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Château Margaux: Launching the Third Wine (Abridged)

"Down, Zorba!" "Come here, Souvlaki!" Corinne Mentzelopoulos commanded lovingly to her two beagles as she strode briskly across the raked white gravel in front of her château. It was mid-February, 2013. The ground fog from the nearby Gironde estuary still lingered over the legendary terroir of Château Margaux. Mentzelopoulos was on her way to the tasting room, located just beside the wine cellars, to take part in some critical decisions regarding the 2012 vintage.

Upon her arrival, she was greeted by General Manager Paul Pontallier, Technical Director Thomas Dô Chi Nam, Cellar Master Philippe Berrier, Commercial Director Aurélien Valance, Chief Financial Officer Olivier Pinon, and their consulting oenologists Jacques and Eric Boissenot. Her eyes quickly turned to the 20 glasses neatly arranged along a table in the middle of the room. "With some luck, I think we can settle on the assemblage of the *Grand Vin* today. Shall we begin tasting?" Pontallier asked. Mentzelopoulos nodded as she lifted her first glass.

The vineyards on the estate were divided into distinct plots, and the grapes harvested from each during the fall were processed separately. The resulting wines were kept in carefully labeled barrels. After four months of cooling, Pontallier and his team mixed samples of the young wines in an effort to determine the "perfect" blend, or *assemblage*, which balanced exquisite taste and quantity. As weather conditions differed from year to year, with each plot's unique soil, elevation, and drainage affecting how the grapes developed, so did the selection for blending. It took three or four iterations to arrive at the final composition of the château's first wine, the *Grand Vin du Château Margaux*. The gravity of making the right call on the assemblage of the first wine weighed heavily on Mentzelopoulos. She felt as though the reputation of Château Margaux was at stake. She also knew that the *Grand Vin*'s final composition would determine which of the château's 80 hectares would remain for making the second red wine, *Pavillon Rouge du Château Margaux*. And following a similar process of blending and tasting, what was left, anywhere from 0–35% of the total production, would constitute the third red wine.

Historically, management had not bothered much with this "leftover" wine, leaving it in barrels and selling it in bulk to local merchants who mixed it with other bulk wine from the Margaux region. But the 2009 vintage had changed things considerably. That year's third wine tasted so good that Mentzelopoulos decided to retain it all, giving her the option of selling it as a Château Margaux wine when it was deemed "pleasurable to drink." In the subsequent two years, she and her team sampled the 2009 third wine and were not disappointed, which led them to keep a portion of what was left after the first and second wine assemblages of the 2010 and 2011 vintages for similar purposes.

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When the 2009 third wine was tasted in early 2013, it was quite obvious that it would be ready for commercial sale by fall. What was less obvious was how best to market it. Mentzelopoulos, Pontallier, and Valance had engaged in heated debates on the matter. One straightforward option they contemplated was to sell the third wine to the Bordeaux merchants, called *négociants,* and entrust them with maximizing the market opportunity. Early discussions suggested that they would be delighted to do so. A different option was for Château Margaux to develop a complete marketing plan for the new offering. Although this option seemed attractive at first, the more they dug into it the more questions began to surface. Who should be the target market for the third wine? What should be its brand image relative to the château's first and second wines? What were the best channel and communication approaches? What price should the consumer expect to pay for a bottle? Even seemingly simple issues, like what name to give it and what color to select for the label, proved difficult to resolve.

Unlike reaching consensus on the assemblage for the château's traditional wines, a process she had been overseeing annually for over 30 years, reaching consensus on the launch strategy of an entirely new wine was something Mentzelopoulos had never done before.

The Global Wine Industry

As of 2013, the global wine industry was estimated at about $110 billion in revenues annually, with hundreds of thousands of wineries worldwide producing over 30 billion bottles.[1]

Supply and Demand

Few barriers existed to making wine, as virtually anyone between the latitudes of 30 and 50 degrees in both hemispheres, with a reasonably warm and dry summer, could plant a varietal of the common grapevine in their backyard. Yet until recently, almost all wine was made in Europe, with France and Italy as the main "Old World" producers. This pattern changed in the second half of the 20th century, as winemaking dramatically increased in the New World, which primarily consisted of the U.S. and Southern Hemisphere countries. Names like André Tchelistcheff and Robert Mondavi shaped the fine wines of Napa Valley, while Ernesto and Julio Gallo built up volumes of table wines in the Central California Valley region. In the 1980s, Argentina became one of the largest producers of wine in the Americas, and Chile began building sizable domestic and export wine businesses. In the 1990s, Australia harnessed large tracts of land in the south and declared wine an export imperative. New Zealand followed suit, leading with its Sauvignon Blanc from the Marlborough region. By the turn of the 21st century, New World producers began taking meaningful market share of global wine exports from Old World producers. (See **Exhibit 1** for data on worldwide wine production.) The increased number of wine-producing locations resulted in excessive quantities supplied to market, forcing many winemakers to lower prices, curb yields, or exit the business altogether. In several countries, such as France and Australia, the government actively stepped in. Measures ranged from subsidies to help clear excess capacity to imposing restrictions on the planting of vines.

Global wine exporting was dominated by EU countries, with Italy, France, and Spain accounting for 55% of all wine traded by volume, while Argentina, Chile, Australia, and New Zealand made up roughly 33% combined; the U.S. accounted for 8%. As for wine importing, the U.K. and Germany were the largest by volume, followed by the U.S. Fine wine tended to be exported in bottles, whereas low-end wines were often shipped in bulk containers. Large U.K. retailers commonly imported bulk wine and then bottled and sold it under their own private labels, a trend seen in other countries as well.[2]

Global demand for wine was highly uneven. Annual per capita consumption in 2012 was still the highest in Old World countries, such as France, Italy, and Spain, yet was gaining momentum in other places, such as Australia, the U.S., and China. (See **Exhibit 2** for trends.) In many European countries, wine was tied to daily traditions and was a common part of family meals. However, the erosion of typical family structures and a move away from alcoholic beverages were weakening this tradition, leading to a decline in wine consumption in recent years. By contrast, in many New World countries, wine consumption was more occasion-driven and took place away from home. There was also a correlation between the tendency to drink wine and various demographics. In countries like the U.S., U.K., and Australia, wine drinkers tended to be older, have higher disposable income and education levels, and be female.[3] Consumption location affected spending. In the U.S., for example, about 50% of wine purchases by dollar amount occurred in bars and restaurants (called "on-premise"). But because of the high markup at these venues, such purchases represented only 20% of the volume sold.[4] The 80% of wine volume purchased "off-premise" was through liquor stores, grocery stores, wine shops, domestic wineries that sold direct, and, increasingly, Internet retailers, such as Wine.com and Lot18.

