

Instituto Superior de Ciências do Trabalho e da Empresa



INTERNATIONALIZATION PROCESSES OF PORTUGUESE
WINE PRODUCING SME'S IN GERMANY AND RUSSIA

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ABSTRACT

In order to shed some light on the common problems wine producing SME's are facing in their internationalization processes, this paper will provide decision makers with some tools for better evaluation of their true international potential.

The objective is to allow some reflection on the possibilities of cooperation between firms with limited resources that wish to explore the Eastern and Central European markets. This is done by evaluating all the current internationalization possibilities in two example markets – Germany and Russia – and making an approach based on internal factors (e.g. financial and human resources) as well as external (e.g. market's potential, entry barriers, ...).

The paper will show that the answers lie in the combination between the firm's characteristics and the market in question's potential. Although there is not one true and single "best way to go international", there are some common threads that will make decision making more rational.

The paper ultimately intends to create a bigger discussion amongst wine producers as to their true possibilities of internationalization as independent firms and the exponential increase of possibilities as part of organized cooperative groups.

Keywords: *internationalization processes, cooperation, international potential, market potential.*

ABSTRACT (Portuguese)

O objectivo desta Tese de Mestrado é dar aos decisores de PME's produtoras de vinhos em Portugal algumas ferramentas que permitam uma melhor avaliação do seu verdadeiro potencial de internacionalização.

O trabalho partirá de uma reflexão acerca das possibilidades de cooperação entre empresas com recursos bastante limitados mas com objectivos comuns, que passem pela expansão dos seus negócios nos mercados da Europa Central e de Leste. Tal reflexão será feita através da avaliação de todas as possibilidades de internacionalização em dois mercados representativos das regiões em causa – Alemanha e Rússia – e utilizando uma forma de aproximação aos mercados que tenha em conta factores internos da empresa (como os recursos humanos e financeiros), bem como externos (como o potencial do mercado ou as barreiras à entrada).

No final será demonstrado que as respostas às questões da internacionalização estão na combinação entre as características de cada empresa e o potencial de cada mercado. Apesar de não se encontrar uma fórmula única para a internacionalização, existem pontos comuns que permitirão melhores tomadas de decisão.

A intenção final deste trabalho é criar alguma discussão entre produtores de vinhos quanto ao seu verdadeiro potencial de internacionalização enquanto empresas isoladas e o aumento das suas possibilidades de sucesso enquanto grupos cooperantes.

Keywords: *internationalization processes, cooperation, international potential, market potential.*

EXECUTIVE SUMMARY

This paper will focus on the Portuguese wine industry and its existing and possible future relation to the Central and Eastern European markets of Germany and Russia. These countries were selected due to their size and market potential, as stated by the Portuguese wine industry in general. Also, they are used to represent two different market groups – Central European and Eastern European.

The investigation will be directed at potential market entry strategies in the above stated markets and how Portuguese firms can participate more actively in marketing their own products. The government and EU support options made available to firms is also in focus, along with the credit and insurance options made available. Also, the study of legal aspects of promotion and marketing of wines and internal specificities that characterize these markets will be reviewed.

The results point to a differentiation in the form of approaching these markets. Germany shows a tremendous capacity for accepting Portuguese wines with a market entry strategy of taking part in local Distribution firms by associated groups of small wine producers. As for Russia, the country still shows a relative instability (political, social and economical), which make it a secondary choice for internationalization.

Although there is already some relevant market research made by national promotion Institutes (Viniportugal and others), the research on market entry strategies is still scarce. This Thesis plans to contribute on opening a discussion regarding the best possible market entry strategies for Portuguese wine SME's.

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INTRODUCTION

The area of research is the wine industry and its potential in taking on internationalization.

Much of this work has been based on annual reports compiled by AICEP offices in the respective countries (Germany and Russia). Although not purely academic research, these studies count for a strong base of information that helped in the research done in the present paper. There was also a study made by a former MIM / ISCTE student – Rianne Uijterwaal Antunes – which was presented last year (2008) as a Master Thesis and helped draw some conclusions used in my study. The external institute in charge of promoting Portuguese wines abroad – Viniportugal – also compiles several yearly studies, which were of great help in this presentation.

This is still a fairly unstudied field and as the Portuguese wine industry turns to external markets, it is expected to draw the attention of more researchers and academics.

Portuguese wine producers have been taking greater notice in the role foreign markets can play in their sales. From 2000 to 2007, the rate of wine exports has grown more than 81 % in volume, now representing about € 600 million in sales¹.

Taking in consideration the average yearly growth of 9 % in wine exports directed at EU countries, this region's importance for Portuguese wine firms is clearly stated. According to the latest information, the whole region is expected to grow systematically in the next five years, with the main targets aimed at newly added EU countries of Central and Eastern Europe.

Since the beginning the choice for Portuguese wine producers has been to simply sell their wines to local wine distributors, hoping that these local companies would perform their best and create a local market. Time and foreign competition have proven that this is not nearly enough.

¹ *In* Exportações por Mercado – Serie 2000 a 2007, INE.

Because many studies have been done on local consumption habits and trends, the present paper will focus mostly on how the successful firms organized themselves in the local business arena. Management issues such as the choice for simple exports, choice of local Agents, Foreign Direct Investment and others should be argued with greater depth, as they play a key role in the success of any local venture.

The main objective is to develop market entry strategies for Portuguese wine producing SME's in the Eastern and Central European countries, with a main focus on the Distribution sector in these countries.

TARGET GROUP

This thesis can be useful to every individual or firm interested in doing business in Eastern and Central Europe, specially related to the wine industry and from a SME's starting point.

Because of the specificity of the topic, the Portuguese wine industry (one of the most promising industries in the country) can gain by looking at how business can be done in the region.

PERSONAL MOTIVATION

Because I work for a Portuguese wine producing SME for nearly 5 years now, I have come to the conclusion that merely selling wines to a local importer or distributor in a foreign country is not enough when it comes to creating a solid growing business.

Due to the growth and still relatively uncompetitive markets of East and Central Europe², it is my firm believe that this region offers enormous potential to Portuguese producers. In this thesis I will focus my attention on the largest importer of wines in the

² The term “uncompetitive” is used in comparison to other established markets like the U.K.

world (Germany) and one of the future consumption giants of the world (Russia). Due to the proximity of these countries to other key markets, they can be used as gateways for small Portuguese wine firms to access others.

