred to by this term.</td>
</tr>
<tr>
<td>Market Maven</td>
<td>In Marketing, this is the group of individuals in a “buying unit” who are regarded as experts and who influence the decision maker.</td>
</tr>
<tr>
<td>New World Wines</td>
<td>Refers to wines from other parts of the world that are cultivated since the colonial period (i.e., the Americas, Australia and New Zealand, and South Africa). These wines are generally regarded as crisper and stronger in taste as compared to Old World wines.</td>
</tr>
<tr>
<td>Off-trade</td>
<td>The retail sale of alcoholic beverages for consumption elsewhere from place of purchase (i.e., supermarkets, liquor stores, etc.). Also known as off-sales.</td>
</tr>
<tr>
<td>Old World Wines</td>
<td>Refers to wines from mainly European countries with long histories of wine making (i.e., France, Italy, Spain, Germany and others). These wines are generally considered as more subtle and complex in taste as compared to New World wines.</td>
</tr>
<tr>
<td>On-trade</td>
<td>The sale of alcoholic beverages in food services establishments for consumption at place of purchase; i.e., restaurants, bars, lounges, etc.</td>
</tr>
<tr>
<td>Table wine</td>
<td>An alcoholic beverage that is made from fermented grape juice. It comes in red, white, or rose varieties depending on the type of grapes. It is distinguished from sparkling wine, champagne, ice wine, fortified wine, and brandy.</td>
</tr>
</tbody>
</table>
VQA  A voluntary certification developed by the wine industry that guarantees the quality, origin, and variety of the grape and wine. The BC VQA is similar to, but independent from, the Ontario VQA.
1: INTRODUCTION

In 2008, the Hong Kong government abolished the 80% duty on wine imports and removed the licensing requirements associated with the importing, storing, and selling of these goods (Hong Kong Government Information Services Department, 2008). This new fiscal policy was intended to position Hong Kong as a leader in the emerging table wine retail and re-exportation industry. Hong Kong had historically been the regional finance and trade centre of South East Asia, but various major cities in Mainland China have recently been competing for the same business. However, the Chinese government has a mandate to maintain Hong Kong’s economic status. The initiative to stimulate the wine sector in Hong Kong is just one of many to secure the city’s position as a leader.

Consumer interest in fine dining has also been growing. The local population has always enjoyed the existence of a wide variety of foods and, thanks to Hong Kong’s colonial and port history, the locals have always been familiar with both Asian and Western cuisines. As proof of this, many small, private, prix fixe restaurants have sprung up in recent years. The television channels have also caught onto this trend. Food programs, increasingly popular in Hong Kong television, have been showcasing these trendy restaurants. With sophisticated establishments vying to offer the best complete dining experience, consumers are paying increasing attention to wine pairings and a general appreciation of premium table wines.
This trend in wine consumption is supported by a recovering local economy. According to International Monetary Fund data, the 2009 GDP for Hong Kong decreased by 2.76%, but is estimated to have increased by 6% in 2010. It is further forecast to rise by 5% and 4% in 2011 and 2012, respectively. Furthermore, quarterly data indicate that the economy was, in fact, growing in the latter half of 2009.

The zero wine duty policy, coinciding with this consumer trend in food appreciation as well as support from a strong economy, has led to a strong growth in table wine consumption. Sales have grown steadily since the introduction of the zero duty policy despite the recession in 2008 and 2009. As illustrated in Table 1-1, wine sales grew significantly since the period when the duty was lifted, which was undertaken in two stages in 2007 and 2008. Wine sales continued to grow consistently by 6% in 2009 and 2010.

Table 1-1: Table Wine Sales Growth in Hong Kong

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volume (‘000 Litres)</td>
<td>6,419</td>
<td>6,946</td>
<td>7,709</td>
<td>8,141</td>
<td>8,639</td>
</tr>
<tr>
<td>Annual % Change</td>
<td>4.4%</td>
<td>8.2%</td>
<td>11.0%</td>
<td>5.6%</td>
<td>6.1%</td>
</tr>
<tr>
<td>Sales (HKD$ million)</td>
<td>1,504</td>
<td>1,549</td>
<td>1,659</td>
<td>1,754</td>
<td>1,867</td>
</tr>
<tr>
<td>Annual % Change</td>
<td>4.9%</td>
<td>3.0%</td>
<td>7.1%</td>
<td>5.8%</td>
<td>6.4%</td>
</tr>
</tbody>
</table>

(Euromonitor International, 2010)

On the other side of the Pacific Ocean, British Columbia (BC) possesses a well-established wine production industry with 189 wineries producing approximately 13 million litres of table and sparkling wine in 2010 (BC Wine Institute, 2011).
Approximately 7.8 million litres of this production was premium wine under the VQA designation, which is an industry-established, quality assurance certification. The BC wine industry exports only about 10% of its total production (BC Ministry of Agriculture, Food and Fisheries, 2004), but wineries seem to be eager to investigate further export opportunities. An indication of this interest is the establishment of the National Export Working Group in 2007 by the Canadian government and wine industry associations. The Working Group aims to double national exports within an unspecified time period. It identified Hong Kong as one of the priority target cities in the Asia-Pacific region.

Currently, only the Mission Hill winery in BC has products in Hong Kong. Less than 50,000 litres of wine valued at CAD $800,000 were exported from Canada to Hong Kong in 2009. This is a miniscule amount compared to the total of 35 million litres valued at CAD$594 million imported into Hong Kong (the difference between the total imported and the CAD$219 million consumed is re-exported) (Euromonitor International, 2010). The outlook of local consumption trends in Hong Kong and the existence of a mature wine production industry in BC suggest that there may be an opportunity to link the supply in BC to the demand in Hong Kong.

This project will examine the feasibility of establishing a small business focused solely on exporting premium BC table wine into Hong Kong. The product will be sourced from one or more BC wineries. It will then be shipped to Hong Kong and sold to on-trade or off-trade retailers or both. Chapter 2 begins with an external analysis to define the industry boundary and the market. A “PESTLE” analysis will paint the background for subsequent analyses. The table wine market will then be defined by product and then
by price, before the boundaries of each strategic group are drawn. Consumer trends that are common across all strategic groups are presented. The industry supply chain will be drawn to summarize the distribution in the market. In chapter 3, the competitive landscape will be examined in detail using Porter’s Five Forces analysis and the Blue Ocean Value Curve analysis. Chapter 4 will focus on the evaluation of the business opportunity with a marketing plan and financial analysis. A break-even analysis will also be performed with financial scenarios of selling in different channels. Lastly, a discounted cash flow will assess the viability of a business plan.
2: INDUSTRY BOUNDARY AND MARKET DEFINITION

Wine has many products in different major markets. Within each market, the consumption, distribution, pricing, and other marketing factors differ between strategic on-trade and off-trade groups. To take advantage of the opportunity presented in this analysis, the successful small business must identify its relevant market to compete effectively. This chapter will first review the macro-environment in Hong Kong by performing a “PESTLE” analysis. Based on this background knowledge, the rest of the chapter will define the market boundaries in terms of strategic groups, present consumer trends common to these groups, and present the industry supply chain.

2.1 Macro-Environment

In this section, the underlying macro-environment of the wine industry will be analyzed using the “PESTLE” framework. “PESTLE” is an acronym for the following factors: political, economic, socio-economic, technological, legal and environmental. An individual firm cannot affect these macro-environment factors, but understanding them helps the firm to seize opportunities and anticipate threats (Chartered Institutue of Personnel and Development, 2010).

2.1.1 Political Factors

Hong Kong has historically been an important finance and trade centre with over 7 million inhabitants and a GDP that currently ranks 38th in the world—ahead of Greece
and Singapore (US Central Intelligence Agency, 2011). It achieved this status mainly because of China’s closed economy. International trade and financial activities with China were funnelled through Hong Kong. Such activities were also encouraged by the Hong Kong government’s non-interventional policies. In the recent decade, however, China has opened up its economy by creating Special Economic Regions around several major cities. This has allowed trade to bypass Hong Kong. The success of China’s new policies is evident in the recent news that the GDP of Shanghai—one of the aforementioned Special Economic Regions—has recently surpassed that of Hong Kong (Qiang, 2010). Moreover, competition for business has increased from outside China. Singapore, for instance, looks to overtake Hong Kong in the financial sector by creating a business environment with fewer restrictions than that of Hong Kong (Huat, Lim, & Chen, 2004).

Facing decline, the Hong Kong government is attempting to create a competitive advantage in various industries. For example, the government considers Hong Kong’s existing high-quality post-secondary education as an asset. To take advantage of this asset, the government offered tax incentives to high-tech businesses and made post-secondary institutional reforms in order to create a technology cluster similar to America’s Silicon Valley. In another example, the government recognized tourism as a significant industry in Hong Kong, so it attracted Disney with a land deal. Similarly, the government sees the rising popularity of wine consumption as an opportunity that fits with Hong Kong’s special trading status. Lifting the wine duty was a fiscal policy
designed to stimulate consumption and re-open the export channels into China. This policy is expected to be an enduring commitment.

