

A Work Project, presented as part of the requirements for the Award of a Masters Degree in Management from the NOVA – School of Business and Economics.

INTERNATIONALIZATION STRATEGY OF QUINTA DOS TERMOS TO CANADA

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Abstract:

Quinta dos Termos, a Portuguese winery, currently faces the need to expand internationally due to difficulties in distributing its current production in Portugal.

This work project will analyze the firm's characteristics, its development in the Portuguese market and the value proposition it offers. A market analysis will also be performed prior to evaluating the internationalization need of Quinta dos Termos.

The Canadian market will be assessed as an opportunity to expand internationally by evaluating factors supporting that strategy; namely the market attractiveness, the most adequate implementation plan and a competitive analysis to better understand the success expectations in the market.

Keywords:

Internationalization, Wine, Quinta dos Termos, Canadian Liquor Boards.

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1. Description of the firm

1.1. Presentation

Quinta dos Termos is a family-owned estate located in Belmonte, in the south ridge of *Serra da Estrela*¹, that has been dedicated to wine production for the past 60 years, as can be seen in the more detailed history of the property at Appendix 2, however the project to expand and to modernize the winery was taken under the management of João Carvalho² since 1993.

Currently, the property has an area close to 180 hectares, from which 54 hectares are dedicated to the production of several grape varieties, as also stated in Appendix 2. This area translates into a current yearly production of 600.0000 bottles. However, the production capacity, rest period and storage in the wine cellars can currently achieve levels of 800.000 bottles per year, which materializes into an important idle capacity in the company.

Quinta dos Termos has its production under the D.O.C. classification, *Denominação de Origem Controlada* (D.O.C.) is the classification of protected designation of origin for wine products in Portugal. Furthermore, the company is also certified in Integrated Crop Management, which ensures that the production process is natural, resulting in the production of ecological wines.

Its wine portfolio has 25 different wine references, among whites, reds, rosé and sparkling wines (detailed in Appendix 3). These wines are targeted at different market segments, in an end consumer price range from €2,50 to €17,70.

¹Location can be seen in the map at Appendix 1.

²Additionally to the position as owner and general manager of Quinta dos Termos, João Carvalho is also a partner and managing director of Fitecom, a textile company that exports over 90% of its production.

The oenology process is conducted under the direction of Virgílio Loureiro, an acclaimed oenologist in Portugal with teaching experience in Industrial Microbiology, Food Microbiology and Enology Microbiology at the School of Agronomy from the University of Lisbon.

In terms of Research and Development, Quinta dos Termos makes regular partnerships in academic research, exemplified by Quinta dos Termos' clone field, where researchers from School of Agronomy (University of Lisbon) are currently studying a grape variety of Beira Interior, Fonte Cal.

1.2. Mission and Vision

Quinta dos Termos has the Vision “To be a family winery, that produces, with passion, quality wines, differing from the others by being wines of terroir and having a great gastronomic aptitude”. In what concerns its Mission Quinta dos Termos aims “To follow traditional techniques of viticulture and winemaking, envisioned by reputable oenologists, promoting the environmental sustainability and taking advantage of Quinta dos Termos' terroir synergies”.

1.3. Awards

Quinta dos Termos has been awarded with several medals and honors in the recent past. Furthermore, Quinta dos Termos has also been referenced in Portuguese and international wine magazines.

Some of the most relevant awards include the prize “Best Wine of Beira Interior” in 2008 and 2011; and the presence in the best 50 Portuguese wines of the year by *Revista dos Vinhos* in 2010, 2012 and 2013. In Appendix 3 are identified some of the awards attributed to each wine of Quinta dos Termos' portfolio.

2. Market Evolution

2.1. Targeted markets and expansion trajectory

The market of election for Quinta dos Termos is the usually called Horeca channel: comprising hotels, restaurants and *Cafés*. Approximately 95% of sales are directed to this channel, while the off-trade channel, which includes the retail market, represents only 5% (mainly through supermarkets).