It is, however, necessary to create a significant change in the way Portuguese wines are entering this and other markets, as the current way of doing business is simply to sell to a local Agent and hope for the best. Simple participation in international Fairs and events is no longer enough and this Thesis intends to offer different entry strategies for Portuguese producers.

RESEARCH METHOD

The method employed in the research was mostly secondary research and direct interviews with local importers. Firstly, there was the analysis of macroeconomic studies related to the focus region (Eastern and Central European countries); previous market studies related to consumer habits and sector analysis; trends in the Distribution industry and also success cases from other wine producing firms (both from Portugal and from other countries). There was also some informal gathering of information with existing players in some of the markets.

This method of study was chosen due to the lack of previous basic academic research on the markets in question and to the fact that being a working part of the industry in my country, I favor information which I can also use in my day-to-day activity. My presence in Germany for the duration of part of this work (September-December 2008) also helped me shape it in order to later use it for a practical end.

By using mostly secondary research and directing this study to the Eastern and Central European markets, I served the purpose of both my academic and business needs.

RELATED LITERATURE AND THEORETICAL FOCUS

For a greater understanding of the issues related to this topic, there are some publications which are of great use: several AICEP publications, the Porter Report on the Portuguese Wine Cluster; the Government of Australia's 2006 study on the Russian Wine Project; the GAIN Report PL6050 by the USDA Foreign Agricultural Service; etc.

THE WINE INDUSTRY

The exports of wines in Portugal count for about € 700 million in 2006³. The industry has taken in a serious warning that the only way to grow (if not to say survive) is to make this number higher in the short run.

Broken by years of low investment in promotion, lack of international strategy and absence of a positive overall image, the Portuguese wine industry has struggled to improve in the last few years.

In 2003, a study order by Viniportugal (the national Institute for wine promotion and industry development) to Michael Porter revealed the industry's weaknesses and potential. The group lead by the marketing guru identified the causes for low development in the Portuguese wine business as related to quality, overall image, market investment and targeting.

Since then, some changes have been made. These changes are mostly related to wine itself, as quality requirements have improved substantially. The wine labeling and other factors have also improved and the industry exports are expected to generate some € 1.000 million by 2010. Although a huge improvement, it is still not nearly enough when compared to the position of other countries like Australia, Spain, France or Italy.

One of the main problems that are still creating difficulties is the small size of Portuguese wine producers. In fact, an average size estate in Portugal has around 40 to 50 hectares at best, with the largest estates rising up to 300 hectares. When compared to the average size of an Australian producer, we can easily understand how this can be a problem in terms of generating low production costs.

Also, the lack of association culture among wine producers is leading to greater problems in terms of internationalization. The costs of promoting wines abroad are high and continuous, which means that probably only through combined efforts can these wine SME's create an impact on any given foreign market.

³ *In* Exportações por Mercado – Serie 2000 a 2007, INE.

Despite the multitude of problems the industry is facing, this paper will now focus mostly on one of these issues – the Distribution and promotion of Portuguese wines abroad.

RESEARCH RESULTS AND DISCUSSION

Region Profile

Due to the territory's extension and multitude of countries in the region, this thesis will focus mainly on two (2) countries – Germany and Russia. Although several factors could be taken into account in defining which markets to focus the study, the choice for Germany and Russia was made by looking to market dimension⁴, wine consumption trends, current and future economic growth estimates and lack of knowledge by Portuguese wine producers of the realities and potential of these countries. Also, these two countries will be used as reference to their respective regions – Central and Eastern Europe.

Germany – Country and Market Overview⁵

Located at the heart of Europe and with a total population of over 82 million people, Germany is the world's fourth largest wine market, with a total consumption of 20,6 million hl in 2007.



It borders nine (9) countries – Denmark, The Netherlands, Belgium, Luxemburg, France, Switzerland, Czech Republic, Austria and Poland – and is considered Europe's industrial centre. Due to the cold climate, wine growing is not a very powerful industry and only the white wines have any clear possibility of success in international markets.

The country's wine imports registered a considerable increase in recent years and it still remains as the world's biggest importer, with 14,6 million hl in 2007 (13,9 million hl in 2006) in terms of volume and some € 2 billion in total imports. National production

⁴ Over 224 million consumers.

⁵ In AICEP Portugal Global (2009), *Mercados – Alemanha Informação Global*, January.

currently accounts for about 70 % of total consumption, which makes it even more attractive for foreign producers to invest in this market.

TABLE 1 – GERMAN WINE IMPORTS (market share)

	VALUE				VOLUME			
	2007	2006	2005	2004	2007	2006	2005	2004
Italy	35,7	34	34,3	40	42,5	45,4	41,3	43,8
France	29,2	30,4	28,7	34,3	16,7	16,4	17,1	22,4
Spain	14,4	15,3	13,1	18,6	15,4	16,6	15,4	24,4
South Africa	3,3	2,9	3,3	3	2,8	3,9	2,8	2,2
Chile	3,3	3	4,2	4	3,3	4,3	4,4	5,6
USA	3,1	3,4	3,4	3,8	3,3	3,2	3,4	4,4
Australia	2,9	3,2	3,8	3,7	2,9	3,1	3,1	2,9
Austria	2,1	1,8	1,7	2	2,2	2,4	2,4	3
Portugal	1,5	1,4	1,7	1,7	1	1	1,2	1,5
Greece	0,9	0,9	1,3	1,8	0,9	0,8	1,1	1,7

Source: Statistisches Bundesamt, 2008.

In terms of value, it is clear that New World countries (USA and Australia) are losing market share, whereas Italy and Chile (also New World) are growing in total weight.

As for Portugal, it remains with a very low market share (both in value and volume) but shows signs of growth in the last year. In 2007 the total Portuguese wine imports grew by 10,8% in value and 10,3% in volume, with a total of 151.000 hl (137.000 hl in 2006) worth € 30 million (€ 26,7 million in 2006). The country is now in 9th place in terms of Germany's wine imports.