Although per capita wine consumption in China was considered low, its pace of growth since 2008 had been impressive—more than triple that in the U.S. In the past decade, wealthy Chinese developed a taste for fine wine, and in 2008, Hong Kong eliminated all taxes and restrictions on wine imports. These factors created a surge in demand, and by 2012, China displaced the U.K. as the fifth-largest market by volume, with nearly 2 billion bottles consumed. Affluent Chinese commonly bought an expensive wine for a special occasion or for gifting, and business deals were often sealed by opening a first-growth Bordeaux wine. There was also a very active aftermarket in China, with prices of leading wines often quadrupling over a three year span. For instance, a 12-bottle case of *Château Lafite Rothschild* 2009 recently sold for £43,000 in a Hong Kong auction, and counterfeiters were paying up to $450 for an empty bottle of a high-end wine, refilling it with cheap wine, and reselling it as an original at market prices. As one wine dealer put it, "This is always going to be a danger when people are drinking not out of passion but because they think that fine wine is what they should be seen drinking."[5]

Buyer Behavior and Influencers

The vast range of wine prices—from under €3 at a local French supermarket to upwards of $3000 at a high-end Chinese restaurant—suggested considerable heterogeneity in consumer wine-buying patterns. Several criteria seemed relevant for segmenting wine buyers: drinking frequency, information sources, consumption setting (private vs. social), purchase channel, and price sensitivity. A recent study partitioned wine consumers into several segments (See **Exhibit 3** for segment details.)

Fine-wine buyers were often categorized as either "connoisseurs" or "luxury" consumers. The former tended to be knowledgeable about wines and able to discern between different regions and vintages; their sophistication and appreciation for quality were a source of pride. Luxury consumers, on the other hand, typically lacked deep knowledge of wines, and their choices were intended to portray an image of wealth and stature. Many attributed the run-up in prices of fine wines to luxury buyers in emerging markets, such as China and Russia. A third, but growing, segment of premium buyers were willing to spend more on wines that fit their desire to be perceived as distinctive, trendy, and adventurous; as one blogger put it: "A fashionable wine from a faraway region that allows them to stand apart, will get this group reaching for your bottle (and their wallet)."[6]

Taste and quality were important criteria in wine selection. However, because wine was an "experience good," the ability to assess these attributes prior to purchase was limited. Although sampling was sometimes possible (for example, on a visit to a winery), for the majority of purchases, consumers used extrinsic cues. Some relied on previous consumption experiences, while others held preconceived notions of where and when good wines were made. Many trusted the advice of others to learn about wines they might like and to reduce the risk of buying an unsavory bottle, especially since the relationship between wine quality and price was often seen as distorted. Recommendations could come from friends, retail sales associates, sommeliers, or wine journalists. Critics were yet another group with a strong voice, and the one with perhaps the most influence was Robert Parker.

Robert Parker Jr. had worked as a bank attorney. In 1978, his passion for wine led him to start a newsletter called the *Wine Advocate*. In 1983, Parker tasted the 1982 vintage in the trade tastings held in Bordeaux. The established critics were unimpressed with the new vintage, commenting that the wines lacked acidity and tannic structure, were not age-worthy, and were unlikely to hold their fruit flavors over time. Parker disagreed. His descriptions of the vintage captured the enthusiasm of the U.S. market for Bordeaux. By the time the 1982 vintage was bottled and tasted by consumers in 1984, the world sided with Parker, and prices were reset to a much higher level than a year earlier. His newsletter jumped in circulation, and he decided to quit his job at the bank to work full-time on his passion.[7]

Each year, Parker sampled around 10,000 wines and published his comments and rating scores in his newsletter. He assigned each wine a number between 50 and 100, awarding 50 points for "just showing up," up to 5 for color and appearance, 15 for aroma, 20 for flavor and finish, and 10 for overall quality or aging potential.[8] When asked how he was able to apply a seemingly objective standard, he replied, "A wine goes in my mouth, and I just see it. . . . The textures, the flavors, the smells, they just jump out at me."[9] From the U.S. to Hong Kong, Parker's impact was felt throughout the wine ecosystem; a wine's price could tumble on a bad rating or skyrocket on an especially good score. Winemakers commonly believed that "if my Parker rating is under 90, I cannot sell it; if it is over 90, my traditional customers cannot buy it!" Other well-known critics included James Molesworth of the *Wine Spectator* and Jancis Robinson of the *Financial Times*. The *Wine Advocate* and *Wine Spectator* ratings, which did not always agree, were often displayed in retail stores or restaurants ("WA 90/WS 92").[10] Some in the industry didn't approve of these single-number ratings and believed critics like Parker wielded too much power and pushed the industry in the direction of their particular preferences.

The Bordeaux Wine Region

In French, *bord d'eaux* meant "beside the waters." Bounded by the Bay of Biscayne on the west and the Gironde estuary on the east, much of the Bordeaux wine region was a large peninsula surrounded by water, which served to mediate temperature fluctuations, thus improving conditions for growing grapes. The area north of the city of Bordeaux and west of the Gironde was referred to as the "left bank." Here the soil was mainly gravel and sand, a combination well suited to develop the tannins of the Cabernet Sauvignon grape. The region to the east of the Gironde was referred to as the "right bank." The soil there contained more clay and limestone deposits, favoring the nourishment of Merlot and Cabernet Franc grapes. Bordeaux was the largest "origin-controlled" wine region in France and had about 60 "appellations," or named wine sub-regions. It contained over 11,000 châteaux and 118,000 hectares of vineyards, and produced on average 730 million bottles of wine a year.[11] The vast majority of Bordeaux wine was sold in supermarkets for less than €10 a bottle. But the leading wines were sold in specialized shops and upscale restaurants around the world at prices that could exceed €1,000 per bottle. Bordeaux fine wines were typically blended from different grape types, a process believed to add complexity in texture and flavor, and tended to improve with age, sometimes for several decades.

The 1855 Classification

In 1855, Napoleon III decided to hold a World's Fair. He asked the Bordeaux wine merchants, or *négociants*, to send "the finest Médoc wines to Paris, and to classify them so the very best could be easily distinguished."[12] Faced with this task, the *négociants* invoked a trusted metric: market prices. They reviewed prices that had been recorded since the 17th century and created a five-tier ranking or classification scheme: *Premier Cru, Deuxième Cru, Troisième Cru*, and so on. They declared the wines from the châteaux of Lafite, Latour, Margaux, and Haut-Brion as *Premier Cru*, or first-growths.

Although wine critics voiced reservations from time to time as to whether this ranking was still valid over 150 years later, the general opinion was that the 1855 classification got it right—the superiority of the "*terroir*" at the first-growth estates would always come through. This French term referred to the combination of the soil, the sub-soil structure, the tilt of the vineyard, the drainage properties, and the position of the water table. Vineyards that made their vines "work hard," to send out roots through difficult soil to find water and nutrients for their grapes, tended to make more concentrated juice. Vineyards that sloped toward the river but were not beside it tended to drain well and keep the grapes from getting bloated with water after a rainstorm. All of these factors combined to favor some parcels of land over others. The vineyards of the first-growth estates were believed to be blessed with respect to these characteristics. Common belief was that terroir trumped technique. Yet viticulture experience, grape selection during harvest, and careful winemaking all contributed to great wines. And several châteaux had consistently achieved more than their allotted "growth ranking" indicated. For example, Léoville-Las Cases, Palmer, Lynch-Bages, and Pontet-Canet were often referred to as "Super Seconds" for their outstanding wines. Nevertheless, there had been only one change to the 1855 classification. In 1973, Château Mouton Rothschild was elevated from second to first-growth, in a complex and political process. (See **Exhibit 4** for information on first-growths.)