The company has followed an approach of selling through its own distribution network, employing distributors that sell directly to retailers and to the Horeca channel. This strategy constituted a high initial investment, with the acquisition of vehicles and storing facilities for wine, and is also costly on an on-going basis. However, with this approach Quinta dos Termos was able to obtain a valuable knowledge on the market dynamics, which could be lost if an outsourced distribution function was applied, and therefore became better adapted to the market needs.

Quinta dos Termos developed a sustainable growth on the domestic market. In 2002 Quinta dos Termos began the wine commercialization near its production facilities in the *Beira Interior* region. The company expanded to Lisbon and Oporto in 2007, and later to *Coimbra*, *Marinha Grande* and *Funchal*. In 2011 Quinta dos Termos made its first exports, with a residual volume and mainly to European countries.

Quinta dos Termos has been focused in the Horeca channel given the gastronomic aptitude of its wine' portfolio and due to the higher margins provided. This last element is explained by the lower bargaining power of these agents when compared to the large retailers, since the later ones can order larger quantities and possess an expertise in negotiation that typically is not common among the agents involved in the Horeca channel.

2.2. Medium term objectives and recent events

In what concerns sales, in 2013 Quinta dos Termos had a total sales volume of €853.341, a significant increase when comparing to sales of €542.650 in 2012. Around 7% of those were done in international markets. Regarding medium term strategic objectives, Quinta dos Termos aims to achieve total revenues of €2.000.000 in 2016. This volume of revenues will represent sales of approximately 800.000 bottles, which matches the current production capacity of the firm. This target is highly dependent on the success of the internationalization strategy the company pursues since it expects to export around 60% of its production at that time.

3. Value Proposition

3.1 Value Chain

An important step in understanding the value proposition of Quinta dos Termos consists in the detail of the value added at each stage of the production process. This set of stages corresponds to the Primary Activities identified by Michael Porter³ for a Value Chain. The main stages that will be analyzed are (i) grape production, (ii) wine development and production, (iii) inventory and distribution and (iv) marketing and sales.

When looking at (i) grape production, Quinta dos Termos currently produces around 60% of the grapes in its own vineyards, while the remaining 40% are acquired at local grape producers with whom Quinta dos Termos cooperates in order to guarantee the same quality of its own vineyards. The quality factor is taken as a priority to Quinta dos Termos in order to maintain the certification of Integrated Crop Management that the company holds.

³ Porter, Michael E. 1985. *The Competitive Advantage: Creating and Sustaining Superior Performance*. NY: Free Press.

The next stage concerns the (ii) wine development and production. On this stage the role of oenologists is key since they will define the wine blends according to the grape characteristics, with the ultimate objective of creating differentiated types of red, white, rosé and sparkling wines that constitute the portfolio of Quinta dos Termos.

Concerning stage (iii) goods inventory and distribution, Quinta dos Termos only outsources the bottling doing the remaining activities internally, namely the labeling and the packaging. As already discussed before, the activities concerning storage and distribution are performed internally.

Finally, when looking at (iv) marketing and sales the company has followed a strategy of selling to retailers and to the Horeca channel through distributors that work for Quinta dos Termos, therefore such distributors also develop the role of salesmen due to their personal contact and proximity with the agents of the Horeca channel. In what concerns promotion activities, the company participates in several wine fairs in Portugal and abroad.

From an interview with João Carvalho, the cost structure associated with each stage is as follows: (i) grape production – 10%, (ii) wine development and production – 17%, (iii) inventory and distribution – 38% and (iv) marketing and sales – 35%. For the wine that will be evaluated for export, Quinta dos Termos Red D.O.C., the average cost is estimated at 1,44€ per bottle.

Following the Value Chain proposition of Michael Porter it is then also necessary to look at the Support Activities of a company. Namely infrastructure, technology, human resources and procurement.

Concerning the first two support activities, Quinta dos Termos benefits from modernly equipped facilities that can achieve a total annual production of 800.000 wine bottles.

Regarding human resources the company is constituted by trained employees in all of

the steps that constitute primary activities; from the international experienced management to the nationally recognized oenologist. When looking at the procurement activities one can look at the cooperation relations with the local grape suppliers and the outsourcing of the bottling process.