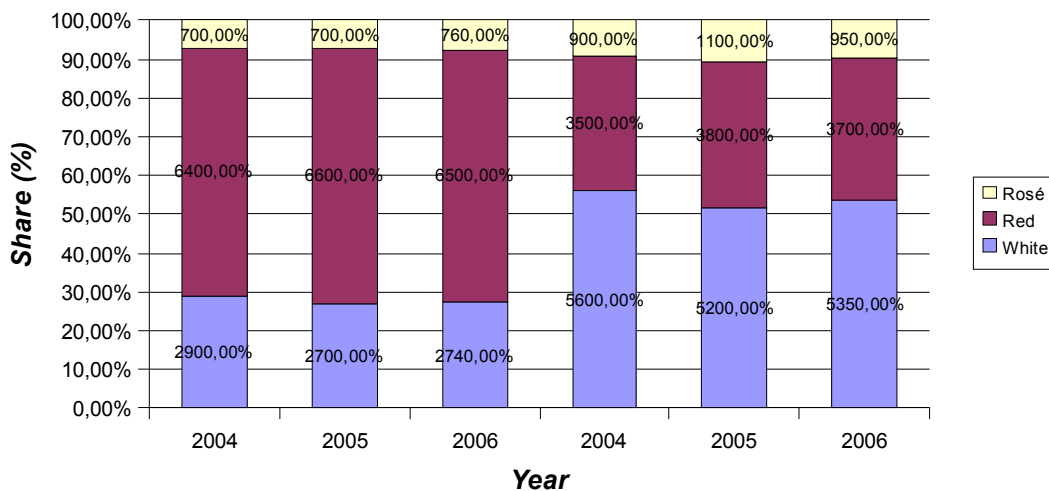
The Portuguese wine denomination that is showing greater success in the market are table wines with 73,5 %, followed by the V.Q.P.R.D. / D.O.C. with 26,5 % of the overall imports.

Bottled wines with a net sales price lower than € 2,00 / bottle represent 70 % of the total market. Outside the discount stores the growth rate of wines priced above € 2,99 is increasing by 11%. There is a growing search for ecological/biological wines in the country, although total consumption is still quite low.

New World wines represent a higher price in excess of 18% over the European wines, fact which can be explained by the transport and import charges that these products face. In spite of this, the success of wines coming from, for example, Chile can be considered amazing.

As for buying standards, 80 % is made via retail stores and 20 % in restaurants and bars. The next tables show the buying trends for the market in terms of type of wine consumed.

GRAPH 1 - WINE CONSUMPTION BY TYPE OF WINE (volume in %)



Consumers choose to buy wine mostly in Discount stores⁶ for in-house consumption and according to one importer *Lusitania Wein Import* “large market operators are now more open to creating a Portuguese wine category, shifting away from the current «Rest of the World» sales point reference”.

⁶ Official data varies but shows a number of around 70% of total wine purchases.

Backed by a positive media attention and growing consumer interest in trade fairs and tastings, wine imports from Portugal are growing at an average rate of 10% per year⁷.

On the other hand, as part of the EU, Germany now faces increasing legislation on alcohol consumption and growing alcohol taxes. The consumer is also shifting away from the traditional cork to a synthetic one and even the use of screw caps is now in vogue. This may pose as a danger to producers, as Portugal is well known for its cork industry as well as its use in wines.

PEST ANALYSIS WINES IN GERMANY

<i>POLITICAL</i>	<i>SOCIAL</i>
<ul style="list-style-type: none"> - Increasing legislation on alcohol consumption 	<ul style="list-style-type: none"> - Growing knowledge of Portuguese wines - Larger in-house consumption - High importance given to trade fairs / tastings
<i>ECONOMIC</i>	<i>TECHNOLOGICAL</i>
<ul style="list-style-type: none"> - Current recession - Growing taxes on alcohol - 70% of purchases in Discount stores - Growing Media attention to Portuguese wines - Growing consumption of wines - Growing Portuguese wine imports (+10%) 	<ul style="list-style-type: none"> - Synthetic cork (lower production costs) - Screwcap (lower production costs)

Source: Own table.

As the Michael Porter / Monitor Group study revealed almost 7 years ago, there are a few factors that can trigger a greater interest in Portugal over other countries. These factors relate to the existing natural grape variety (just after Italy, Portugal has the

⁷ In AICEP Portugal Global (2009), *Mercados – Alemanha Informação Global*, January.

largest number of indigenous grapes), the high increase in wine quality over the last few years and the uniqueness of some of the wines such as Port, Madeira and Vinho Verde.

The fact that Portugal is a relatively unknown wine country for most consumers can be viewed as both an opportunity and a threat, as it can trigger curiosity in trying a new thing or, on the other hand, push away consumers due to lack of knowledge. The fact that these wines are not present in most importer's portfolios can also be viewed both ways, because on one hand, there can be room for a new region and, at the same time, importers might not be interested in expanding to "unknown territory".

Competition is fierce in this sector and New World wines have added a very powerful marketing capability to an otherwise traditional industry. The growing weight of discount stores in total sales push the decision to an even more professional level and make it impossible to succeed without a strong marketing strategy backing up the whole industry. The current economic crisis is making it even harder to penetrate the market, as prices are pushed down every month in order to maintain competitiveness.

Portugal high production costs when compared to other countries (especially New World)⁸ and, in addition to that factor, presents much higher transport costs when compared to competitors from Spain, France or Italy.

All these factors taken into account, the conclusion that cheap wines sold in large Discount stores must not be the main target for Portuguese wine producers. Although representing a lower share, specialty stores and the On Trade seem like the best bet for Portuguese SME's.

⁸ *In* Mont Gras Export Strategy for a Chilean Winery, HBS Case Study, November 2002

SWOT ANALYSIS

STRENGTHS	<p>Grape variety</p> <p>Natural grapes</p> <p>High increase in quality</p> <p>Regular participation in Trade Fairs / Tastings</p> <p>Uniqueness in fortified wines (Ports, Madeira, Moscatel)</p>	<p>Reduced presence in large supermarkets and discount stores</p> <p>High production costs</p> <p>Transport costs</p> <p>Lack of presence in importers current portfolio</p>	WEAKNESSES
OPORTUNITIES	<p>Support from national institutions (Viniportugal, CVR's)</p> <p>New product / country</p> <p>Increasing demand for quality red wines</p> <p>Good price/quality relation</p> <p>Lack of presence in importers current portfolio</p>	<p>Strong competition</p> <p>Price increase</p> <p>Growing weight of discount stores in total sales</p> <p>Lower share of sales through speciality stores</p> <p>Lack of knowledge of portuguese grape varieties by german trade</p> <p>Current economic crisis</p> <p>Lack of consumer awareness</p> <p>Country image</p>	THREATS

Source: Own table.

The tendency is pending towards the retail sector, with over 46% of total volume sold by Discount Stores (Aldi, Lidl, ...). This has obviously a very low sales price, as we can see when comparing sales in volume with sales in value (see Graphs 2.1 and 2.2).