In addition to being a Special Economic Region of China, Hong Kong is also a Special Administrative Region (SAR)—meaning it operates semi-autonomously from the central authority in Beijing. Part of the reason that it was granted this status is China’s desire to leave intact all factors conducive to Hong Kong’s economic success. Specifically, Hong Kong’s reliable contract laws, low taxes, integration with global financial markets, ease of obtaining credit, and its government’s non-interventionist policies have all been retained from colonial times. These factors have contributed to Hong Kong being second on the list of world economies ranked by ease of conducting business (The World Bank Group, 2010). Almost all items can be shipped freely in and out of Hong Kong with the exception of tobacco and firearms. However, the SAR status is only guaranteed until 2047; afterwards, Hong Kong may be expected to integrate with Mainland China.

In conclusion, there is no political barrier to importing table wine into Hong Kong. On the contrary, the government supports it.

2.1.2 Economic Factors

Hong Kong has one of the highest GDP per capita in the world; Hong Kong, at US Dollar (USD) $45,600 per capita, ranks 11th in the world (US Central Intelligence Agency, 2011). Furthermore, the local economy has recovered from the recession of 2008. Having grown an estimated 6.0% in 2010, it is estimated to grow by 4.7% in 2011 and
4.3% in each of the subsequent years from 2012 to 2015. Other economic indicators suggest that the economy is robust. Inflation, estimated to fluctuate between 2.7% and 2.5% in the next five years, is lower than many other developed countries. The unemployment rate, expected to hover around 4.0%, is much lower than in Canada or the United States. Table 2-1 lists these indicators as recorded and estimated by the International Monetary Fund.

Table 2-1: Major Economic Indicators for Hong Kong and China (in percent change)

<table>
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</thead>
<tbody>
<tr>
<td>GDP annual growth rate (%)</td>
<td>-2.76</td>
<td>6.04</td>
<td>4.69</td>
<td>4.32</td>
<td>4.30</td>
<td>4.28</td>
<td>4.28</td>
</tr>
<tr>
<td>Inflation rate (%)</td>
<td>0.52</td>
<td>2.7</td>
<td>3</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>5.14</td>
<td>4.39</td>
<td>4.08</td>
<td>3.97</td>
<td>3.96</td>
<td>3.96</td>
<td>3.95</td>
</tr>
<tr>
<td>GDP annual growth rate – China (%)</td>
<td>9.10</td>
<td>10.5</td>
<td>9.59</td>
<td>9.54</td>
<td>9.49</td>
<td>9.47</td>
<td>9.45</td>
</tr>
</tbody>
</table>

Note: figures from 2010 to 2015 are estimates
(International Monetary Fund, 2010)

Hong Kong’s economy is, however, very much dependent on China’s growth. Table 2-1 includes the annual growth rates of GDP in China for comparison. Hong Kong, like many other developed economies, no longer has a significant manufacturing sector. As a result of this, it is dependent on the financial sector and its import/export activities in and out of China. In the financial sector, Hong Kong’s stock exchange has become the major venue for initial public offerings and listings of Chinese company shares. This is because capital movement in and out of China, as well as the exchange of China’s currency, the Renminbi (RMB), is severely restricted by the Chinese government.
However, China has granted Hong Kong special freedom on the movement of capital. This, coupled with Hong Kong’s financial integration with the world, use of international accounting standards, and reliable legal system make it an attractive location for both Western and Chinese investors.

Foreign currency risk is a major consideration in any international business. The HKD is fixed at around HKD $7.80 to USD $1. The exposure of Canadian businesses to HKD denominated revenue is therefore dependent on the strength of the USD. The RMB exchange rate, which is also fixed to the USD, also needs to be. China has been criticized for keeping the RMB undervalued to sustain an export advantage to offset the rising cost of labour. It is under pressure from other countries, such as the US which has a large trade deficit with China, to remove this unfair advantage. Moreover, China has come to hold a significant amount of assets in foreign currencies. The Economist, in the article “The Rise of the Redback”, argues that in order for China to reduce its foreign exchange exposure, it needs others to adopt the RMB. An undervalued currency that can only strengthen is unattractive to borrowers. It is, therefore, in China’s long-term interest to allow the RMB to rise while its economy is strong (The Economist, 2011). It seems the RMB can only revalue. A revaluation will make imports cheaper in China, other things equal, making importing more favourable..

In conclusion, the economies of Hong Kong and China are strong and growing. The importer is dealing with an exchange rate that is pegged to the USD. In addition, the long-term exchange risk is favourable to the importer that might expand into China.
2.1.3 Socio-economic Factors

Hong Kong has a sophisticated middle class with high disposable income and a culture for consumption. As previously mentioned, not only is its GDP per capita ranked 11th in the world, but at purchasing power parity it is also higher than that of Canada (US Central Intelligence Agency, 2011). An average resident in the labour force typically works longer hours than his or her North American counterpart—almost 50 hours per week (Welford, 2008). Furthermore, the average home size is only 600 square feet while the average household size is 2.9 persons (Chung, 1999; Hong Kong Census and Statistics Department, 2011). Consequently, workers looking to relax and splurge are not only short on time, but also short on space. This results in a high demand for “third place” establishments (Mok V., 2010; Kwan, 2011).

Since Hong Kong was formerly a British colony, a significant amount of its business is conducted in English and many of its citizens are familiar with Western culture. There are also a large number of expatriate residents from other developed countries working in the local headquarters of multinational corporations. These people bring more diversity and an appreciation of different cuisines to the city. This may explain why local consumers readily accept new trends. One example is the recent opening of a wine bar by California Vintage, which offers 88 different labels from 22 participating Californian wineries. Customers use in-store Apple iPads to browse and learn about the available wines and obtain their choices from integrated vending machines. This wine bar opened in an area of high-end bars and lounges in the Central
District, which is the downtown core of the city. More significantly, it is the first store of a planned chain of five to be opened in other cities throughout Asia.

The fact that California Vintage chose to open its first location in Hong Kong also illustrates another notable socio-economic phenomenon. Hong Kong has traditionally been a trendsetter and test market for the vast Chinese market. This is due to the more modern and advanced lifestyle in Hong Kong, as compared to China before its significant economic growth. Since this growth, the living standards of the large Chinese middle class have become comparable to those in Hong Kong. However, China’s social and regulatory framework has not caught up. Consumers in China still rely on consumers in Hong Kong to highlight trends in world culture. They also rely on Hong Kong as a gatekeeper of authentic, quality goods. A well-known example is the tainted milk incident in China, where the chemical melamine was added to cow’s milk to fraudulently increase its protein test rating. It caused a crisis by damaging kidneys in children who consumed the widely distributed contaminated formula (Reynolds, 2008). The Chinese consumers’ response was to purchase only goods made in Hong Kong or other countries. Since this is generally not possible within China, those who can afford to do so travel to Hong Kong to buy groceries and other household items. During the Lunar New Year, a major shopping season in China, many Hong Kong shopping centres organized day-trips for Chinese citizens for the sole purpose of grocery shopping (Lee, 2011).

Intellectual property (IP) rights are generally recognized to be unenforced in China. Copyright infringement is rampant and counterfeit goods are widely available.
Luxury goods are especially attractive targets for IP theft. For example, ice wine, a high-value, rapidly growing market segment in China, is a prime target for counterfeiters. Some industry players even estimate that fake ice wine comprises 80% of the Chinese market (O’Donnell, 2011). Hong Kong stores carrying luxury brands, such as Louis Vuitton and Gucci, frequently have line-ups outside the door made up of Chinese tourists looking for authentic goods.

In conclusion, consumers in Hong Kong are sophisticated and at the forefront of international trends. Furthermore, consumers in China regard Hong Kong as a gatekeeper of international trends and a source of authentic, reliable, foreign products. The implication is that the success in marketing premium BC wine in Hong Kong can potentially lead to success in the Chinese market.

2.1.4 Technological Factors

The total land area of Hong Kong, at 1,076 square kilometres, is approximately one-third that of Metro Vancouver but has over triple the population (Wikipedia, 2011). The terrain is also hilly and mountainous with little arable land. Consequently, there are no grapes grown in Hong Kong, so almost all wine is imported. In 2008, an entrepreneur tried to overcome this by removing the vineyard from the production process. A winery was established in an industrial warehouse by making wine from imported frozen grapes (Chiou, 2009). This technological change has not had any real impact on the wine market because wine is relatively inexpensive to import. Moreover, a significant part of the willingness of consumers to pay comes from the prestige of the wine’s origin.
The wine industry is generally resistant to innovations that affect the marketing of wine. In packaging, for example, glass bottles are sealed with cork. Cork is actually susceptible to fungus that can spoil the wine. Screw-tops and synthetic corks are superior, but consumers still associate cork with premium wine. Ironically, screw-tops and synthetic corks, technological innovations in themselves, are commonly used only in low-end wines (Bonné, 2003).

As previously mentioned California Vintage is bringing marketing innovation in the use of interactive interfaces and specialized vending machines. This technology adds to the customer experience but does not alter the product itself. The success of this approach remains yet to be seen. This type of customer experience improvement is more appropriate at off-trade points of sale such as supermarkets or wine stores. Off-trade customers would appreciate instant access to information while shopping in stores. This is especially true in Hong Kong where, as mentioned in section 2.1.3, people have little time. Automation is also a way to promote products at a lower cost rather than hiring and training customer service representatives. In on-trade establishments, a waiter or sommelier would likely provide a better experience.