The Sale and Distribution of Fine Bordeaux Wine

In keeping with a time-honored tradition, the leading Bordeaux châteaux distributed their wines through the *négociants.* And though most wineries sold their wines after bottling, the top 50 or so châteaux in Bordeaux sold the majority of their wine while still in barrels in an *en primeur*, or futures, market system. For example, the wine produced from grapes harvested in the fall of 2012 would only be delivered by the châteaux in late 2014 or early 2015, but *négociants* were given the opportunity to purchase allocations of it during the spring of 2013. The sale of wine futures to these merchants came on the heels of an annual tasting ritual. In early April, the leading châteaux hosted a weeklong event, called "*en primeurs* week," where journalists, critics, importers, and merchants were invited to taste samples of the newest vintage still in barrels. The industry waited anxiously for the top critics to place a score on the wines. Mentzelopoulos described the scene and its pricing implications: "We do our best during *en primeurs* week to feel the excitement level for our wines. We pay close attention to the chatter of the *négociants* and wine critics. We also factor in our yields and assessment of consumer trends and global economic conditions. This helps us set the price." Valance added, "Once we have all this information, we also check which of our past vintages received a similar critic evaluation. The release prices for those wines were set in expectation of future demand, but the popularity and willingness to pay for them could differ considerably once consumers tasted them. Hence, we look to see what those previous vintages sell for at retail now. Then, given typical markups by the various channel members, we back out what price makes sense for us to charge *négociants* for the new vintage." From year to year, the opening *en primeur* release prices could vary wildly, from a low of €60 all the way up to €500 per bottle. (See **Exhibit 5** for Parker scores and *en primeur* and retail prices for Château Margaux wines.)

The new vintage was sold in several offerings, called "tranches," during the late spring. Hundreds of *négociants* were eager to buy classified growth wines. The châteaux had to decide which merchants to sell to; what quantity to allocate to them; and whether to hold back some wine in their own cellars to sell in future years. With a good vintage, the châteaux would release a limited quantity at a first-tranche price. Reactions, if enthusiastic, usually resulted in successive offerings at much higher second- and third-tranche prices. The châteaux dealt with a limited number of *négociants,* and relationships mattered. A chateau favored merchants that had shown commitment to its image, sold to reputable importers, and came through in good as well as bad years. The first-growth châteaux typically held back 10%–20% of their first and second wine production each year, and sold it to the merchants after bottling. Mentzelopoulos summed up the process: "Because market and weather conditions varied so much from year to year, every vintage is like the IPO of a new company, and the *négociants* are in a position to invest in its shares. We have to decide how many shares to put up and at what price."

After agreeing to purchase allocations from the châteaux, *négociants* turned to large importers and distributors around the world and resold part of their futures. In turn, these channel members sold to smaller distributors and retailers in their local markets. Valance estimated that each player in the chain sold about 80% of its allocation. *Négociants* marked up futures by about 15%–20%, while other players in the chain marked them up by 10%–15%. Mentzelopoulos declared, "Because the market value of first-growths can climb so much over time, each player stashes away some to make more money than in the *en primeur* market. Many people wonder whether these margins truly reflect their costs of doing business." Indeed, on the quantities held back, *négociants'* profits could more than double for the same vintage, depending on when they sold it.

The use of *négociants* dated back to the 18th century. The practice spared châteaux owners from the commercial aspects of the business and let them focus on winemaking. Owners remained behind the scenes and were thus not held accountable for final price fluctuations or product availability. Some defended the *négociants'* role, observing that they had the scale economies to maintain a global sales force, develop new markets quickly, and deal with hundreds of importers, some of whom might not pay on time or be of dubious reputation. Moreover, the leading châteaux were often able to sell their entire production in one day and collect the cash almost two years before shipping a single bottle. Yet many regarded the *négociants* as an anachronistic practice, arguing that the highly profitable châteaux had less need today for a financial buffer and personally knew many of the importers and key global purchasers. Moreover, truly "bad" vintages had become rare. "The *négociants'* job has gotten easier, yet their profits have increased," Valance quipped. Lastly, the Internet had emerged as an efficient vehicle for direct communication and sales, which could replace many functions of the *négociant*.

Château Margaux

The Château Margaux estate was located on the left bank of the Gironde estuary, in the heart of the Médoc region. Although ownership records of the land date back to the 12th century, the estate's reputation for great wine was established in the 16th century by the Lestonnac family. Future owners continued the tradition of exceptional winemaking, and, fueled by strong demand for Bordeaux wines by the British, Château Margaux experienced a golden age during the 18th century. In 1810, a new owner, the Marquis de la Colonilla, redesigned the estate's buildings. The result, which constitutes the current property, was considered an architectural masterpiece. The estate's palace, nicknamed the "Versailles of the Médoc," was placed at the center of a small "viticulture city." On one side was the tradesmen's yard, and on the other, the cellars and vat room.

In 1977, André Mentzelopoulos, owner of a successful French supermarket chain, purchased Château Margaux for about $16 million. At the time, Bordeaux wines were experiencing a decline in popularity. The estate had been up for sale for over two years, with little interest. But André immediately fell in love with the property and believed he could restore its glory. He orchestrated a complete overhaul of the vineyards, improved drainage, built the first underground cellar, and initiated new plantings. He reintroduced the château's second wine, *Pavillon Rouge*, which was created in 1906 but had been forgotten for years, and redefined the *Pavillon Blanc* white wine. The estate's 1978 vintage, the first he had overseen, was recognized as exceptional and one of the best that year. André's vision, attention to quality, and innovation inspired many Bordeaux winemakers.

A Dynamic Duo Takes Control

André Mentzelopoulos died abruptly in 1980. Corinne, his 27-year-old daughter, inherited the estate. She felt compelled to follow in her father's footsteps. "We continued my father's work out of love for Margaux; we simply didn't have the right to let it fall." In 1983, she hired 27-year-old Paul Pontallier to succeed the retiring general manager. Pontallier held a doctorate degree from the Talence Institute of Oenology. Mentzelopoulos recalled, "The other leading châteaux would have dismissed Pontallier's application, as he had no experience. But I was impressed by his entrepreneurial spirit, his passion for Bordeaux wines, and his commitment to improvement. I did not hesitate to hire him."

The Mentzelopoulos-Pontallier combination proved successful. Practices that would become commonplace only in the 1990s were ushered into Château Margaux in the 1980s. Ideas such as strict temperature control during fermentation and novel techniques for extracting tannins led to finer wines. Mentzelopoulos reflected, "Paul and I always believed in the potential for increasing first-growth wine quality. One of my proudest moments was when our picture made the *Wine Spectator* cover in 1984."

Buoyed by Parker's highly favorable reviews, Americans' newly found enthusiasm for classified first-growths, and the rekindled interest of connoisseurs in the U.K. and Germany, the leading Bordeaux châteaux saw an explosive rise in demand from the early 1980s onward. The enthusiasm in the West was but a precursor to the astonishing fascination in the East in subsequent decades. Mentzelopoulos commented, "Our wine, even though it had been appreciated for centuries, had never known such success; enthusiasts from all over the world were coming to visit, taste, and compare." Among the many distinguished visitors were the president of China, Hu Jintao; the king of Sweden, Carl XVI Gustaf; and Bono. "After a few bottles of Château Margaux 1982, we were all singing U2 songs at the top of our voices," Mentzelopoulos recounted with a wide smile.