In-house consumption is, therefore, the rule, but there is still room for improvement in the On Trade. This is even more true for low production wines (such as Portugal), as the costumer tends to prefer these wines over the major low-price brands.

There should also be great importance to be given to the “direct” purchases, whether it is at a producer's own shop or through the internet.

By relating all the previous information, the following **Critical Success Factors** can be identified:

- ✓ New and unique grape varieties;
- ✓ Excellent price/quality relation;
- ✓ Overall country image;
- ✓ Presence and importance in importer portfolio;

Distribution Strategies

With such a large territory and total population, it will be very difficult for Portuguese firms to reach the whole market very quickly. So being, the best choice is to pick only a few regions and put all of its marketing efforts into smaller clusters.

The presence of Portuguese communities can contribute to the initial success of the internationalization process, as these communities can contribute with the initial sales volume necessary to build a critical mass that can justify investment.

As shown in Table 4, the country is divided in to 16 regions. The table can provide us with a better evaluation tool on where to place the producer’s marketing efforts.

Considering factors such as total population, geographical area, per capita GDP, per capita wine consumption and local Portuguese community, the following regions seem to be the most promising:

- Hamburg
- Bremen
- Nordrhein-Westfalen
- Baden-Württemberg
- Berlin

The focus needs to be on major cities where it is easier to contact Horeca and consumer's purchasing power is higher. In this sense, cities such as Hamburg, Bremen, Berlin, Frankfurt, Stuttgart and Duesseldorf or Köln should be the first target markets where to place the first efforts.

Due to the small dimension and overall capacity of Portuguese wine producers, direct negotiation with large supermarket chains and discount stores such as Lidl or Aldi seems to be out of the question. The average cost of production in quality wines per liter in Portugal is well above countries such as Spain or specially the New World, which makes it impossible to compete in terms of price with wines from most countries.

So being, I'll try to focus this study on negotiation procedures with wine importers, distributors, wine shops, supermarkets and small retail stores.

Table 5 shows a list of the most interesting Agents (Importers/Distributors) in the most promising regions for Portuguese wines in Germany.

By looking at local wine importers and distributors, there doesn't seem to be a high representation of Portuguese wines. This can be looked at as both an opportunity (because there could be room for representation) and a threat (as the reason for this lack of representation can be the lack of interest from consumers).

Transport costs and procedures

Arranging transport for Germany is fairly easy and there are many firms that will take on the job with short preparation time. In the case of direct export to a German importer, it is usually up to the importer to assure transport.

The overall cost of transport per bottle can go from € 0,30 (in the case of 100 cases – 1 pallet) to about half of this (around € 0,20/bottle for 5 pallets). If the cost of transport is settled to be charged to the producer, then these costs need to be taken into consideration when calculating the price of sale.

Local representation

The marketing strategy should focus on direct participation from the producer together with the local representative (importer). A Representative Office is a good choice. For the first few months there should be someone from the producer's side present in the market, visiting potential costumers and overseeing the work of the Importer/Distributor. The cost for this presence may be high and the period should not be less than 6 months.

The main purpose of this presence is to prepare for a joint venture with a local partner (distribution firm), gain knowledge of the market and its players and lay the ground for a solid partnership.

Trade Fairs / Tastings

There are two international Trade Fairs of interest from the producer's point of view, which should be considered:

- ✓ Prowein in Duesseldorf (West Germany)
- ✓ Koelnmesse in Cologne (North Germany)

There are also other local tastings regarding the wine industry which could be of high interest. The German embassy and Viniportugal usually arrange such events, although there is no set framework or schedule known in advance.

Working in close relation with the Agent for a given territory, a wine producer should show incentive to arranging wine dinner's, presentations and other events in places such as restaurants, art gallery inaugurations, theaters, among others. For wines positioned in such a high range but with such a low awareness by the consumer, this is one of the most important ways to promote and show these Portuguese products – local action aimed directly at the consumer.

Fiscal system – Local taxes and export formalities

Because both countries are part of the European Union, customs and import duties are not issues when exporting to Germany. Wines under 15% alcohol have a 19% value added tax (VAT) and are exempt from alcohol duty.

When exporting wines to Germany, it is mandatory to register a “DAA Documento Administrativo de Acompanhamento”. This document, along with the corresponding invoice should accompany the products from their expedition to their arrival at destination, and can be executed via the site <http://www.e-financas.gov.pt/> . The invoice must contain:

- Name (company) and address of seller and buyer
- Place and date of issue
- Number, kind, sign
- Consecutive number of packages
- Precise description of articles (usual trade description in terms of nature of goods, quality grades etc)
- Volume or quantity in normal commercial units
- Invoice price
- Terms of delivery and payment

Once the goods are in the German importer's possession, they should be put to recognize by the local customs authorities. Only the person authorized to dispose of the goods is in a position to file the entry (German importer).

The person liable to pay duty has to declare the dutiable goods at the customs office, stating characteristics and facts relevant for customs treatment, and the nine-digit code number of the German Official Customs Tariff, as the level of customs duties depends on the classification of the imported goods within the customs tariff. The classification of goods for customs purposes follows the "Harmonized System" (HS-nomenclature), which has been developed under the auspices of the World Customs Organization (WCO). Under this system, every item is grouped in a category which carries a specific identification number.

Approach and negotiation procedures/formalities

Dealing with German firms can mean lengthy discussions and negotiations. Things are talked and agreed upon in detail, in order to avoid misunderstandings and wrongful interpretations. Germans tend to say exactly what they mean and are usually very direct in speech and, as such, irony and humor can easily be misunderstood. Although distant at first and hard to negotiate with, once a business relation is established it cannot be destroyed too easily.

Credit insurance

Germany is rated as a medium/low risk country. So being, there are a number of options available for insurance, which can easily be reached (e.g. Cosec).

Market Entry Strategies

Direct and Indirect Exporting

This has been the most common entry mode for Portuguese firms in Germany. After establishing contacts with local importers and/or Distributors (many of which Portuguese emigrants or of Portuguese background) usually at a local (German) trade fair or tasting event the price of sale and minimum volumes are established.

The easiest way for a producer is to sell Ex-works, but the most common is FOT (Free-on-truck), which means that responsibility is taken by the selling side until the order is placed safely on a local transport agent.

Although the easiest and most chosen form of doing business currently for Portuguese wine producers, it usually gives them the worst results, as the entire marketing and selling process is out of their control and placed in the hands of German firms.