In conclusion, there is little innovation in the wine industry, especially on any aspect of the supply chain that may be perceived to alter the authenticity and quality of the product. However, added value may be possible by using technology to enhance the overall customer experience.
2.1.5 Legal Factor

The World Bank ranks the ease of doing business in different countries by assessing the degree of “red tape.” Hong Kong has ranked second in the world for the past two years and currently ranks sixth in the sub-category of starting a business (The World Bank Group, 2010). In lifting the duty on wine, the Hong Kong government also abolished any licensing and restrictions on the importing, storing, and distribution of wine. This means an import operation will require only minimal dealings with the government. A new company needs only to register for name use and for tax purposes. The complete requirements are listed in Table 2-2.
Table 2-2: Requirements of Starting an Incorporated Business in Hong Kong

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Government Department</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certificate of Incorporation or Certificate of Registration of Non-Hong Kong Company</td>
<td>Companies Registry</td>
<td>To ensure the rights to the business name.</td>
</tr>
<tr>
<td>Business Registration Certificate</td>
<td>Inland Revenue Department</td>
<td>To pay profits tax. There is no requirement to deduct payroll tax for employees.</td>
</tr>
<tr>
<td>Licence for Storage or manufacture of Dangerous Goods (Excluding Explosives)</td>
<td>Fire Services Department</td>
<td>Obtain a fire safety permit for the warehouse.</td>
</tr>
<tr>
<td>Employee enrolment in a Mandatory Provident Fund (pension) scheme</td>
<td>Mandatory Provident Fund Schemes Authority</td>
<td>Mandatory pension plan paid by the employer and obtained from private providers.</td>
</tr>
<tr>
<td>Enrolment in a Employees’ Compensation Insurance policy</td>
<td>Labour Department</td>
<td>Mandatory injury insurance paid by the employer and obtained from private insurers.</td>
</tr>
<tr>
<td>Registration for Hong Kong Registered Wine Exporter</td>
<td>Trade and Industry Department</td>
<td>To expedite customs clearing when re-exporting into Mainland China.</td>
</tr>
</tbody>
</table>

(GovHK, 2010; Hong Kong Trade and Industry Department, 2009)

Hong Kong ranks second in the sub-category of enforcing contracts. This is an indication of the time and cost necessary to resolve a contract dispute (The World Bank Group, 2010). The Judiciary in Hong Kong is separate from the Legislative Council. The legal system is based on the English common law preserved from colonial times. The UK, Canada, and the US all use the common law system, but since this system is based on legal precedence, the law in Hong Kong has developed some differences from those
jurisdictions (Glofcheski, 2002). Hong Kong’s SAR status means that its justice system operates independently from that in Mainland China, which uses the civil law system.

The Hong Kong government has no labelling requirements for alcoholic beverages containing more than 10% alcohol (US Department of Agriculture, 2005). A guideline exists, but usage is voluntary. In general, labelling can be either in English, Chinese, or both. In reality, since wine has an alcohol content exempt from labelling, the label on the product can be in any language.

The government has been focusing on the issue of drinking and driving. The public is concerned about an increase in media reports of serious, alcohol-related accidents—some even involving innocent bystanders. Consequently, new legislation passed in 2009 hands out harsher penalties for drinking and driving and gives more power to the police for breath tests (The Standard, 2009). The current blood-alcohol limit in Hong Kong is 22 milligrams of alcohol per 100 millilitres of blood (mg/100mL)—lower than the 50 mg/100mL limit in BC. The police have used their new powers to conduct a program of road checks. The Hong Kong Medical Association and the Law Society of Hong Kong, the statutory bodies for medical doctors and lawyers respectively, have also initiated an educational campaign on drinking and driving. Although more people opt for public transportation over driving in Hong Kong, the low blood-alcohol limit and heavy law enforcement may affect on-trade sale of wine.

In conclusion, Hong Kong has strong contract laws for conducting business while labelling laws are minimal. Consumers may be discouraged in consuming alcohol due to new drinking and driving laws, but most people still use public transit instead of driving.
2.1.6 Environmental Factors

The people in Hong Kong are as keen on environmentalism as in other parts of the developed world. This is especially due to the lack of space and the density of the population. For example, the public overwhelmingly supported a retail-level levy introduced on plastic shopping bags (Hong Kong Environmental Protection Department, 2011). In newer residential developments, recycling collection is common (Kwan, 2011).

Unfortunately, there is no large-scale bottle return program in Hong Kong. The refundable deposit requirement commonly found in Canada does not exist in Hong Kong. There is also no voluntary effort from the industry to collect and recycle empty bottles. Only 3,000 tonnes of glass bottles were recycled out of a total of 86,000 tonnes disposed in 2006. The reason for the lack of effort is that most beverages are imported. Local beverage companies that previously collected and reused glass containers have mostly moved their bottling operations to Mainland China or some other South East Asian country. Companies find it cheaper to use new bottles than to transport and reuse recycled bottles. The used glass bottle also has no market value as raw material because the cost of transportation negates the cost savings from melting down old material (Waste Reduction Group, 2007).

In conclusion, although consumers are concerned about environmentalism, there is no direct impact on the industry. The beverage industry is not involved in the recycling business.
2.2 Definition of Table Wine

2.2.1 Types of Grape Wine Products

Grapes can be used to produce six different types of wine products. This section will identify these six types and provide a definition for table wine.

There are six types of wine products differentiated by their means of production. Table wine is fermented from grape juice. Ice wine is fermented from the juice of grapes picked while frozen on the vines. Champagne is table wine fermented a second time to produce carbonation. Sparkling wine is essentially champagne made outside the Champagne region of France. It may be artificially injected with carbon dioxide. Brandy is made from distilled wine. Lastly, fortified wine is wine with another spirit added. An example of this is sherry, which is white wine fortified with brandy.

Each type of wine product serves a different consumer market. Table wine is the most widely consumed wine. It is typically consumed by itself or as a complement to meals. Wine products are finely differentiated by grape variety and origin. The consumer must also have a certain degree of wine knowledge to properly pair these different varieties of wine with different foods. In contrast, the other five types of wine products are more limited in market reach. Ice wine and fortified wine are typically consumed as dessert wines after a full course meal. Champagne and sparkling wine are generally reserved for special occasions. Brandy is typically consumed in lounges. However, in Mainland China brandy is often consumed during a meal as a substitute for other strong spirits such as rice wine or whiskey.
The market size for each wine product also differs. Hong Kong consumes far more table wine than any of the other types. As shown in Figure 2-1, not only does table wine have much larger sales revenue than other wine products, but its sales are also growing faster. To be specific, growth in sales was 7.1% in 2008, which was the first year the wine duty was lifted. Sales grew at 5.8% and 6.4% in 2009 and 2010, respectively (Euromonitor International, 2010). It is also interesting to note that local consumers greatly prefer red wine over white and rose wines combined, by a ratio of 3:1. This preference has slowly become more pronounced over the past five years. Ice wine, not shown in the data, is a small but growing segment. Anecdotal evidence indicates that ice wine is gaining popularity in China (Agri-Food Trade Services, 2008; Susan O’Dell & Associates, 2009). In Hong Kong, consumers prefer champagne over sparkling wine due to it being perceived as a luxury item (Agri-Food Trade Services, 2008).
BC produces only table wine, ice wine, and sparkling wine. Table wine is produced in the largest volume, but it has an insignificant share of the Hong Kong market. Ice wine is exported in high volume and is already found on the Hong Kong market. Most of the ice wine that Hong Kong receives is actually re-exported to Mainland China, where Canadian ice wine is well-known and popular. The Canadian ice wine export market is currently dominated by Ontario. Sparkling wine has a very small market share, and, as mentioned, is not as preferred as champagne (Agri-Food Trade Services, 2008).

### 2.2.2 Table Wine Price Segments

The table wine industry consists of four segments: ultra-luxury table wine, luxury table wine, premium consumer table wine, and consumer table wine. There are no
sharp distinctions between the categories, and wineries often market products in adjacent segments. All four categories are active in the Hong Kong market, but BC only produces the latter two types of consumer table wine.

Ultra-luxury table wine are priced around HKD $40,000 (CAD $5,200) and beyond. These are rare wines typically produced by “Premier cru” (First Growth) Bordeaux or other prestigious Old World wineries. Like other luxury goods, competitors in this strategic group rely on the intangible qualities of expertise, prestige and exclusivity. Brand equity has been built over centuries. These brands have also been successfully built on the notion of terroir—the unique combination of soil, terrain and micro-climate.

Luxury table wines are priced at HKD $800 (CAD $102) and beyond. Typically, luxury wines are in the thousands of HKD (hundreds of CAD). They can come from both the Old World and the New World, but they are marketed based on the same elements of wine-making expertise—exclusivity and terroir. Production is limited to sustain high prices. Successful wineries in this segment often have vintages that become priced into the ultra-luxury table wine segment. Examples of New World brands are Penfolds Grange from Australia and Screaming Eagle from California.

Premium consumer table wines are priced at HKD $800 (CAD $102) or less. Most products in this group are priced from HKD $200 to $300 (CAD $26 to $38). This is below luxury table wines but higher than consumer table wines. Both producers of luxury table wines and consumer table wines extend their product range into this pricing category. Marketing elements of luxury table wines are used. Examples of brands are cheaper
labels from Penfolds Grange, and “reserve” labels from larger wineries such as Mission Hill.