Making the Wine Although the estate grounds comprised some 250 hectares, the terroir suitable for growing grapes was limited. Eighty carefully chosen hectares were devoted to vines for red wine and 12 hectares for white wine. In 2013, the estate employed about 100 people, mainly in production. Other expenses included equipment and maintenance. An industry expert estimated that a bottle of first-growth wine cost between €25-€50 to produce, depending on weather, yield, and selectivity. Dô Chi Nam explained, "In a vintage like 2009, things went smoothly. Spring rains came in time for vine flowering to occur in May, summer was warm but not oppressive, the grapes ripened on schedule in September, and the harvest was completed before fall rains began. Costs were on the low side that year. But with the 2008 vintage, early fall rains delayed ripening. Had we not reduced the number of grape clusters per vine, we might have lost the harvest altogether. Costs were higher that year."

Over the past 30 years, management was inclined to put less of the production in the first and second wines and also to reduce yields overall in the vineyard, concentrating the flavors in the remaining grapes. Thus, while 51 hectoliters of wine were produced per hectare in the 1980s, this number had dropped to 35 by 2012. These decisions had led to fewer bottles, but with increasing quality. Pontallier expounded, "In responding to the market, we found ourselves in a vicious cycle. The more consumers were willing to pay for a Bordeaux first-growth, the more incentive we had to increase our quality by being more selective, which resulted in stronger reviews and hence even higher willingness to pay, which prompted us to be even more selective, and so on."

Marketing the Wine Until recently, if management had been asked about marketing practices, it would have simply replied, "We don't do marketing." Mentzelopoulos believed the 1855 classification, along with the quality and scarcity of the product, created the allure for wine aficionados. The château relied on the channel to serve as the distribution *and* marketing arms for its wines. Yet Mentzelopoulos noted demand shifts: "Twenty years ago, 100% of our wines were bought by connoisseurs. Ten years ago, that changed to 80% connoisseurs and 20% luxury buyers. Today the split is 60% vs. 40%, and those 40% luxury buyers are mainly from China." Valance estimated that in 2005, Mainland China and Hong Kong accounted for 4% of sales, but by 2012, that number had climbed to 35%. Conversely, sales in Japan and the U.S. had dropped by about 10% each; sales in France remained relatively flat.

Dealing exclusively with the *négociants* simplified life, but meant that Mentzelopoulos and her team were far removed from the market. Valance outlined some recent steps taken to change this: "We began organizing events in key markets and invited journalists, wine experts, and channel members. We made sure a representative from Château Margaux was present, and we staged wine tastings. We engaged with the media and hired a PR person." Valance estimated that 2,000 bottles of Château Margaux wines were allocated to these events every year. Perhaps the biggest marketing initiative was in China. In 2010, the château appointed an "ambassador." Pontallier elaborated, "China is a large country with many distributors and retailers. We wanted to make sure they were aware of the quality of our wines, and we needed to better communicate the value of our brand." The ambassador in China met with channel members, wine professionals, and journalists to build relationships. He also organized events—the most spectacular to date was a gala dinner on the Great Wall of China. In 2012, Château Margaux expanded the ambassador program to the U.K. and the U.S.

The Third Wine Opportunity

The idea to sell a third wine was planted in Mentzelopoulos's mind in 2008 by a young Chinese visitor, frustrated at how difficult it was to obtain first-growths in China. Mentzelopoulos dismissed the idea at the time. "We didn't think the quality of what was left after making our first two wines was good enough. Moving 'downstream' also went against everything we had done since my father acquired the château—to relentlessly increase quality and build a reputation for spectacular wines."

But then came the 2009 vintage. Pontallier described the sequence of events: "We were working on the assemblage of that vintage, which was one of the best we could remember, and realized that by being more selective, we could bring our first and second wines to a truly exceptional level, which we believed was something the market wanted. A by-product of that decision was that the volume of the third wine was more than 20% of the entire production. When I tasted it, I was pleasantly surprised. It was so good that in some past mediocre years, it could have easily qualified as our second wine. It seemed a shame to sell it as bulk, so we decided to keep it and see in a year if it was worth bottling."

As they thought about the prospects of the third wine, various trends struck management as noteworthy. Pontallier elaborated, "We had no control over final prices, and in the past few years, our second wine's price had tripled. In talking to several merchants and experts, it seemed that *Pavillon Rouge* went from being perceived as 'the Grand Vin's little brother,' made from grapes that weren't good enough for the first wine, to having a reputation as a high-quality wine on its own." Mentzelopoulos added, "Our core markets were shocked by the recent price escalation and believed they were unduly inflated by luxury consumers. Our second wine began disappearing from retail stores and restaurant wine lists, similar to what had happened to our first wine a few years ago."

A big moment of truth came in early 2011 when two tastings had to go well in order for the third-wine concept to be further pursued: the 2009 vintage had to show it was aging well in the barrels and the recent 2010 vintage third wine had to be of sufficient quality. Both passed with flying colors. There was no doubt about what to do with the 2009 third wine, as Pontallier announced, "Bottle it!"

The Future Marketing of the Third Wine

Mentzelopoulos and her team brainstormed about what to do when the third wine was ready to hit the market. The simplest option was to sell it to a select set of *négociants*. Valance said: "We have a good sense of these merchants and what drives them. They will accept a high price for the third wine because they want allocations of our first and second wines. They would likely pay us up to 50% of what they pay for *Pavillon Rouge*." Mentzelopoulos added, "I don't think they will have a hard time selling this wine. This option can maximize profits, but most of the wine will probably end up in China."

The team debated what it was they hoped to achieve with the third wine. Pontallier said, "Our wines have become inaccessible to our core customers in traditional markets, like the U.S., U.K., Japan, and France, who used to buy our wines regularly. We need to bring them back; a third wine can do that." Valance differed, "We do need more presence in traditional markets, but we should reach consumers new to the wine-loving world and introduce them to our brand." Mentzelopoulos weighed in:

> I see the merits of going after each of these segments. I would like to regain the hearts of the loyals who have been "priced out." They admired our wine because of its uniqueness and excellence. But we need to think hard about how to position a third wine to them, as they "grew up" on our first and second wines. We can't allow a perception that this is an inferior product. It is also important to breed the next generation. These are consumers with a certain profile and may in the future want to buy our top wines, despite the high prices; the third wine should let them understand what the magic of Château Margaux is all about.

Place To target specific consumers, management believed it would have to bypass the *négociants*. This meant contacting importers or large distributors directly to try to reach the desired end consumers at the right time and place. Valance felt one such promising "place" could be restaurants, particularly high-end or trendy ones. He elaborated, "We would canvas the metropolitan cities we decided to go into and find the right venues for our wine. Sommeliers would be critical here by featuring our third wine on lists and promoting it to guests." An alternative "place" would be wine shops, primarily boutique ones. Sales associates could bring the third wine to the attention of relevant customers.