Greenfield investment

Making a brand new investment in distribution is another option for wine producers trying to win the German market. Due to the lack of knowledge in the market, most producers tend to look for people and/or firms that can help them and take care of the whole selling procedure. However, a brand new investment in distribution, when associated with the right local people can be an interesting choice.

Due to its inherent risks (most specially lack of market knowledge and high costs), most firms tend to abandon the idea of Greenfield investment.

Acquisition

Gaining control over a local distribution firm seems like a sound choice for producers within a SME structure. It may allow them to gain the necessary knowledge and experience in a foreign market and to better understand how this market works from the inside.

Joint Venture

Although harder to put into practice, a joint venture also seems like a good choice for Portuguese wine producing SME's. It can allow them to gain the necessary knowledge of the market and to establish strong partnerships with existing distribution firms. However, trust plays a key role in a joint venture, and people from both sides need to create a very strong partnership in order to succeed.

Table 6 shows a matrix that each producing company should use to evaluate the best choice for itself.

RUSSIA – Country and Market Overview

Located at the most eastern part of Europe and with a total population of over 142 million people, Russia is the largest country in the world in terms of total land area, occupying two continents (Europe and Asia). The population is disperse and the country's major city is Moscow with a total population of around 10.000.000 people.



It borders fourteen (14) countries – Norway, Finland, Estonia, Latvia, Belarus, Lithuania, Poland, Ukraine, Georgia, Azerbaijan, Kazakhstan, China, Mongolia and North Korea – and is nowadays one of the world's most booming economies. Its major industries are chemicals, oil, gas and military equipment.

Russia's wine production is relatively small, with a large total area of 71.300 ha but a small production of 338.000 tons of grapes⁹. Per capita consumption is rather low (8,6 liters) but is much larger when considering only the larger urban areas of Moscow or St. Petersburg.

During the past three years total wine consumption in the country has risen by an extraordinary 100 million liters (15% increase) due to greater per capita consumption, rising disposal incomes and the ban imposed by the government on Moldavian and Georgian wines due to health concerns. So being, local production is not nearly enough to satisfy the demand and much of the wine is imported either bottled or in bulk. In this context, Spanish, Italian, Chile, Argentinean and Greek wines have taken up a considerable position on the previous Moldavian and Georgian market shares.

⁹ 2006 estimate. *In Russian Wine Project. Government of South Australia, 2006.*

TABLE 7 – RUSSIAN RETAIL WINE MARKET PRICE POINTS

Segment	Estimated Share of Total Volume	Retail Value	
		Price Range	Volume
Super Premium	1%	> € 11,50	> 500
Premium	4%	€ 4,60 – € 11,50	200 – 499
Popular	35%	€ 2,30 – € 4,60	100 – 199
Commercial	60%	< € 2,30	< 100

Source: Russian wine project, Government of South Australia. Retail survey, 29 October 2006

Table 7 shows the price point share of wines and respective origin. It points out that Portuguese wines can never compete with “commercial” price points, as the transport cost alone will make them uncompetitive. As it is, Portuguese wines can and should position themselves in the Premium or above price points.

TABLE 8 – PRICE SECTORS OF WINES BY COUNTRY

Country	Average Price (SUS)
Italy, France, Spain, New World	\$12 – \$25
Georgia, Moldova, Spain, Italy, France	\$3,20 - \$12
Georgia, Moldova, Azerbaijan	\$1,70 - \$3,20
Russia	< \$1,70

Source: Komkon

As shown on Table 8, countries that border Russia place their wines in the low end, as both traditional New and Old World try to place their products in the > 3,20 price point.

TABLE 9 – TOTAL WINE CONSUMPTION

Year	Volume ('000 litres)
1996	590.000
1997	580.000
1998	550.000
1999	430.000
2000	469.900
2001	606.700
2002	640.400
2003	868.200
2004	1.015.900
2005	1.050.000

Source: OIV. In <http://www.sawis.co.za/info/download/RussiaCP.pdf>

Alcoholism is a serious problem in Russia, as the country is the world's biggest consumer of spirits. As drinking patterns alter and the country becomes ever more developed, wine is taking up a notable position in the drinks market.

Drinking wine is now a signal of social and economic success, as spirits consumption (namely vodka) are linked to an older generation. According to *Euromonitor*, wine sales are expected to rise some 20% to 30% per year over the next three years¹⁰

¹⁰ In http://www.winealley.com/atlas_49790_en.htm

TABLE 10 – PER CAPITA CONSUMPTIONS

Year	Wine	Beer	Spirits	Total Acohol
	Litres		LAA	
1993	3,5	17,3	4,86	6,1
1994	4,7	15,2	5,51	6,7
1995	5,8	24,2	6,99	8,8
1996	5,7	24	5,49	7,3
1997	5,9	25	5,5	7,3
1998	6	26	6	7,9
1999	7,2	28,4	6,5	8,6
2000	7,2	28,4	6,5	8,6
2001	7,7	30	6,3	8,6
2002	8	31,1	6,2	8,6
2003	8,6	32,8	6,2	8,7

Source: World Drink Trends 2005

Russians have shifted their taste towards wine, more than doubling the per capita consumption in 10 years (1993-2003). In fact, as all major alcohol types (wine, beer and spirits) have seen tremendous opportunities in the Russian market, wine has surpassed all other sorts in relative growth terms.

TABLE 11 – FREQUENCY OF CONSUMPTION

Frequency of Consumption	Percentage
2 or 3 times a month	20%
Once a month	27%
Less than once a month	53%

Source: Komkon

Although very fashionable at the moment, wine drinking is still saved for somewhat special occasions, as Russians mostly drink it less than once a month. The percentage of frequent consumers is still low when compared to most western countries (20%).

TABLE 12 – PLACES WINE IS DRUNK

Place Wine is Drunk	Percentage
At home	85%
Bar or restaurant	8%
Place of work	3%
Other	4%

Source: Komkon

The place of consumption is mostly at home, which represents for the lack of habit of drinking in bars/pubs or restaurants. The Russian consumer is not so open to an outdoor social life as it is common in the west and prefer to drink at home (we can thereby conclude that supermarkets/hypermarkets and specialist shops should have a key role in distribution).