Consumer table wines are priced around HKD $100 (CAD $13) or below. The lowest prices are typically comparable to beer by volume. The recognized low-cost producers in this segment come from Chile, Argentina and South Africa.

The BC table wine industry currently produces both premium consumer table wine and consumer table wine.

2.3 Industry Supply Chain

A visual representation of the industry supply chain is presented in Figure 2-2. The next section will define and discuss strategic groups in the consumer table wine industry. Table wine re-exportation, which is not included in this figure, will also be examined. As discussed in the next section, the activities of each strategic group often overlap when selling through each channel.
2.4 Table Wine Strategic Groups

Strategic groups are clusters of rival firms with similar competitive approaches and positions in an industry. In Hong Kong’s table wine industry, there are several strategic groups selling table wines that overlap in product and price ranges, but differ by distribution channel. These strategic groups are: auction, conglomerate off-trade, independent off-trade, on-trade, and re-exportation.
2.4.1 Auction Strategic Group

Much headline space in the Hong Kong media has been given to the success of wine auctions thanks to the zero wine duty policy. News articles have described how cases of rare, ultra-luxury table wine achieved record prices, and how sales have surpassed the traditional wine auction centres of London and New York. Prices are extreme in this strategic group. For example, a case of 1982 Château Lafite-Rothschild, a much sought-after First Growth vintage, fetched HKD $780,000 (CAD $101,000) at a recent Christie’s auction in Hong Kong (Christie's, 2010).

The products in this strategic group are in the ultra-luxury and luxury price segments. BC produces in neither segment.

2.4.2 Conglomerate Off-Trade Strategic Group

The conglomerate off-trade strategic group mainly consists of grocery chains and specialty wine store chains. Two local conglomerates possess significant market share in both of these areas, while hundreds of other independent importers fill niche markets, which are discussed separately in section 2.4.3. Distribution is characterized by centralization of procurement and warehousing, and vertical integration backward into these activities.

2.4.2.1 Conglomerate Off-Trade Segments

There are two segments in this strategic group. The segments are separated by their underlying retail industries. They are the grocery and the specialty chain wine
retailer industries. They are included in the same strategic group for this analysis because of their similar procurement and distribution characteristics.

The grocery industry, which includes supermarkets and convenience stores, is highly concentrated and vertically integrated. Two conglomerates hold 43% of the market share by sales in Hong Kong, while smaller chain operators and multi-national corporations make up the rest of the market (Euromonitor International, 2011). These two conglomerates are the Jardine Matheson Group (Jardine) and Hutchison Whampoa Limited (Hutchison). Most of this market share is spread among three retail chains: ParknShop Supermarkets owned by Jardine, and Wellcome Supermarkets and 7-Eleven Convenience Stores owned by Hutchison. These supermarket chains each have over 200 locations, and 7-Eleven has almost 1,000 locations. Consumers can select from approximately 300 to 500 different table wine labels at each supermarket chain. Based on a survey of the product lists at Wellcome and ParknShop, the supermarkets stock wine with an average price of HKD $100 (CAD $13) and a maximum price of HKD $500 (CAD $63) (Wellcome Supermarkets, 2010; ParknShop, 2010). Consistent with its marketing strategy, 7-Eleven has less product choices at a lower price ranges.

In addition to the grocery chains, Hutchison also owns the Watson’s Wine Cellar chain. It is the predominant specialty wine retailer in Hong Kong, and it receives minimal competition from independent wine retailers (Euromonitor International, 2010). There are 18 Watson’s stores selling more than 2,000 different wines. Jardine owns Oliver’s The Delicatessen, which specializes in fine foods but has only one store. There are many independent wine retailers in this market as well, but none of them carry as broad a
selection as Watson’s, according to a survey of online catalogues from these retailers. The stock at Watson’s Wine Cellar has a price range that starts around the supermarket average price of HKD $100 (CAD $13) and ends at HKD $29,000 (approximately CAD $3,700). Customers who frequent specialty wine stores include connoisseurs and expatriates (Agri-Food Trade Services, 2008).

2.4.2.2 Conglomerate Off-Trade Distribution Characteristics

The major retail chains benefit from significant market concentration. Each of the chains achieves economies of scale in supply chain management (SCM). The management of these chains results in three operational characteristics:

- These chains prefer suppliers of non-perishables to deliver directly to their centralized warehouses, because they have sophisticated SCM for their vast retail networks. Some of the deliveries are done as “flow-through” distribution, or what is known as “cross-docking” in North America. Flow-through distribution is where stock is transferred directly from the suppliers’ trucks into waiting retailer’s trucks thereby eliminating the warehousing step (Mok V., 2011).

- The conglomerates achieve synergy in purchasing through negotiation of general contracts. Subsidiary chains then make sub-contracts with terms based on their specific needs such as volume and frequency. In the case of Hutchison, owner of Wellcome and 7-Eleven, warehousing and some purchasing operations are shared. However, for Hutchison, owner of ParknShop and Watson’s Wine Cellar,
the warehousing and purchasing operations are independent because the latter chain’s size and product differences require specialization (Mok V., 2011).

- These chains often procure by “direct indent.” This is the practice of sourcing imported merchandise directly from a supplier abroad rather than through a local importer. (Mok V., 2011).

From the perspective of an importer, there are three factors affecting the retailers’ procurement decisions. They centre on the retailers’ practice of management by product categories. First, price plays an important role because there are many similar table wine products available, but there is limited shelf space. Second, retailers use overseas sales performance and awards as indicators of marketing potential. And last, the degree of marketing support from the importer is also important to the sales potential (Mok V., 2011).

2.4.3 Independent Importer Strategic Group

This strategic group consists of small and medium enterprises (SME) and large corporations. Unlike the Conglomerates Off-Trade strategic group, players engage mainly in importing activities and engage only in specialty retail and wholesale. Large importers include local subsidiaries of multi-national enterprises (MNE) of alcoholic beverages, as well as major local importers. SMEs and large corporations use the same sales channels. However, their marketing expenditures are different due to capital limitations.
2.4.3.1 SME Off-Trade Segments and Distribution Characteristics

Players in this strategic group conduct their own importing operations and compete in four main niche segments: retailing consumer table wines, retailing luxury table wines, wholesaling consumer table wines, and wholesaling luxury table wines. Players often compete in multiple segments. The main difference between rival players is their direct marketing spending; otherwise, there is no sharp line separating them.

There are over 300 independent table wine retailers and wholesalers listed in the Hong Kong Yellow Pages. There are at least two independent chains competing against Watson’s Wine Cellar and Oliver’s The Delicatessen. Rare & Fine Wines Ltd. is an independent chain operated by MNE importer Maxxium Hong Kong. It has three stores specializing in its own imported brands. Red Wine Cellar is an independent chain not owned by a MNE. It has three stores selling several hundred different wines. Other independent retailers offer smaller, more specialized selections. All independent table wine retailers are essentially “direct indent” operations on a small scale. They compete with the conglomerate off-trade players with unique selections of consumer table wines or with the ability to source luxury table wines. Many independent retailers compete with luxury wines because profit margins are higher and scale is not required to be competitive against the conglomerate players. Luxury wines are limited in quantity and are sourced through independent dealers abroad; therefore, conglomerate players have no advantage in buyer power over the independent retailers (Deighton, Dessain, Pitt, Beyersdorfer, & Sjoman, 2007). Large MNE importers carry their own global brands, and so compete on the strength of their own brand assets. Other independent importers of
non-luxury wines obtain their competitive advantage from secured distribution rights to specific labels (Mok R., 2011).

Most retailers also sell the wines that they import to the conglomerate off-trade group, to the on-trade group, and directly to final customers.

Of all the independent wholesalers, over 100 of them are general importers. For general importers, table wine is only one of their revenue sources, as their operating strategy is to achieve economies of scope by importing a wide range of goods such as pre-packaged foods and clothing. Therefore, unlike table wine wholesalers, general importers are established as high-volume wholesalers and tend not to deal directly with consumers (Hong Kong Yellow Pages, 2011; Mok R., 2011).

Direct marketing expenditure is a major difference between rival players. Direct marketing expenditure excludes sales and price-related promotions, and includes consumer product education. Most importers that engage in direct to final customer sales hold wine tasting or sampling events. The difference between the SME and large importers is the magnitude of these events. SME importers often hold informal events in-store. Large importers are able to throw large social events with reserved venues, elite and celebrity guests, and combined media activities. Four large importers make up 17% of market share by volume, with the largest importer owning 7% of the market (Euromonitor International, 2010).
2.4.4 On-Trade Strategic Group

2.4.4.1 On-Trade Segments

There are three segments where consumers drink on-site: dinner at a full-service restaurant (FSR), casual drinking at a bar, and a wedding banquet at a wedding venue. Wedding consumption is a significant segment on its own due to the nature of wedding planning. Table wine is also consumed at catered events or private functions, which are included in the FSR segment. In the FSR and bar segments, beer is a main substitute for table wine. At a wedding banquet, wine has no substitute.

Table wine is popular among FSRs of all cuisines in Hong Kong. There are four trends that contribute to consumer demand for table wine in this segment:

- Consumers readily expect sophisticated wine lists for pairing with specific foods. This is due to the influence of western culture in Hong Kong (Mok R., 2011; Mok V., 2010).