In France, Château Margaux could sell directly to consumer-facing outlets, but management felt it should work with a large distributor who would sell to restaurants or stores. Selling in other EU countries would also involve two steps. In the U.S., imported wine had to go through a three-step distribution scheme that involved an importer and state distributor before reaching retailers or restaurants. Management assessed the margin each player expected to earn as follows: importers or large distributors 25%, retailers 30%, restaurants 60%, and U.S. state distributors 28%.

Price Management had to select a price to charge the channel partner buying the wine from the château—be it *négociants*, importers, or large distributors. If bypassing *négociants*, the team felt they should approach this task by working in reverse, that is, determine the price end consumers should pay and then back out the price to charge based on typical channel margins. Valance remarked, "We think the price consumers pay should fall somewhere between \$100 and \$150 per bottle. If we lean toward \$100, say, in the U.S., we are perhaps sending a message of affordability or 'value for your money.' At closer to \$150, we are perhaps preserving the upscale image of our wines." He continued, "Although we don't have immediate control, we could select channel partners that shared our vision. We would explicitly articulate our strategy and monitor where our third wine ended up and at what price. If things didn't go according to plan, we would consider switching partners the next year."

One benchmark was Latour's third wine, *Pauillac de Château Latour*, which Latour had offered consistently since 1990. A strong vintage bottle cost between $100 and $150 at retail, with higher prices at restaurants. As far as Valance could tell, Latour used *négociants*. Mentzelopoulos asserted, "The quality of our third wine should not be below that of Latour's and our price should not be above theirs."

Promotion Proactively marketing the third wine meant influencing key decision makers. For example, having the wine offered at prestige restaurants required convincing sommeliers to order it. But leading sommeliers' attitude toward Bordeaux wines seemed to have soured in recent years. Such was the case at the sleek Manhattan restaurant Rouge Tomate, where many Bordeaux wines had been taken off the list. In an article titled "Bored of Bordeaux," the wine director of the restaurant noted that authenticity in winemaking "is what Bordeaux used to be before it became a brand," and that the traditional Bordeaux châteaux could benefit from less "snob appeal." In explaining the backlash against Bordeaux first-growths, the *New York Times* wine critic cited "monstrous prices" and complacency toward the U.S. market, adding, "They perhaps imagined that they would always sell all the wine they could want through the enthusiasm of Parker, not realizing that a generational shift was occurring."[13]

Mentzelopoulos acknowledged the negative attitude among sommeliers: "We became too expensive for them, and it got harder and harder to get supply. They are better off telling a story that first-growths are overpriced, not trendy and boring." She believed sommeliers would welcome a reasonably priced third wine from Château Margaux: "I wouldn't put my hand in the fire, as we have not done formal market research, but I think they will love it. Our third wine will give them a new and better story to tell; it will allow them to surprise and delight their clients." Valance added, "If we handpick a select set of restaurants in each major city we wish to reach and commit to sommeliers through our distributors that they will get consistent supply of the third wine, they will feel special."

Brand name Mentzelopoulos asked her team to carefully consider what name to give the new wine. "How we call it will create expectations in the marketplace, including for those buying our first two wines," she said. Pontallier advocated for a name signaling that this was, after all, the *third* wine. One proposal was *Margaux du Château Margaux*; other names that had been floated were *Petit Margaux du Château Margaux* and *Esprit du Château Margaux* (*petit* means small; *esprit* means spirit). Suggestions also included finding a way to leverage the Pavillon name or crafting an entirely new moniker.

Product and production Château Margaux was blessed with the 2009 vintage in terms of both the quality and quantity of the third wine. With the 2010 vintage, management decided to be more selective; hence less than half of what was left after blending the first two wines was deemed of high enough quality for the third wine, while the rest, now constituting a fourth wine, was sold in bulk. The overall lower quality of the 2011 vintage resulted in even less bottled third wine. (See **Exhibit 6** for wine production.) This fluctuation in quantity raised several issues. In the short term, as there were fewer third-wine bottles from the 2010 and 2011 vintages, the château faced a decision on how many 2009 vintage bottles to release in the upcoming launch. Valance proposed an approach: "If we want a consistent supply every year, perhaps we should not sell all the 2009 third-wine bottles in 2013 and wait to release some of them with the 2010 vintage." But what was the "right" amount to sell to smooth out the supply across robust and scanty years? And what if there were years when practically none of the wine left after blending the first two was of sufficient quality?

In the long term, what if the third wine was so well received that there was demand for more of it? How could supply be increased? Pontallier felt he could be even more selective in making the first and second wines, which would result in a greater "pool" from which to make the third wine. But was that wise? Increasing the yield of existing plots was another option, but Mentzelopoulos was concerned about jeopardizing quality. She urged her team to think "outside the château box." One option was to buy grapes or bulk wine from other estates within the appellation. (See **Exhibit 7** for bulk wine prices.) This would allow retaining the "Margaux" appellation designation on the label. A more radical route would be to purchase land or even an entire estate. For instance, between 2005 and 2012, Latour had purchased individual plots within the Pauillac appellation to add 20 hectares and boost its third-wine production. Because French regulations allowed classified growths to add hectares from within their appellation and sell the wines under their own name, an industry insider recommended that Château Margaux consider buying an estate in the Margaux region. For example, although the terroir at Château Malescot St. Exupéry was not considered as good, some plots of its first wine were comparable to Château Margaux's second wine, and other plots to the third wine. He believed that even if Château Margaux reduced yields at Malescot and was more selective, with bottled production going down by 10%, such an acquisition could make sense. (See **Exhibit 8** for details on Malescot St. Exupéry.)

Noteworthy in this context was that a number of first-growth châteaux had introduced wines targeted at a broad consumer base. A prominent example was Mouton Rothschild's Mouton Cadet, which used grapes from all over the Bordeaux region. Demand kept increasing and by 2012 the wine sold 15 million bottles a year at a price of $15 or less a bottle.[14] The brand was aggressively promoted: Mouton Cadet was the official sponsor of a Winter Olympic Games, tennis tournaments (e.g., Roland Garros), and entertainment events (e.g., the Cannes film festival). The bottle's label noted that it was made by "Baron Philippe de Rothschild." Some first-growth châteaux had expanded globally. In 1979, Mouton Rothschild formed a joint venture with Californian winemaker Mondavi to produce the Opus One wine. The label featured the signatures of Robert Mondavi and Baron Philippe de Rothschild. Selling prices were $250–$300 per bottle. Domaines Baron de Rothschild (DBR), which managed Château Lafite Rothschild, acquired the Los Vascos estate in Chile in 1988, and partnered with Argentine winemaker Catena starting in 1998 to coproduce the CARO, Amancaya and ARUMA wines. The wines sold at various price tiers. For example, a Los Vascos Cabernet Sauvignon sold for under $10 at U.S. wine stores. Pontallier stated, "Our skills and expertise are similar to Lafite's. We *could* bring our know-how and successfully run an estate in, say, South America. And I must admit it would be an intriguing challenge for our team." Mentzelopoulos cautioned, "I worry about spreading ourselves too thin. I can see why Mondavi wanted the Opus partnership, but what does it bring to Mouton Rothschild? As for Lafite, is selling cheap wines, which are directly associated with the Rothschild and Lafite names, good for their brand? There is a fine line between leveraging a brand and diluting it."