TABLE 13 – RUSSIAN WINE IMPORTS (million litres)

Country	2001	2002	2003	2004	2005	2006 (01-09)	% Change 2001-2005
Moldova	151,6	139,9	173,7	199,6	212,3	47,5	0,088
France	34	44,2	55,9	61	78,1	69,6	0,231
Georgia	26,3	26,7	34,5	38,8	65,3	16,8	0,255
Bulgaria	5,8	12,3	19,7	27,9	46,5	34,9	0,679
Spain	7,9	10,8	16,3	25,3	41,5	60,4	0,517
Italy	10,6	13,7	20	24,9	36,2	32,4	0,36
Ukraine	13,5	9,6	14,4	16,5	22,1	15,4	0,131
Argentina	2	3,5	16	12,2	17,8	21,3	0,728
Chile	2,8	5,1	7,8	11,3	16	15	0,542
Germany	4,4	5,9	8,1	9,9	13,9	18,6	0,333
Uzbekistan	4,1	3,6	3,3	0,8	5,4	5,6	0,074
Hungary	2,1	3,4	3	3,6	4,5	4,8	0,209
South Africa	0,4	0,7	0,9	2	2,8	2,5	0,633
USA	2	1,6	1,7	2,4	2,6	2	0,073
Cyprus	0,4	1,1	1,3	2,1	2,4	0,5	0,598
Australia	0,5	0,7	1,1	1,7	2,1	1,4	0,424
Other	5,9	3,9	5	5,3	6,9	6,9	0,039
Total	274,4	286,7	382,5	445,2	576,5	355,6	0,204

Source: Russian Customs

Portugal is not shown on the previous table, as its exports to Russia are not yet significant. Also, the figures shown for Moldova and Georgia have suffered significant changes in the past 3 years, as the ban on wines from these regions took place.

TABLE 14 - PEST ANALYSIS (WINES IN RUSSIA)

Political	Social
<ul style="list-style-type: none">- Political stability- Rejection and ban on Georgian and Moldavian wines (former market leaders)- Existing corruption	<ul style="list-style-type: none">- Drinking wine is considered a sign of social status- Adoption of western habits and trends
Economic	Technological
<ul style="list-style-type: none">- Growing available income- Increasing middle class- Current economic crisis	

Source: Own Table.

Distribution Strategies

TABLE 15 – DISTRIBUTION MARKETSHARE

Distribution Network	Percentage
Supermarkets	52 %
Specialist shops	22 %
Local/corner shops	13 %
Markets	8 %
Bars and restaurants	4 %
Other	1 %

Source: Komkon

Generally speaking, trade is concentrated in the larger population areas, with Moscow and S. Petersburg taking the lead. Traditional commerce remains more powerful than

organized commerce such as supermarkets and hypermarkets but, paradoxally, the amount of supermarket floor space per inhabitant is higher than in many developed countries.

Nowadays, there is a large investment made by foreign retail multinationals in the Russian market, with insignias such as Metro Cash & Carry, Stockman, Auchan, Marktkaup, Spar, Billa and Real taking up strong positions. Russian insignias are also making a strong effort and developing their brands in order to respond to an ever more demanding consumer.

Wine shops are growing in number and there are currently (2007 estimate) around 50 stores in Moscow and 15 elsewhere. These stores have a limited display space with middle and top-range references and direct themselves to an upper class consumer with high purchasing power. They are usually operated by wine importers, who find it difficult to obtain an import license.

These licenses are usually attributed for a five month period, allowing the import of just 50 hectoliters of pure alcohol. They are of difficult access to retailers, who have to submit to regular visits and inspections¹¹. There is certain seasonality in sales between cities, as S. Petersburg takes the 1st place during the tourist season (summer) and Moscow sells more than any other city in the winter.

Transport costs and procedures

Transport costs are one of the major problems when looking at market potential in Russia. As Portugal is at the far west of Europe, the cost of transport in wines to Russia is rather high (up to € 0,80 per bottle). This will obviously put some pressure on the price of sale, making it one more reason to invest in high-end value wines.

¹¹ In WineAlley - Atlas.

Trade Fairs / Tastings

Although wine consumption is still relatively low when compared to other drinks (mainly vodka and beer), there are already at least two large Trade Fairs in the country, both taking place in Moscow:

- ✓ Drinks Industry / Russian Wine Fair (November)
- ✓ Russian International Wine and Spirits Fair (December)

Fiscal system – Local taxes and export formalities

The following has been compiled by Vesselin Tentchev from Tentchev Consulting:

The law relating to wine and alcohol commerce in Russia requires several authorizations such as authorization to sell and Distribution licenses.

The state has reinforced control over the production, import and circulation of alcohol throughout the Russian federation since the law of December 2005. This new system, called EGAIS, is based on the sharing of information (electronically) between customs services, tax services and various partners in the alcohol market.

The procedures to register are long and complicated, new software has, since the law of July 2006 came into force, created disorganization which the market has not withstood. Imports ceased temporarily and shops were empty. This system, supposed to half fraud and contraband, has proved ineffective for the moment. The numerous demands for the suspension of system have not cause the Russian government to yield, and shops in Moscow have full shelves again.

Labelling

- Brand (if applicable)
- Appellation of origin for wine, brandy, cognac and other spirits.

- Alcohol content
- Sugar content in grams per liter (apart from dry wines, cognacs, brandies, Calvados and flavored wines). For Champagnes and sparkling wines, denomination must follow sugar content: crude, dry, semi-dry, sweet, semi-sweet.
- Storage conditions
- Composition: for drinks based on wine and brandy, as well as cocktails, indicate the type of ethyl alcohol and water as well as the main ingredients used. Cognacs produced traditionally are exempt from this rule.
- Date of bottling (for all types of wine) and packaging (only sparkling wines created by in-bottle fermentation, and wine aged or matured in the bottle). This information must be displayed on the label (front or back) or on another part of the packaging or on the bottle itself.
- Vintage (for vintage wines).
- Average age of *eaux de vie* for cognacs.
- Best before end date obligatory for all wine-based drinks, cocktails and other alcoholic drinks with 10% alcohol content or higher. All wines including grape-based wines, fruit wines, mead, cider and grape-based alcoholic drinks are exempt from this rule.
- Name of the company which bottles the wine (must be displayed on one side of the label or on the cover).
- Reference to an interior standard.
- Information on certification (No. GOST R 20560).
- Warning on the dangers of alcohol abuse.

This information must be in Cyrillic on the label or packaging. If the packaging does

not permit this, the necessary information must be displayed on a label;

Important point: The amendment of 23/02/2006 of government law No. 80 has introduced the obligatory display (on the reverse of the label) of the following information:

- Ingredients, additives, GMO's.
- Energetic value (in Kcal).
- Nutritional information (proteins, glucose, lipids etc.).