- Food television programs, a local staple of weekend prime time entertainment, continue to advocate fine dining and wine consumption (Television Broadcast Limited, 2011).

- The consumption of table wine is becoming more common at Asian restaurants in addition to Western ones, although beer is still the most widely consumed alcoholic beverage everywhere (Mok V., 2010).

- Hong Kong’s economic recovery is expected drive growth in the FSR industry. Sales in the FSR industry shrank by 6.9% in 2009, but are expected to have
returned to growth for 2010. The decline was probably more significant at the high-end segment of the FSR industry, which is most relevant to the table wine industry, because consumers switched to less luxurious FSRs during the recession (Euromonitor International, 2010; Mok V., 2011).

The bar industry in Hong Kong, for the purpose of this analysis, includes bars, lounges, wine bars, and pubs. These establishments are similar in style and nature to those in North America. The demand for table wine in this segment comes directly from the current popularity of wine. Based on casual observation of venues at popular locations such as Central, Lan Kwai Fong, and Causeway Bay, beer is still the most commonly consumed product at bars. However, there seems to be a higher proportion of customers drinking table wine than one might see in North America. It is also not uncommon to see tables of two or three people consuming a full bottle of wine. In terms of general consumer spending, the bar industry has been hit even harder than the FSR industry by the recession. The industry shrank by 12.0% in 2009. This is a result of consumers frequenting bars less often, as opposed to reducing spending or switching to cheaper establishments as in the FSR case. On the upside, the bar industry is also estimated to have recovered in 2010. From 2004 to 2008, this industry grew at 10.2% per year on average (Euromonitor International, 2010; Mok V., 2010).

At Hong Kong weddings, the practice of buying cases of wine to serve guests at the banquet is similar to that in North America. There are two main drivers for this segment. First, the practice of serving table wine is expected at wedding banquets.
Second, conspicuous spending for wedding banquets is also expected due to the cultural norm of giving high-value, monetary gifts (Lau & Hui, 2010).

Table 2-3 compares the performance of the FSR and bar industries with that of the on-trade table wine industry as a whole. The sales of on-trade table wine have recovered faster than these two underlying on-trade industry segments. It is important to note that while both FSRs and bars declined in 2009 during the recession, on-trade table wine sales still managed to sustain sales growth (Euromonitor International, 2010).

<table>
<thead>
<tr>
<th>Year</th>
<th>On-Trade Table Wine</th>
<th>Full-Service Restaurants</th>
<th>Bars</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>5%</td>
<td>4%</td>
<td>9%</td>
</tr>
<tr>
<td>2007</td>
<td>2%</td>
<td>11%</td>
<td>13%</td>
</tr>
<tr>
<td>2008</td>
<td>7%</td>
<td>10%</td>
<td>9%</td>
</tr>
<tr>
<td>2009</td>
<td>3%</td>
<td>-7%</td>
<td>-8%</td>
</tr>
<tr>
<td>2010</td>
<td>6%</td>
<td>n/a</td>
<td>n/a</td>
</tr>
</tbody>
</table>

There are three characteristics common to all on-trade segments. First, the average retail price of table wine in the on-trade segment is much higher than in the off-trade segment. The volume of table wine sold in the on-trade segment is only approximately 60% of that in the off-trade segment; however, sales revenue is 10% higher. This means the average prices are approximately 95% higher. In general, profit margins in this segment are generally higher than in the off-trade segment due to the nature of the food service business. Second, beer is the top-selling alcoholic beverage in on-trade consumption and is a substitute for table wine at FSRs and bars. On-trade sales of beer in 2010 were HKD $6.0 billion (CAD $780 million) while on-trade sales of table wine were merely HKD $1.3 billion (CAD $170 million). And last, the on-trade strategic
group is expected to outperform the off-trade strategic group in sales because the underlying food services industries are more sensitive to economic recovery (Euromonitor International, 2010).

2.4.4.2 On-Trade Distribution Characteristics

In the FSR and bar industries, individual establishments tend to procure supplies independently. The concentration of these industries is low. Chain FSRs, for instance, only constitute 15% of the FSR industry. Bars and hotels are typically independently operated (Euromonitor International, 2010). There are on-trade distributors that supply these industries, but they generally specialize in produce, such as vegetables or meats, and general supplies. Most table wine is, in fact, supplied by players in the off-trade strategic groups (Mok R., 2011; Mok V., 2011).

In the wedding banquet segment, there are three main marketing channels. One of these channels is via wholesaling to the on-trade establishments that provide wedding banquets. Wedding banquets in Hong Kong are generally hosted in hotel ballrooms or Chinese restaurants. The two types of establishments have an almost equal market share (Lau & Hui, 2010). Furthermore, wedding clients often purchase wedding packages from the establishments because the clients save on search costs for each component of the wedding. Both hotels and Chinese restaurants have wine catalogues for this purpose. A second channel is through direct consumer sales by retailers in the conglomerate and SME off-trade strategic groups. It is a common occurrence for consumers to buy their own wine themselves in an attempt to reduce
costs. A likely source is the supermarket or the specialty wine retailer. The third main marketing channel in the wedding banquet segment is by means of consumer sales at wedding or wine expositions. Similar to the concept of the hotel wedding package, consumers often complete their wedding checklist at a wedding exposition (Mok V., 2011; Mok R., 2011). In sum, being a viable player in this market segment means supplying Chinese restaurants and hotel events departments as well as creating direct sales.

2.4.5 Re-Exportation Strategic Group

A significant portion of imports to Hong Kong are re-exported elsewhere. Re-exports in 2009 generated HKD $760 million (CAD $112 million), which was 19% of the total import revenue. As one might expect, most re-exports are destined for China. To be exact, China received 88% of Hong Kong’s re-exports in 2009. The remaining percentage went to other South East Asian countries, the US, and the UK. The latter two destinations received products from the auction strategic group (Euromonitor International, 2010).

The growth in re-exportation to China is fuelled by the popularity of drinking table wine there. This interest in table wine is influenced by the increase of discretionary spending power in China. There are two reasons why table wine is catching on for this type of spending. First, premium table wine is an established luxury good that can be readily marketed to wealthy consumers. And second, table wine has always been popular in Hong Kong where the culture is similar to China; therefore, it
was logical for marketers and importers to promote table wine there using similar
cultural insights (O'Donnell, 2011; Mok R., 2011; Mok V., 2011).

There are two mobility barriers limiting movement from the other strategic
groups to Chinese re-exports. The primary barrier is distribution. Distribution in China is
fragmented and complex. Cross-country or city-only distribution is difficult, and the
importer must rely on local distributors thereby reducing operating margins. As a case in
point, the urban area of Shanghai is five times the size of Hong Kong. The other mobility
barrier is taxes and regulations. These exist at all levels of government. The lifting of
duty and licensing requirements only applies within Hong Kong. The data shows,
however, that the benefits of entering the re-exporting group may outweigh the costs.
Hong Kong table wine sales grew at approximately 6% in both 2009 and 2010, but re-
exports to Mainland China grew by 15% in 2009 (Euromonitor International, 2010).

2.4.6 Strategic Group Map

The two main strategic variables in the table wine industry are pricing and
distribution. Pricing is an indicator of product differentiation, and distribution is the key
mobility barrier. Figure 2-3 is a visual interpretation of the information in the previous
sections using these two strategic dimensions. The auction strategic group is isolated by
price, while the re-exports strategic group, specifically for China, is isolated by
distribution. However, the local consumer markets, namely the conglomerate off-trade,
the independent importer, and the on-trade strategic groups, overlap in pricing and
ease of distribution. The logistical characteristics of the three groups described earlier are similar. The importer can probably sell to all three strategic groups.

2.5 Consumer Trends

There exist certain industry trends or characteristics that are relevant across some or all strategic groups. There are currently four main trends.

First, consumers in Hong Kong overwhelmingly prefer red wine over other types of table wine. Red wine sales constitute 72% of total table wine sales. The colour red is preferred in wine because it is generally perceived to be of higher class. This is most likely because expensive French wines are typically red (Agri-Food Trade Services, 2008).
The Chinese culture is another reason why red is preferred. Red is traditionally a colour of fortune and happiness. It is a colour used in everything from food to clothing during the Lunar New Year, weddings, and other celebratory occasions. The red variety cabernet sauvignon made up 40% of all table wine sales in 2010, followed by the white variety chardonnay at 15%, and the red variety merlot at 13%. The detailed sales figures of major grape varieties are listed in Table 2-4. Wineries in BC produce all of these listed varieties.