Moving Forward

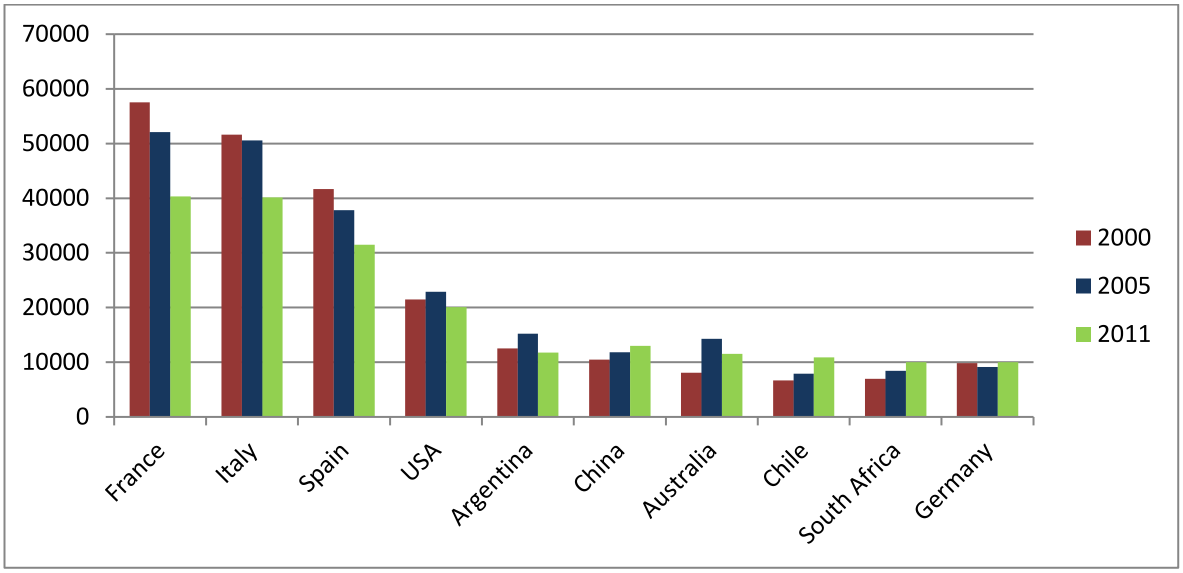
Every morning I wake up and think – what am I missing? What can go wrong?

— Corinne Mentzelopoulos

Mentzelopoulos reflected on what her next steps should be. "My father left me with a jewel in the rough. We have tried to polish that jewel and we hope we have been a devoted steward of this precious terroir. People who drink our wines use words such as 'soft power,' 'perfume,' and 'harmony' to describe their complex and subtle virtues. We bought the estate for $16 million and could sell it for much more today. Maybe that is what an MBA student would advise, given the uncertainty on weather patterns, consumption trends, and shifts in critics' opinions. Many in Bordeaux worry about the region's popularity when Parker retires." She concluded, "It boils down to whether I see myself in the wine business or in the Château Margaux business."

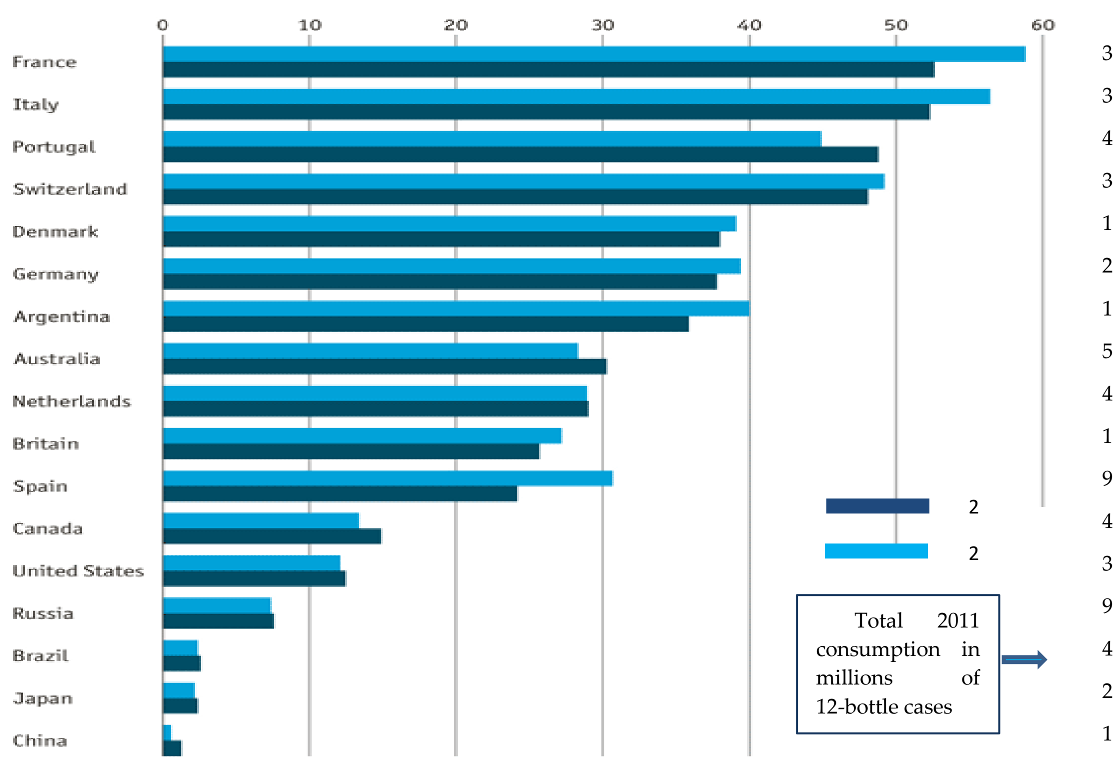
Mentzelopoulos had much on her mind as she pressed the first glass of wine she lifted from the assemblage table to her lips. She and her team had to carefully navigate the next few years. Although the destination was not altogether clear, it was becoming obvious to her that the marketing of the third wine fed into the complex mosaic of the château's future. It was time to taste.

Exhibit 1 Worldwide Wine Production: Top-10 Producing Countries (thousands of hectoliters)



Source: Adapted from International Organization of Vine and Wine, "Statistical report on world vitiviniculture 2012," http://www.oiv.int/oiv/info/enstatistiquessecteurvitivinicole#secteur, accessed March 27, 2013.

Exhibit 2 Per Capita Wine Consumption in Liters (2007 vs. 2011) and Total Cases Sold (2011)



Source: Adapted from "Grape expectations," *The Economist* online, March 22, 2012, http://www.economist.com/blogs/graphicdetail/2012/03/daily-chart-15, accessed May 15, 2013.

Exhibit 3 U.S. Wine Consumer Segments; % of Total Consumers (% of category spending)

Enthusiasts: 12% (25%)

- Consider themselves to be passionate and knowledgeable about the total wine experience.
- Entertain at home often and enjoy wine with friends.
- Constantly seek additional knowledge and appreciate sophisticated wine information.
- At retail, read labels and enjoy lingering in the wine section. Like to be offered both well-known as well as unique wine selections. On-premise (i.e., at restaurants), typically buy wine by the bottle.