VAT for all alcoholic drinks in 18% of the total including:

- Value declared at customs.
- Custom rights.
- Total excise duty.

The State Committee of Customs determines the number and position of customs posts authorized to regulate alcohol imports to Russia. After checking the accompanying documentation (invoicing) customs officials must make a partial examination of the merchandise before it is transferred to a customs terminal.

The customs inspector controls the documents accompanying the merchandise. The importer has to make a customs declaration in which he indicates the value. He will then make a bank transfer to pay the various taxes and duties. The merchandise is only cleared when the customs account has been credited.

All merchandise must be released in the three days following the deposition of the declaration, without which the file cannot be completed. The importer can speed up the procedure by furnishing in advance all documentation required by customs, and taking merchandise to the warehouse.

Credit insurance

Poland is considered a country of medium/high credit risk by COSEC. Short term credit is open without restrictions and medium/long term credit is subject to a bank warranty by the buyer.

So being, credit is limited to buyers from this country and a Portuguese SME should look towards payments upon delivery or (even better) FOB. Although limiting the options, this would minimize risks in sale.

Market Entry Strategies

Russia shows a medium potential for Portuguese wines. Due to inexperience in the market and to the fact that we are on opposite extremes of Europe, the best way to internationalize seems to be via direct exports to the country. After the consolidation in other markets (such as Germany and more especially Poland) a Portuguese wine SME can look differently to this market. However, for the first steps of internationalization, Russia seems to be a bit far out of reach in terms of resources needed and potential turnover.

CONCLUSION

Taking into consideration all the information before, and analyzing the options available for successfully entering a foreign market, we can come to the conclusion that the best way to reach success for Portuguese wine producing firms in these markets is different according to the country targeted:

Germany and Poland seem to be reachable by establishing a joint venture with a distribution company already operating in these countries. Buying a position in such a firm will allow producers to gain some knowledge of the market and to be present in decision making regarding the marketing of their own products.. Before doing this, the Portuguese SME should, however, get a better understanding of these markets by placing a worker on the field.

The key internal element is to see what are the company's resources, but taking in account that they are usually scarce for Portuguese wine SME's, then the best way is to find credible partners in the wine industry (other wine producing firms) that share the same goals and to build a credible network of partners that are also willing to invest in a foreign joint venture with a local Agent/Distributor. This option will reduce costs and risk whilst making it possible for fairly inexperienced firms to make a first attempt at controlling some of their marketing abroad.

The main risk with this option (and also with any option taken, for that matter) is that trust is a key element in the equation and the producing firms need to realize that their constant presence (via their own representative) is a fundamental for business success. As these countries hold no currency risk (Germany is a part of the single currency and Poland is expected to become one in the short term) and the joint venture would comply with EU rules and regulations (mostly common to all EU countries), the greater threat comes from within. This means that the relation between firms investing in these foreign countries needs to be of top value.

As for Russia, there is a different scenario presented. The country is still not as stable as desired and the existing middle class (although on the rise) is still not strong enough to justify allocation of a considerable amount of resources. So being, the best way would be to place a foot in the market by trying to find a local importer/distributor that can introduce Portuguese wines and give some feedback on reactions from costumers.

As a Portuguese SME directs its efforts to two countries in the region (Germany and Poland) it can gain some international experience and firstly consolidate their foreign position inside EU countries that more or less share the same laws and currency. The effort to be put in Russia (and other countries in the region) should come at a later stage, as this does not seem like the best time to invest in such an uncertain destination such as Russia.

So far, most of the research made is aimed at knowing the consumer's habits and trends. Little has yet been done to offer insight to Portuguese SME's on how to go abroad. The main idea so far is that all that needs to be done is to make good wines and the market will result by itself. Competition, however, is far ahead, and as countries like Spain or Australia are building a quality image for their products (wines included), Portugal still lacks a firm investment in its own values.

With this added difficulty in mind, the only alternative is to put some effort into controlling a part of local Distribution in foreign markets. The union of efforts by small producers can give each of them the necessary critical mass to go international.

This report aims at giving academics and industry players added data for the in-depth study of different possibilities of internationalizing small wine producing firms.

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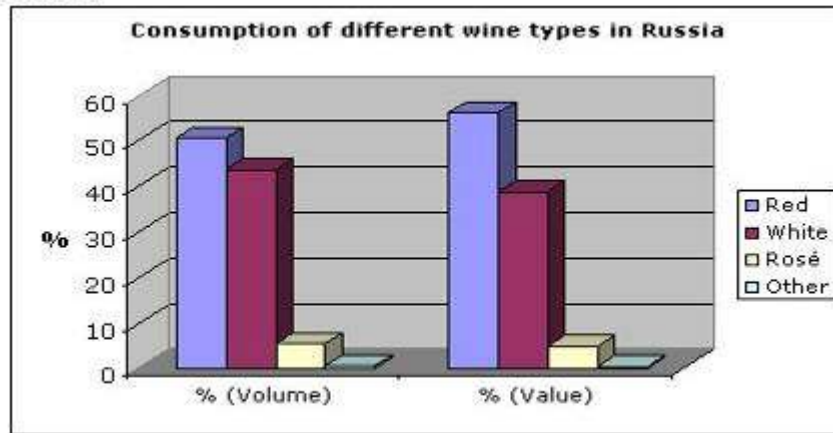
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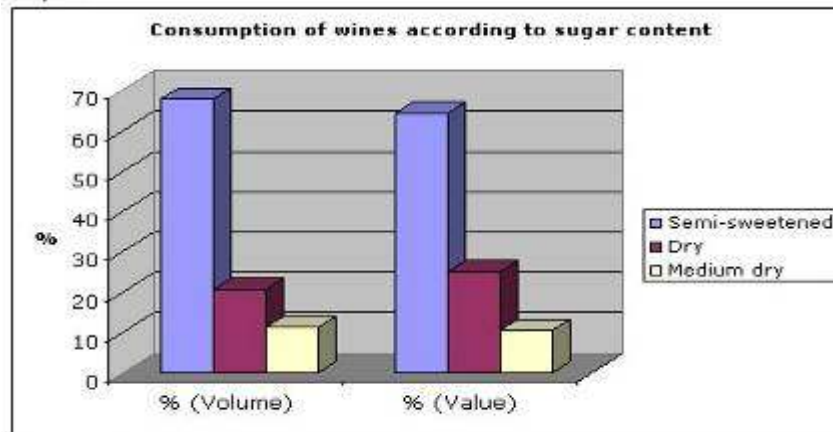
ANNEX