Table 2-4: Hong Kong Table Wine Sales by Grape Variety (HKD$ Millions)

<table>
<thead>
<tr>
<th>Red Varieties</th>
<th>2010 Sales</th>
<th>White Varieties</th>
<th>2010 Sales</th>
<th>Rosé Varieties</th>
<th>2010 Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cabernet Sauvignon</td>
<td>$740</td>
<td>Chardonnay</td>
<td>$274</td>
<td>Cabernet Sauvignon</td>
<td>$12</td>
</tr>
<tr>
<td>Merlot</td>
<td>242</td>
<td>Riesling</td>
<td>67</td>
<td>Pinot Noir</td>
<td>12</td>
</tr>
<tr>
<td>Shiraz/Syrah</td>
<td>168</td>
<td>Sauvignon Blanc</td>
<td>79</td>
<td>Shiraz</td>
<td>12</td>
</tr>
<tr>
<td>Others Reds</td>
<td>195</td>
<td>Others Whites</td>
<td>44</td>
<td>Others Rosés</td>
<td>23</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,346</strong></td>
<td><strong>$464</strong></td>
<td><strong>$58</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Euromonitor International, 2010)

A second consumer trend is the influence of reviews and awards on purchasing decision. This is similar to North America where the general consumer often feels confused by the seemingly complex relationships among variety, region, vintage, methods, and other factors (Boulos, 2010). The industry of wine critics and ratings significantly affect the industry of selling table wine. Wine critics are “market mavens” who are regarded by consumers as possessing definitive information about table wine. For instance, the Robert Parker Score, a rating given by a well-known and singularly influential critic, is frequently listed next to price tags in Hong Kong. Consumers aware of the various score systems use them together with awards as the basis for buying decisions (Mok V., 2010). It is interesting to note that research has shown reviews and
ratings to be extremely subjective. For instance, a researcher at the University of Bordeaux found that test subjects evaluated two samples of wine differently according to the reputation of the supposed labels when, in fact, both samples were of the same wine (Keefe, 2007).

The third consumer trend is the dominance of French wines. French wines accounted for 61% of all 2010 table wine sales in Hong Kong. The next two leading countries of origin are Australia and the US, both at 9%. French wines also tend to extract a higher premium than wines from other regions. French wines sell for HKD $145 (CAD $19) per bottle on average, while Australian wines sell for HKD $33 (CAD $4), and American wines sell for HKD $19 (CAD $2). However, the higher unit prices of French and other Old World wines, as well as an increasing consumer awareness of New World wines, are leading to higher sales growth in New World wines versus Old World wines (Euromonitor International, 2010).

Lastly, wine bottles smaller than the standard 750 millilitre (mL) size are slowly becoming common in the grocery retail segment of the conglomerate off-trade strategic group (Euromonitor International, 2010). Half bottles containing 375 mL and split bottles containing 187 mL are becoming available. Based on a survey of the catalogues from grocery chains, half bottles are priced in the mid-range of the full bottles, but split bottles are only available for low-end wines. This implies that smaller bottle size is associated with unexceptional or inferior product.
3: OPPORTUNITIES AND RISKS

3.1 Porter’s Five Forces (Augmented)

Michael Porter’s Five Forces model of industry competitiveness is a framework for analysing the factors that affect the profitability of a market. (Porter, 1979) The five forces are: supplier power, threat from substitutes, buyer power, threat from new entrants, and internal rivalry. A sixth force from the government is added to augment the original model (Parent, Shapiro, Boulos, & Vining, 2010). The forces will be analyzed from the perspective of a potential entrant. Figure 3-1 is a graphical summary of the analysis in the following sections.
**Figure 3-1: Summary of Augmented Porter's Five Forces Analysis**

**Buyers**  
*Consumers, Off-Trade and On-Trade Retailers*  
- Off-trade and on-trade buyers own customers  
- Conglomerate Off-Trade buyers have volume from vast networks  
- On-trade buyers own channel to consumer education

**New Entrants**  
- No barrier to entry  
- No sunk cost  
- No economies of scale  
- Incumbents’ marketing plans easily replicated

**Internal Rivalry**  
*Independent Importers*  
- Differentiated players from French and MNE labels  
- Low cost leader from Chile and others  
- Many other similar products

**Substitutes**  
*Beer and Spirits*  
- Table wine has stronger growth  
- Possible reverse substitution effect

**Suppliers**  
*BC Wineries*  
- Desire for new opportunities due to:  
  - Competition from non-BC rivals  
  - Overcapacity  
  - Limited access to export markets

**Government**  
*BC*  
- Suppliers enjoy protection from non-BC competitors at home

**Government**  
*Hong Kong*  
- Freedom from duties or regulations  
- Lowers pricing to substitute into beer markets

(Author, 2011)
3.1.1 Supplier Power

From the perspective of a business set up to export BC table wine, suppliers consist of large and small independent wineries. These suppliers sell primarily in the BC market. In a report prepared by Dr. Anil Hira and Alexi Bwenge, it was found that these suppliers rely on “wine tourism” and BC on-trade sales for growth. Wine tourism is tourism that includes the visiting, tasting, and purchasing at wineries. However, it was also found that suppliers fear saturation in the BC wine industry due to rivalry from imports and overcapacity, among other things. Despite a government distribution monopoly that protects local suppliers, foreign suppliers, especially those from Chile, are still able to undercut BC wines. General sales of imported wines are also increasing. In terms of production capacity, Figure 3-2 shows that the growth rate of Canadian wine sales in BC has decreased while the growth rate in grape acreage has increased. At present, BC wineries produce 2.4 tons of grapes per acre. However, the report indicated that three to four tons per acre is the normal production capacity. Lastly, the report found that the wineries have been unable or unwilling to export, despite a National Export Working Group initiated by the Department of Foreign Affairs and International Trade (DFAIT). Lack of knowledge about BC wine in markets abroad is cited in a report for the Working Group as a major hurdle preventing any significant exports. Few Canadian products are rated in prominent reviews and most of them are from large wineries in Ontario. Only Mission Hill Estate Winery, the largest in BC, has any products in the Watson’s catalogue (Hira & Bwenge, 2011; Susan O’Dell & Associates, 2009).
In conclusion, suppliers are stable and profitable by serving the wine tourism and on-trade markets; however, they are wary of the lack of alternative markets in the face of outside competition and overcapacity. Therefore, suppliers should welcome the opportunities that an export agent might offer. Suppliers pose a low threat to profitability.

3.1.2 Threat from Substitutes

There are two main substitutes for table wine: beer and spirits (e.g., whiskey, tequila, etc.) Beer constitutes 59% of the Hong Kong alcohol market while spirits and table wine constitute 22% and 14% respectively. Both beer and spirits have sales channels in the off-trade and on-trade markets similar to those for table wine. Logically, one might expect sake (Japanese rice wine) and other rice wines to be more direct...
substitutes to table wine because they have similar pricing and consumption style, but sake and other rice wine sales are only one-tenth of table wine sales.

Growth trends suggest that wine may actually be a threat to beer and spirits as a substitute instead of the other way around. As shown in Figure 3-3, table wine is the only product among alcoholic beverages to maintain consistent positive growth. It has also achieved the highest growth rate. However, it is unclear if growth in ultra-luxury table wines might be masking a substitute effect in the consumer table wines. Moreover, marketing campaigns for beer in Hong Kong, as in North America, are massive and extensive. The beer industry is dominated by MNEs that spend millions of HKD in advertising. For example, San Miguel, the largest beer MNE by volume, spent HKD $10 million (CAD $2 million) for a single Christmas campaign in 2002 (Liu, 2004). In contrast, marketing for wine is small-scale and done mainly through in-store promotions, media events, and trade shows.
In conclusion, the threat from substitutes is low for table wines in general but may be higher in the lower price segments. However, based on consumer trends discussed in Section 2.5, it is reasonable to assume the ability of beer to substitute for table wine. Furthermore, a Blue Ocean Strategy, to be explored in Section 3.2, may be effective in countering this threat.

3.1.3 Buyer Power

Buyers fall in two general groups: consumers and retailers. All buyers have low switching cost due to the large number of importers and the many available channels to reach them. However this relates more to internal rivalry in the next section. Retailers are generally powerful because they control access to the final consumers. In the
retailer group, conglomerate off-trade buyers have the most power due to their extensive distribution chains.

Retailers have additional power by controlling access to end consumers. Large buyers, who can use their power to systematically extract economic rents, such as those from the Conglomerate Off-Trade strategic group, have four unique advantages that force the importer to compete on price:

- The extensive retail networks of the major chains offer potentially high volume.
- The centralized purchasing and distribution departments of these chains lower the transaction costs for the importer.
- The extensive retail networks also offer exposure to consumers. Exposure helps drive recognition and sales in other channels.
- The conglomerate buyers are capable of “direct indent,” barring any distribution rights the importer may hold. They can threaten to cut out the importer completely.

Buyers from the On-Trade strategic group have power through ownership of the customers. The on-trade industry is a key marketing channel where extensive consumer education takes place. The on-trade industry is especially favoured by new brands because it is sensitive to economic recovery, offers a higher profit margin, and has immediate exposure (Euromonitor International, 2010).

In conclusion, buyers hold significant power due to the availability of choices. Buyers who control access to the end consumer hold additional power. The importer
can probably mitigate buyer power by holding distribution rights to brands in demand; however, no such brands are produced in BC. The overall threat to profits for the BC table wine importer is high.

3.1.4 Threat from New Entrants

The import and export industry in Hong Kong is generally easy to enter and exit. Typically for an importer, the key success factor is the ownership of distribution rights to differentiated products that can attract consumers who would eagerly purchase them. Otherwise, there are few barriers to entry. Virtually no sunk cost is required in the shipping, storing, and distributing of wine. No significant economies of scale exist in these activities. Furthermore, since BC table wine has no brand equity in Hong Kong, any marketing plan can probably be easily replicated by new entrants.