Image Seekers: 20% (24%)

- For them, wine is a status symbol. They only have basic wine knowledge and are driven by the latest trends. They often use the Internet as a key source of information.
- When not sure about what to buy, they will typically go for the one that's more expensive.
- When going out to a nice restaurant, they will typically check out the wine list ahead of time online so they can impress their friends.

Savvy Shoppers: 15% (15%)

- Enjoy shopping for wine and discovering new brands and varietals on their own. Get a lot of personal satisfaction when they buy a great $15–$20 bottle of wine and only pay $10 for it.
- Shop in a variety of stores to find the best deals. Heavy users of coupons and rebates.
- On-premise, typically buy a glass of the house wine as it's a better value for the money.

Traditionalists: 16% (15%)

- Enjoy wines from established wineries that they feel have perfected the art of winemaking.
- Like to be offered a wide variety of well-known brands; influenced by marketing efforts.
- Don't try new brands often and shop at retail places that make it easy to find their preferred brands.
- On-premise, always order wine brands with which they are familiar.

Satisfied Sippers: 14% (8%)

- Not very knowledgeable about wine. Usually buy the same brand, preferably domestic wine.
- Don't enjoy the experience of buying wine. Tend to shop at places that make it easy to find their preferred brands. Not interested in learning more about wine.
- When dining out, typically order house wine and don't worry about wine and food pairing.

Overwhelmeds: 23% (13%)

- Perceive that there are too many wines on the shelves.
- Look for wine information at retail that's simple and easy to understand. They are very open to advice, so it's frustrating when they go to a store where there is no one in the wine section to help.
- If it's too confusing or there's not any information, they won't buy anything.
- On-premise, they are easily intimidated. Sometimes it's safer not to order wine to avoid getting stuck with something that doesn't taste good.

Source: Adapted from Mike Vesath, "What are wine enthusiasts looking for," *Wine Economist*, April 5, 2008.

Exhibit 4 Comparison of Bordeaux First-Growths

Château	**Lafite Rothschild**	**Latour**	**Margaux**	**Haut-Brion**	**Mouton Rothschild**
Owner	Baron Eric de Rothschild (and other family members)	Francois Pinault, owner of Gucci, YSL, and Christie's auction house	Corinne Mentzelopoulos	Prince Robert of Luxembourg (and other family members)	Baronne Philippine de Rothschild
Appellation	Pauillac	Pauillac	Margaux	Pessac-Leognan	Pauillac
Red Wine Vineyard area[a]	103 hectares	80 hectares	80 hectares	49 hectares	80 hectares
Grape Varietals Planted	70% Cabernet Sauvignon, 25% Merlot, 3% Cabernet Franc, 2% Petit Verdot	75% Cabernet Sauvignon, 20% Merlot, 4% Cabernet Franc, 1% Petit Verdot	75% Cabernet Sauvignon, 20% Merlot, 3% Cabernet Franc, 2% Petit Verdot	50% Cabernet Sauvignon, 40% Merlot, 9% Cabernet Franc, 1% Petit Verdot	83% Cabernet Sauvignon, 14% Merlot, 3% Cabernet Franc
Red Wines Produced: Name and Quantity (average ranges)	First wine: *Château Lafite Rothschild*, 18–20,000 cases Second wine: *Carruades de Lafite*, 15–20,000 cases	First wine: *Grand Vin de Château Latour*, 15–16,000 cases Second wine: *Le Forts de Latour*, 18,000 cases Third wine: *Pauillac de Latour*, 6–9,000 cases	First wine: *Château Margaux*, 12–14,000 cases Second wine: *Pavillon Rouge du Château Margaux*, 14–16,000 cases	First wine: *Château Haut-Brion,* 10–12,000 cases Second wine: *Le Clarence de Haut-Brion*, 5–7,000 cases	First wine: *Château Mouton Rothschild,* 16–18,000 cases Second wine: *Le Petit Mouton de Mouton Rothschild,* 5–6,000 cases
2009 Vintage[b]					
First wine: Parker Score	99	100	99	98	99
Price per bottle	$1,530	$1,745	$1,280	$1,200	$1,100
Second wine: Parker Score	93	95	93	92	90
Price per bottle	$335	$280	$185	$160	$195
Third wine: Parker Score		90			
Price per bottle		$97			

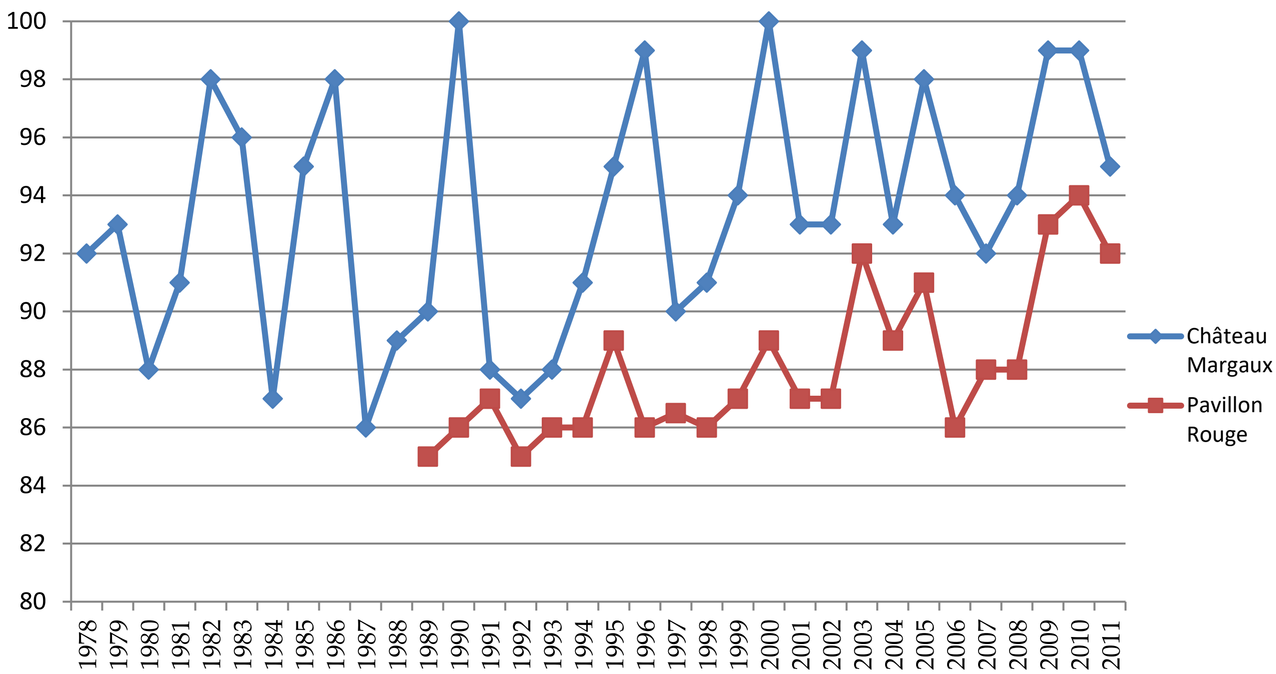
Source: Jane Anson, Decanter.com, accessed May 15, 2013; company data; and 90plusWines, http://www.90pluswines.com/Wine/1655E875/Latour/Pauillac-de-Latour-,-Third-wine-of-Chateau-Latour.aspx, accessed May 22, 2013.