Graph 3



Source : Business Analitica

Graph 4



Source : Business Analitica

TABLE 5 – IMPORTERS / DISTRIBUTORS LIST

NAME	REGION	REMARK
Bley & Bley GmbH	Hamburg	
COPITO Melms & Melms oHG	Hamburg	Works mostly Horeca
Iberico Import - Groß- u. Einzelhandel	Hamburg	
J.H.F. Kaven Jr.	Hamburg	Specializes in Port wines
La Torre GmbH	Hamburg	
Lunaris Wein + Kunst - Dr. Puck & Garbers GbR	Hamburg	
Maniés Portugal-Importe GmbH & Co.	Hamburg	Big importer for ethnic markets
Max Piehl Weinimport GmbH & Co. KG	Hamburg	Low-end wines for sale in large retailers
Mercado Económico	Hamburg	Works mostly ethnic markets
Portimpex GmbH	Hamburg	Works mostly ethnic markets
Rudolf Prehn GmbH	Hamburg	
SILCA Import AG	Hamburg	Works mostly FMCG (not just wines)
SUL Portugal Import-Export GmbH	Hamburg	Works mostly portuguese food and wines
VINO Weinhandlung	Hamburg	
Wein-Fuchs Vertriebsgesellschaft mbH & Co. KG	Hamburg	
BREKO Bremer Weinkontor GmbH	Bremen	
DEPO Handelsgesellschaft - Portugal Wein Shop	Bremen	Specializes in portuguese wines, selling to wine shops
Eggers & Franke GmbH & Co. KG	Bremen	Big player, represents Sogrape
Gute Weine Lobenberg GmbH & Co. KG	Bremen	Specializes in high quality wines, selling to wine shops
Kiek-Rin Weinhandlung	Bremen	
Ludwig von Kapff GmbH	Bremen	
Montini Weinhandel	Bremen	
Vinum Weinhandel GmbH	Bremen	
Mövenpick Weinkeller GmbH (Stammhaus)	Dortmund	15 wine shops. Works the medium/high quality market
Lust4Wine Wein & Events c/o Dolphin Food & Wine GmbH	Düsseldorf	
MarLuso	Düsseldorf	
Vinho de Portugal (Weinhandel) Carlos M. Quintas	Düsseldorf	Specializes in portuguese wines
vinivini - Die Wein-Connection	Düsseldorf	
Der Weinhandel Bürgerheim GmbH	Essen	Small operator in south Germany
Anduronda Import GmbH	Köln	
Global Wines GmbH & Co. KG	Köln	Big nationwide player
Pernod Ricard Deutschland	Köln	
Rosário & Prange GbR	Köln	Specializes in portuguese wines
Smart Wines GmbH	Köln	
Südhang - Weinhandel Jacqueline Palicki	Köln	
Vino et Deco	Köln	
DER PORTUGIESE - Gross- und Einzelhandel Machado	Bonn	Works mostly ethnic markets
Wein Wolf Import GmbH & Co. Vertriebs KG	Bonn	
WIB Wein-Import Bonn Weinhandels GmbH	Bonn	
Ludwig Rilling GmbH & Co.	Stuttgart	
Vino Vero GmbH & Co. KG	Stuttgart	
Weinimport Axel Braasch	Karlsruhe	Specializes in high quality wines
Boutique Brissac - Weine, Geschenke, Keramik	Berlin	Small operator
Dr. Steiner Weinzunft Weinhandelsgesellschaft mbH	Berlin	Works with large volumes
Gärtner & Söhne GmbH - Wein- u. Spezialitätengroßhandel	Berlin	
Nix wie Wein!	Berlin	
Raritäten Cabinet der Weinhandlung Hardy	Berlin	
Spanische Quelle GmbH	Berlin	
Vinho Ibérico - Weine aus Portugal und Spanien	Berlin	Specialized in both portuguese and spanish wines
Wein & Glas Compagnie Weinhandelsges. mbH	Berlin	
Weingalerie - Weine aus PORT ugal	Berlin	

TABLE 4 – REGIONAL POTENTIAL FOR PORTUGUESE WINE

REGION	TOTAL POPULATION ¹	POP. DENSITY (inhabitants / km2) ²	GDP per capita ³	PORTUGUESE COMMUNITY	BORDERS
Schleswig-Hölstein	2.823.000	179	24.250 €	Small	
Hamburg	1.734.000	2.296	47.767 €	Large	
Bremen	663.000	1.640	37.123 €	Small	Free port status
Niedersachsen	7.993.000	168	23.956 €	Small	The Netherlands
Nordrhein-Westfalen	18.080.000	530	27.008 €	Very Large	The Netherland, Belgium
Hessen	6.089.000	288	32.963 €	Large	
Rheinland-Pfalz	4.059.000	204	24.126 €	Small	Luxemburg, Belgium
Saarland	1.061.000	413	26.060 €	Small	Luxemburg
Baden-Württemberg	10.693.000	292	30.433 €	Very Large	Switzerland
Bayern	12.423.000	176	32.041 €	Large	Czech Rep., Austria
Mecklenburg-Vorpommern	1.732.000	75	18.514 €	Small	Poland
Berlin	3.388.000	3.800	23.292 €	Medium	Capital city
Brandenburg	2.575.000	87	18.781 €	Small	Poland
Sachsen-Anhalt	2.523.000	123	19.458 €	Small	
Thüringen	2.373.000	147	20.926 €	Small	
Sachsen	4.321.000	235	19.903 €	Small	Czech Rep., Poland
COUNTRY TOTAL	82.369.548	236	27.174 €	Large	

¹ 2004 OECD estimate

² 2005 OECD estimate

³ in http://www.botschaftportugal.de/downloads/40_anos_analise_dados_estatisticos.pdf

TABLE 6 – ENTRY MODE

Evaluation criteria	Indirect export	Direct export	Marketing subsidiary	Counter trade	Licensing	Joint venture	Wholly owned operation	Acquisition
a) Company goals								
b) Size of company								
c) Resources								
d) Product								
e) Remittance								
f) Competition								
g) Middlemen characteristics								
h) Environmental characteristics								
i) Number of markets								
j) Market								
k) Market feedback								
l) International market learning								
m) Control								
n) Marketing costs								
o) Profits								
p) Investment								
q) Administration personnel								
r) Foreign problems								
s) Flexibility								
t) Risk								
TOTAL								

In <http://www.fao.org/docrep/w5973e/w5973e0b.htm>