In the Hong Kong premium and consumer table wine market, some labels are perennially best-sellers and clearly have brand equity. The importer can negotiate distribution rights to these labels to mitigate the threat from new entrants, as they can in order to limit buyer power. However, this is not an effective strategy for BC table wine, since BC produces no labels with brand equity. This means that the BC table wine importer is unlikely to earn sustainable rents because the threat from new entrants attracted by short-term profits is high.

3.1.5 Internal Rivalry

In the Hong Kong consumer table wine market, French and MNE labels dominate the market. Table wines from France have a competitive advantage because of their
association with the country’s successful ultra-luxury table wine segment. MNEs are able to create competitive advantage in brand equity and are rewarded with perennial best-sellers. BC table wine currently has no brand recognition in Hong Kong. The importer is faced with competing on price. Unfortunately, BC suppliers cannot match the low-cost producers from Chile, Argentina, and South Africa.

In direct sales, consumers have many choices. The abundance of importers and retailers means switching and search costs are low. Search costs are even lower with internet sales and trade shows, which aggregate choices. Unless the independent importer possesses sole distribution rights to a label in demand, the consumer will simply decide according to price.

The successful importer will need to create brand equity. The independent importer will also need to do this with limited financial means. The government of Canada, through the DFAIT, initiated the National Export Strategy to build the image of Canadian wines abroad, but that program has yet to appear effective (Hira & Bwenge, 2011). For the BC table wine importer without brand equity, the threat from rivalry is high.

3.1.6 Government (Augmented Force)

BC suppliers operate in a local market that is protected by the BC government. The supply chain in BC, similar to the rest of North America, includes a wholesaler in between the supplier and the retailer. The intended purpose of the wholesaler is to simplify government control on alcohol. In BC, the wholesaler is a government
monopoly. However, BC wineries are allowed to bypass the wholesaler in direct sales at wineries or on the internet and in on-trade sales. In contrast, non-BC products are assessed an indirect tariff in the form of margins paid to the wholesaler because those products are not allowed to bypass the wholesaler. Therefore, BC suppliers enjoy a form of protectionism, and this reduces their incentive to compete in the world market. This effectively means reduced bargaining power for the independent importer.

The lifting of the wine duty by the Hong Kong government lowers the cost of storing and distributing inventory because bonded warehouses and special procedures are no longer required for tax enforcement. This not only lowers the cost of all incumbent players, but it also removes barriers to new entrants. However, it has enabled lower prices for table wines, to meet the substitute threat from beer.

3.1.7 Conclusion

The Porter’s Five Forces analysis indicates that the Hong Kong table wine market is competitive and unattractive. The table wine market exists in a larger food and beverage industry that is mature, with established rivals and buyers holding significant power. Moreover, the factors that are the driving force of this project, namely the cancelled duty and wine’s growing popularity, can also be taken advantage of by other new entrants. On the other hand, the desire of BC suppliers to expand from their home market, despite protected profits in their home market, can be exploited to support a marketing effort in Hong Kong. The threat from substitutes is also low and may in fact increase the available market space to be exploited. In conclusion, a differentiation
strategy may be feasible with help from suppliers, but will probably be difficult to accomplish due to the strength of the other forces.

3.2 Blue Ocean Strategy

Blue Ocean Strategy (BOS), developed by W. Chan Kim and Renee Mauborgne, is a framework based on creating new market space instead of outperforming rivals. In mature industries, competitive advantage is typically achieved in two ways: the firm succeeds in having higher margins than competitors through lower costs, or the firm succeeds in obtaining a stronger willingness to pay over competitors by differentiation. In BOS, both types of competitive advantage are pursued by looking for elements that can be eliminated, reduced, raised, and created. This, in turn, highlights pathways to new market space (Boulos, 2010).

Despite the less-than-ideal conclusion from the Porter Five Forces analysis, it might be possible to create new market space for BC table wine by following a Blue Ocean Strategy. As outlined in section 3.1.2, beer presents the most obvious threat as a substitute to wine. This threat can be countered by creating a BOS that addresses the pain points and advantages of beer. Moreover, a BOS can potentially pull “non-customers” into the table wine market from the beer market. Consumers from the beer market have three pain points when it comes to table wine. First, they are intimidated by the perceived knowledge required to purchase wine. Second, they are accustomed to each beverage serving being 355 mL to 500 mL (i.e., a pint) and are, therefore, reluctant to purchase and finish a bottle that is typically 750 mL or more. Finally, wine contains
higher alcohol content than beer, which may also deter consumers from the purchase of a whole bottle. Figure 3-4 is a Value Curve Analysis that follows this line of thinking. The general approach is to eliminate or reduce elements of premium consumer table wine that are costly to implement. At the same time, upmarket qualities are offered to beer drinkers by raising or creating elements that increase the willingness to pay of these consumers.

Figure 3-4: Blue Ocean Strategy Value Curve Analysis

The following explains each strategic element in detail:

- Grape variety is an element that adds confusion for the consumer. Simply offering a red blend may be undesirable because it may be perceived as low quality. As discovered earlier, however, Hong Kong consumers overwhelmingly
prefer red wines, specifically the cabernet sauvignon variety; therefore, a BOS can simply offer only this variety. Furthermore, a single winery should be used as the supplier. Distribution rights and supplier price will need to be negotiated beforehand to protect profits in a successful strategy. A single offering can also focus consumer attention on other strategic elements discussed below.

- Tasting events are used by importers and retailers to create exposure. Large, media-oriented events are expensive to conduct. They are suitable for well-known premium consumer table wine brands that can deliver the profit margin to recover the expenses. Small, customer-oriented events have limited reach, especially in terms of beer drinkers and lower-end table wine drinkers. Since the target consumers are in on-trade settings where control is in the retailers’ hands, it may be more effective to offer samples to the on-trade buyer than to hold tasting events.

- Marketing effort should reduce emphasis on prestige and taste. At the same time, marketing emphasis on awards, label aesthetics, and price should be raised. This is because the Hong Kong consumer pays the most attention to awards and ratings. Marketing effort focussed on label aesthetics and price, which are inexpensive to implement, would reinforce the credibility of the product. However, it is important to note that trying to build brand equity by raising the recognition of prestige and taste is usually difficult and expensive for any new product.
• Pricing comparable to the premium consumer table wine level is difficult to attain because BC premium table wine has no brand equity or recognized awards. However, pricing at a discount from the premium level can position BC premium table wine as the next step for beer drinkers and consumer table wine drinkers alike.

• The creation of a single-serving product can both address the pain points mentioned earlier and differentiate the product. Single-serving bottles would be 187 mL in size. The practical advantage of a single-serving container is that freshness can be ensured, unlike glasses of wine that are served from open bottles. However, sophisticated dispensing machines that maintain the freshness of premium consumer table wine are not uncommon at high-end restaurants. This negates the practical advantage of a single-serving bottle. Furthermore, single-serving bottles are currently used for low-end consumer table wine in off-trade retail outlets, which creates a stereotype. However, this specific strategy plays on importance of the visual experience in the on-trade industry. A consolidated effort of the entire BOS can help push the single-serving product as a unique differentiation of BC premium table wine where customers want it to be part of their display on the table.

These specific strategies can lower costs or be conducted in cost-effective ways. The more difficult question, however, revolves around how the single-serving container should be created. There are two extremes in the cost of implementation: a low-cost approach using generic bottles, and a high-cost approach using custom-made bottles.
In the low-cost method, generic single-serving bottles are used. These are bottles commonly used for sales in cafeterias, hotel rooms, airplanes, and retail sales of lower-end consumer table wine. Since these bottles are widely available, they can be procured at low cost. Furthermore, the supplier can easily integrate them into their supply chain. However, these bottles are less effective in terms of marketing because consumers may associate its contents with low-quality products. Successful implementation of this method will depend on the campaign efforts of the other elements of this BOS.

In the high-cost method, distinctive bottles are used. These may be custom-made or existing but rare stock. Both are expensive options due to prototyping and production, especially if the design will be exclusive. There is increased risk because the cost to create the bottles is sunk. Furthermore, custom bottles may not fit existing bottling equipment at the wineries, further adding to the cost of implementation. However, this method is more effective in marketing because it directly differentiates the product visually.

A compromise method may be achievable in using the commonly available generic bottles with cork stoppers instead of the screw-tops commonly found on generic bottles. As outlined in section 2.1.4, consumers associate cork with premium wine. This can be exploited as a differentiating factor to offset the lack of appeal with the generic bottle. To further reduce doubt in the consumer’s mind, the single-serving bottles should be marketed alongside full-size bottles. The full-size bottle can be a
bridge between the consumer’s perception of premium wine and the single-serving bottle that the consumer may actually desire.
4: EVALUATION OF BUSINESS OPPORTUNITY

4.1 Marketing Plan

The independent importer can market through all sales channels identified in the Industry supply chain described in Section 2.3. Each channel offers a different return on marketing effort. At the same time, the importer will need to achieve minimum volume to exploit all the economies of scale in shipping and general operations. Although the off-trade conglomerate retailers have significant buyer power and will squeeze margins and demand “flow-through” delivery, the independent importer will need to retain the off-trade sales channel, not just the ones with the most profit potential.