[a] A hectare is a unit of area equal to 10,000 square meters (roughly the equivalent of 2.5 acres).

[b] All prices are average U.S. retail per bottle. The 2010 Latour third wine scored higher and was selling for $140.

Exhibit 5 Parker Scores, *En Primeur* Prices, and Current Retail Prices for Château Margaux Wines

Parker Rating by Vintage



En Primeur Prices and Current Retail Prices per Bottle (in euros; €1 = $1.32)

Château Margaux

Vintage	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1st Tranche *en primeur* price (€)	120	85	60	120	80	350	270	200	110	450	500	300
Current price (€)	800	385	350	520	350	760	350	335	400	850	695	380
% increase	567	353	483	333	338	117	30	68	264	89	39	27

Pavillon Rouge

Vintage	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1st Tranche *en primeur* price (€)	22	18	16	23	18	30	30	30	22	50	90	75
Current price (€)	150	115	125	160	98	120	95	107	90	94	130	90
% increase	582	539	681	596	444	300	217	257	309	88	44	20

Source: eRobertParker.com, wine-searcher.com, accessed May 13, 2013; and company documents.

Notes: The estate also produced 12,000 bottles a year of the white wine *Pavillon Blanc*, and its current retail prices were similar to those of *Pavillon Rouge*. Current prices listed are average worldwide at retail. During 1991–1998, for a number of *Pavillon Rouge* vintages, Parker ratings were not available; data for those years compiled from other critics.

Exhibit 6 Wine Production at Château Margaux (% of the yield used to make each wine)

Year	*% Château Margaux*	*% Pavillon Rouge*	*% Third Wine*	*% Bulk Wine*
2011	38	28	7-11	23-27
2010	38	38	8-12	12-16
2009	36	41	18-23	0-5
2008	36	53	-	11
Average 06-07	33	56	-	11
Average 03-05	39	56	-	5
Average 00-02	37	51	-	12
Average 97-99	41	49	-	11
Average 94-96	46	54	-	0

Source: Company documents.

Notes: Average red wine production in hectoliters per hectare was: 51 in the 1980s, 48 in the 1990s, 44 in the 2000s, and 35 since 2009 (1 hectoliter = 100 liters and the common bottle size contained 0.75 liters of wine). Storing and bottling the third wine instead of selling it in bulk bore an extra cost of €3–€5 per bottle.

Exhibit 7 Château Margaux Selling Price (€) per Hectoliter to the Bulk Wine Merchants

Vintage	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Price (€/hectoliter)	712	677	600	723	723	777	777	833	723	723	833	889

Source: Company documents.

Notes: 1. If Château Margaux wanted to buy bulk wine from within the appellation, it could coordinate with a broker to purchase from specific estates (at a 2% broker's fee).

2. If Château Margaux bought grapes or bulk wine from within the appellation, it could use the "Margaux" appellation designation on the label but could not use its classified château as part of the name, i.e., it could not say "du Château Margaux."

3. If Château Margaux bought bulk wine from other regions in Bordeaux, the designation would be "Appellation Bordeaux Controlee."

4. Among first-growths, Château Margaux was the only one where the name of the estate contained the name of the appellation. This complicated copying peers' naming strategies. For example, if wine was externally sourced, it would be illegal to call the wine "Margaux Cadet," though it might be possible to use a different name altogether and note on the label "Inspired by Château Margaux."

Exhibit 8 Malescot St. Exupéry: Parker Ratings, Prices, and Estimated Production

1855 Classification	Third-Growth (*Troisième Cru)*
Vineyard Area	23.5 hectares
Average Yield	50–55 hectoliters/hectare
1st Wine	60%
2nd Wine	30%
Bulk Wine	10%

Vintage	*Parker Rating*	*First Wine Current Retail Price ($)*
1994	87	78
1995	90	96
1996	90	93
1997	82	52
1998	90	81
1999	90	87
2000	95	138
2001	88	70
2002	92	73
2003	92	89
2004	90	64
2005	97	155
2006	91	66
2007	89	58
2008	93	64
2009	96	118
2010	95	104
2011	92	52

Source: Data compiled from Stephen Brook, The Complete Bordeaux: The Wines, The Châteaux, The People (Mitchell Beazley, 2012); Robert M. Parker, Bordeaux: A Consumer's Guide to the World's Finest Wines, 4th ed. (New York: Simon & Schuster, 2003); eRobertParker.com; Wine-Searcher.com, accessed May 13, 2013; Rebecca Gibb and AFP, "Insurance Giant Buys Top Bordeaux Château," Wine Searcher, July 4, 2012, http://www.wine-searcher.com/m/2012/07/insurance-firm-buys-top-bordeaux-property-saint-estephe, accessed June 9, 2013; and company and casewriter estimates.

Notes: The average retail price for Malescot St. Exupéry's second wine was about $30–$35. An industry expert estimated average production costs of €15 per bottle at Malescot St. Exupéry, which could increase in proportion to the greater selectivity proposed. For reference, in 2011, second-growth Château Lascombes (118 hectares) sold for €200 million, and in 2012, third-growth Château Calon Ségur (74 hectares) sold for €170 million.

Endnotes

[1] IBISWorld, Industry Report C1123-GL, Global Wine Manufacturing, February 2014.

[2] IBISWorld, Industry Report C1123-GL, Global Wine Manufacturing, December 2012.

[3] Ibid.

[4] Vins de Provence, "The U.S. Wine Market: Facts & Figures," January 2012, http://res.franceguide.com/us/press_2012/weblinks/vin_de_provence_facts_figures.pdf, accessed June 12, 2013; and Mary-Colleen Tinney, "Survey of Top On-Premise Wines Released," Wine Business.com, http://www.winebusiness.com/news/?go=getArticle&dataId=44085, accessed June 12, 2013.

[5] Malcolm Moore, "Empty wine bottles sell for £300 in China," *The Telegraph*, January 7, 2011.

[6] Bruce McGechan, May 31, 2011, http://www.mylocalwinestore.com/winery-marketing/wine-research/, accessed April 4, 2013.

[7] William Langewiesche, "The Million Dollar Nose," *Atlantic Monthly*, December 2000.

[8] The Wine Advocate Rating System, https://www.erobertparker.com/info/legend.asp, accessed June 8, 2013.

[9] Langewiesche, "The Million Dollar Nose."

[10] "Wine Ratings Don't Tell the Whole Story," *New Orleans Times-Picayune,* May 20, 2005.

[11] Julia Pittam, "Chinese connoisseurs buy up Bordeaux's wines," BBC News, February 17 2013, http://www.bbc.co.uk/news/business-21292824, accessed June 8, 2013; and the Office de Tourisme de Bordeaux, http://www.bordeaux-tourisme.com/pl/coup_coeur.pl?lg=uk&id=239, accessed June 8, 2013.

[12] Dewey Markham, *1855: A History of the Bordeaux Classification* (New York: John Wiley & Sons, 1988).

[13] Alice Feiring, "Bored of Bordeaux," *Out & About*, January 2013.

[14] Ibid., and wine-searcher.com, http://www.wine-searcher.com/find/mouton+cadet/2009/-/-/u, accessed June 10, 2013.