3.2 Competitive advantage

The sources of a competitive advantage for Quinta dos Termos are mainly constituted by the following elements: (i) D.O.C. and Integrated Crop Management classification; (ii) awards attributed to the wine portfolio, and (iii) expertise of human resources.

When looking at the first two sources identified, both classifications support a brand image based on the quality of the product and in the respect for the traditional and natural productions processes implemented. These factors translate into the significant number of awards attributed to Quinta dos Termos (ii). The last source of a competitive advantage results mainly from the experience of the current management team and from the participation of an acclaimed oenologist at the production process.

The biggest threat to the competitive advantages of Quinta dos Termos, in the Portuguese market, relate mainly to the lower quality perceptions that consumers transpose into wines that do not come from the most popular wine producing regions, mainly *Douro* and *Alentejo*.

3.3. Domestic Market Positioning

Quinta dos Termos follows a strategy of providing wines with gastronomic aptitude, this fact is emphasized by the suggestions in the labels of wines regarding the best suited types of food for that particular wine. This is in line with the predominance of sales in the Horeca channel, targeting mostly restaurants and bars.

In what concerns price segmentation, see Appendix 3 for specific information, Quinta dos Termos has a price range from 2,5€ to 17,7€. In the range of wines below 5€ the company sells 5 wines, in the range 5€-10€ the company sells 10 wines and above 10€ the company sells 3 wines. This pricing strategy is aligned with the targeted market of medium/high restaurants and bars.

4. Industry description

4.1 Industry Mapping

In order to deeply understand the Portuguese wine industry it is important to identify first the regulators and the policy makers of the industry. The common agricultural policy (CAP), defined by the European Union, sets the objectives for the industry in the near/medium term, this strategy is reinforced by providing a set of incentives in line with the European Union goals.

In Portugal, the regulator and responsible entity for the application of CAP is the *Instituto da Vinha e do Vinho* (IVV), an entity of the Portuguese Ministry of Agriculture and Sea. At a local level, there are regional commissions that assure the compliance of local producers with the national and European law, this entities are also responsible for the certification of a wine under the D.O.C. classification. Quinta dos Termos is under the territory of action of *Comissão Vitivinícola Regional da Beira Interior*.

Concerning promotion, the most influential entity with international impact is ViniPortugal, with a yearly investment of near 7 million Euros to conduct several actions worldwide that promote the brand Wines of Portugal.

When looking at the main market players⁴ of the wine industry in Portugal the most relevant producer and exporter is Sogrape, exporting near 60% of its total sales volume

⁴ Article published by Diário Económico.

worldwide. Sogrape's portfolio is diversified, including several types of wines from the entire country. The second and third largest Portuguese exporters are Symington and Gran Cruz Porto, both specialized in the export of Port wine.

4.2. Portuguese Wine Exports

Looking at the data in Appendix 4, Portugal was the 9th largest wine exporting country in 2013, amounting to 725 millions of Euros in value, and the 5th largest in Europe. The total exports in volume represented 3.059.963 hectoliters, corresponding to approximately 50% of the entire production of that year (Appendix 5 and Appendix 6).

Looking at the data provided in Appendix 6, since 2010 the total volume of wine exports increased from 2.666.454 HL to 3.059.963 HL in 2013, a growth of 14,8%. In value terms the growth was even higher, amounting to 17,9% from approximately 614 million Euros in 2010 to 725 million Euros in 2013. Such increase in value is explained by the growth in the average price per liter from 2,30€ to 2,37€ during the same period.

When looking at the decomposition of Portuguese wines exports it is visible that the category wine (without any certification) was the most exported, amounting to almost 47% of the total wine exports, followed by Port (23%) and by D.O.C. wine (15%). However, in value terms the results are different since Port is the most representative one contributing with 47%. The value of D.O.C. wine exported is much higher when compared to the wine category since both represent around 20% of the total value of exports, despite the later representing 3 times more in volume.

When looking at the main markets of export in Appendix 7, we can observe that the most representative destinations of wine exports in value terms are France, Angola and the UK. The intra EU market represents 57% of total exports, however the extra EU

market increased its share in value terms from 2012 to 2013, since it verified a 5,43% increase versus a 0,28% in the intra EU market.