The proportion of sales in each channel depends on the allocation of marketing effort. As previously mentioned in Section 2.4.4.1, on-trade volume in the table wine industry is approximately 60% of off-trade volume. The sales team can use this as a guideline to determine initial marketing effort in each channel. Subsequently, the sales team can also use this metric to identify underperforming channels.

A key to marketing success is the association of notable awards or ratings with the wine in question. There is currently no BC table wine that has been rated favourably by Robert Parker (in the high 80s or above). However, there are BC table wines that have garnered awards locally and abroad. The award factor should be a major consideration in the selection of the supplier.
As recommended in the BOS, a single wine variety would be offered from a single winery. Also, the single-serving bottle will be marketed together with the full-size bottle. Since the largest asset for the importer is the marketing invested in a label, distribution rights are critical to the success of the importer. The importer should be able to negotiate distribution rights with the winery in return for taking on risks to establish presence and sales in the Hong Kong market.

4.1.1 Logistical Plan

The following is a logistical plan of the start-up of this business.

1. Create the business entities in Hong Kong and BC as required.
2. Select a small to medium-sized winery in BC as a target for partnership.

   Larger wineries may not be interested unless a significant volume can be achieved. Prospective wineries should be short-listed based on the awards won and a story or image that can easily form the basis of marketing.

3. Approach a short-listed winery to negotiate a distribution agreement. This agreement will need to include distribution, price, terms, and special bottling specifications. Since wineries generally enjoy healthy margins from local direct and on-trade sales, they may not be interested in selling at the wholesale price that the government distribution monopoly pays. However, the prospect of opening up a new export market may entice the winery to agree to an aspiration price critical to marketing success.
4. Arrange with the winery to source and bottle in the single serving size of 187 mL. The winery should be able to obtain these bottles from their current suppliers and be able to fill them with existing equipment. The first shipment will include both single-serving and full-size bottles. The size of the first shipment will be dictated by the minimum shipping size, which is approximately 60 full-size bottle cases.

5. Arrange for space lease to receive the first shipment. Other than storage, the sales team can operate from home. At the same time, conglomerate off-trade sales can be solicited through contacts in the industry. Initial sales made in this channel can be a gauge to pricing and perception of the product by professional buyers, as well as provide some initial cash-flow.

6. Once the first shipment arrives, a sales team will approach on-trade establishments. High-end restaurants and bars will be targeted so as to maintain a premium image. Such establishments are also able to produce the highest margins. These are typically located in areas such as Lan Kwai Fong, Tsim Sha Tsui, Causeway Bay and the like. The sales team will have a small amount of product on hand, enough for a immediate, short trial run. The advantages of the single-serving size should be emphasized as a differentiating factor for the establishment. Samples and “freebies” can be offered as incentive to the buyer. The target is to engage five establishments per month to a total of twenty.
7. Subsequent to successful sales in the off-trade and on-trade channels, the cash flow can be used to support attempts at direct sales. This will require small investments such as creating an internet site or setting up a booth at a trade show.

4.2 Financial Analysis

The discounted cash flow analysis is included in the appendix. An initial investment of HKD $71,000 (CAD $9,200) is required for initial inventory and storage leasing. The project will require an additional HKD $256,000 (CAD $33,200) to sustain a burn rate of one year. After one year, the project will be profitable. The net present value of the total project over five years will have an internal rate of return of 22%. The appendix also contains the supporting Pro Forma Statement of Operations and Discounted Cash Flow Analysis.

In financial terms, there are three channels for sales: on-trade, direct, and off-trade. The highest gross margin belongs to direct sales at 53%. However, this number does not include the direct costs of the internet store and trade shows. Those costs benefit other sales indirectly, so they are included in the selling and administrative expenses. The second highest gross margin belongs to on-trade sales at 47%. This value may actually be higher due to higher margins offered in the on-trade food services industry. The lowest margin belongs to off-trade sales at 28%. The off-trade channel has high buyer power but offers the prospect of much higher volume. Volume is required to achieve the minimum efficient scale in shipping.
Table 4-1 shows the break-even volumes required with different utilization of each sales channel. Pricing is set at slightly lower levels than other premium table wines in each sales channel. As expected, less volume is required to achieve break-even when focusing on “On-Trade Only” or “Direct Sales Only.” However, break-even volumes for these channels are expected to be difficult to achieve. The “All Sales Channel” scenario is more realistic, based on the assumption that on-trade sales are 60% of off-trade sales in the whole industry.

![Table 4-1: Break-Even Volume by Sales Channel (cases per annum)](null)

<table>
<thead>
<tr>
<th></th>
<th>On-Trade Only</th>
<th>Direct Sales Only</th>
<th>Off-Trade Only</th>
<th>All Sales Channels</th>
</tr>
</thead>
<tbody>
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<td>On-trade</td>
<td>492</td>
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<td>0</td>
<td>238</td>
</tr>
<tr>
<td>Direct sales</td>
<td>0</td>
<td>388</td>
<td>0</td>
<td>99</td>
</tr>
<tr>
<td>Off-trade</td>
<td>0</td>
<td>0</td>
<td>1,132</td>
<td>297</td>
</tr>
<tr>
<td>(Author, 2011)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Probably the least certain variable in this analysis is pricing. In this analysis, the target retail price of the standard 750 mL bottle is HKD $200 (CAD $26) which is at the lower end of the average premium table wine price range discussed in Section 2.2.2. The single-serve 187 mL bottles would be priced in proportion to the 750 mL standard bottle. Wholesale prices are based on typical industry margins. Table 4-2 shows the increases in break-even volume required for every ten percent discount in prices. If prices are discounted by 10% on average, the “All Sales Channels” volume will need to
increase by one-third. If prices are discounted by 20% on average, the “All Sales Channels” volume will need to nearly double. In other words, failure to market the BC product at premium prices may quickly lead to relatively significant losses.

<table>
<thead>
<tr>
<th></th>
<th>On-Trade Only</th>
<th>Direct Sales Only</th>
<th>Off-Trade Only</th>
<th>All Sales Channels</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prices discounted by 10%</td>
<td>+27%</td>
<td>+23%</td>
<td>+55%</td>
<td>+32%</td>
</tr>
<tr>
<td>Prices discounted by 20%</td>
<td>+73%</td>
<td>+60%</td>
<td>+250%</td>
<td>+95%</td>
</tr>
</tbody>
</table>

(Author, 2011)

### 4.3 Conclusion

The Porter’s analysis uncovered a less-than-ideal competitive landscape. However, with favourable supplier factors, reduced threats from substitutes, and a simple-to-implement BOS, an opportunity may still exist. The financial analysis shows that a reasonable return is possible from a modest investment. Moreover, marketing success in Hong Kong can create the groundwork for further growth in the Re-Exportation Strategic Group.
### APPENDIX

**Pro Forma Statement of Operations**

(HKD $)

<table>
<thead>
<tr>
<th></th>
<th>Annual</th>
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<tbody>
<tr>
<td>Units (cases)</td>
<td>800</td>
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<tr>
<td>Revenue</td>
<td>$ 1,433,000</td>
</tr>
<tr>
<td>COGS</td>
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</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>$ 616,000</td>
</tr>
<tr>
<td></td>
<td>43%</td>
</tr>
<tr>
<td>Selling and administrative expenses</td>
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</tr>
<tr>
<td><strong>Earnings before tax</strong></td>
<td>$174,000</td>
</tr>
<tr>
<td>HK corporate tax</td>
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</tr>
<tr>
<td><strong>Earnings after tax</strong></td>
<td>$145,000</td>
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<tr>
<td>Earnings after tax (CAD)</td>
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## Discounted Cash Flow Analysis

(HKD $)

<table>
<thead>
<tr>
<th></th>
<th>Year 0</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
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</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>628,000</td>
<td>1,390,000</td>
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<td>1,433,000</td>
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<td>COGS</td>
<td>(368,000)</td>
<td>(797,000)</td>
<td>(817,000)</td>
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<td>Selling and administrative expense</td>
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<td>(442,000)</td>
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<tr>
<td>Earnings before tax</td>
<td>(182,000)</td>
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<td>Tax</td>
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<td>(24,000)</td>
<td>(29,000)</td>
<td>(29,000)</td>
<td>(29,000)</td>
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<tr>
<td>Earnings after tax</td>
<td>(182,000)</td>
<td>151,000</td>
<td>151,000</td>
<td>145,000</td>
<td>145,000</td>
<td>145,000</td>
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<tr>
<td>Inventory replenished</td>
<td>(55,000)</td>
<td>(441,000)</td>
<td>(772,000)</td>
<td>(882,000)</td>
<td>(772,000)</td>
<td>(882,000)</td>
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<tr>
<td>Inventory expensed</td>
<td>368,000</td>
<td>797,000</td>
<td>817,000</td>
<td>817,000</td>
<td>817,000</td>
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</tr>
<tr>
<td>Free Cash Flow</td>
<td>(71,000)</td>
<td>(256,000)</td>
<td>176,000</td>
<td>85,000</td>
<td>190,000</td>
<td>80,000</td>
</tr>
</tbody>
</table>

- **Discount Rate**: 10%
- **Net Present Value**: 85,535 CAD$
- **Internal Rate of Return**: 22%
REFERENCE LIST


Mok, V. (2010, November 22). Personal communication. Hong Kong.
Mok, V. (2011, February 17). Personal communication. Hong Kong.