4.3. Portugal Brand Image

The Portuguese wine brand image is highly related with the typical image of the Old World wine producing countries, a concept applied in France, Italy, Spain, Germany, Austria, Romania and Portugal. The Old World wine categorization is associated with centuries of history in developing and adapting wine production for each region characteristics, therefore resulting in a brand image of expertise and tradition.

Looking particularly into the Portuguese brand image worldwide, Portugal is mostly famous for the production of two liquor wines, Port and Madeira. Another wine that Portugal is famous for is the Rosé wine Mateus from Sogrape. Since 1942, Sogrape estimates⁵ to have sold 1 billion bottles worldwide and, at the peak of its fame, in the late 1970s Mateus amounted to more than 40% of the entire exports of Portuguese wine.

5. Quinta dos Termos Internationalization Process

5.1. Internationalization Need

In order to start an internationalization strategy it is necessary to assess first the need for Quinta dos Termos to go abroad. In fact, Quinta dos Termos has accumulated stocks in the recent past, moreover its production capacity is not exploited entirely in order to mitigate an even higher stock accumulation, which suggests that the internationalization need may in fact materialize.

⁵ Available at Sogrape website.

As already mentioned, the sales of Quinta dos Termos are almost entirely done in Portugal (93%), therefore we must evaluate first the expansion possibilities in the Portuguese territory.

The general wine consumption in Portugal has decreased in the past years, according to IVV the wine consumption per capita has decreased from 44,5 liters in 2000 to 42,5 liters in 2012. The most relevant factor suggesting that the Portuguese market is not enough to fulfill Quinta dos Termos' objectives concerns the macroeconomic downturn of the past few years, that resulted in a significant decrease in the activity of the main client of the company, the Horeca channel. In fact, the sector was highly affected not just by that factor but also due to the increase in the VAT for the sector from 13% to 23% in 2011, which AHRESP⁶ estimated to have contributed to the closure of roughly 20.000 companies in the sector.

Furthermore, it is observable that in Portugal the consumer preferences are mostly focused for wines produced in *Alentejo* and *Douro*. Since the overall wine sector suffered, the main channel of sales for Quinta dos Termos is retracting and the overall macroeconomic scenario does not suggest an inverse of this trend in the medium term, it is possible to conclude that the Portuguese market is not a viable source for the company's objective of selling 800.000 bottles in 2016.

5.2. Country Selection

A fundamental step in pursuing an internationalization strategy implies an adequate country selection stage, where the most favorable targets for Quinta dos Termos are assessed. In order to select the target markets the following criteria will be accounted for: (i) classification as strategic markets for Portugal by ViniPortugal, (ii) top

⁶ *Associação da Hotelaria, Restauração e Similares Portugal* - an association that represents Hotels, Restaurants and similar businesses.

countries where Portugal exports D.O.C. wines, (iii) general facts regarding macro-economic performance and (iv) bi-lateral relations.

The (i) strategic markets defined by ViniPortugal are USA, Brazil, China, Canada, Angola, UK, Sweden, Norway, Finland and Germany. From these countries, 5 of them consist of the countries to which Portugal exports more D.O.C in wine value terms (ii), as can be seen in the recent evolution in the growth of exports in volume, value and average price per liter at Appendix 8.

From the 5 countries in analysis (Angola, USA, Canada, Germany and Brazil) only 3 will be selected for the purpose of this work project. Quinta dos Termos has identified its concern of not exploring the Angolan market due to the diplomatic events occurred in October 2013 when José Eduardo dos Santos, Angolan President, has declared that the strategic partnership between the two countries would be suspended. Despite Angola's position has the main market of Portuguese D.O.C. wine exports in value terms, this market will not be analyzed.

From the 4 remaining markets, Germany is the country with the lowest average export price, suggesting that a higher level of competition exists in the market and for that reason it will also not be analyzed.

The three countries that will be assessed for this Field Lab in SME Competitiveness are USA, Canada and Brazil. This specific work project will target the Canadian market.

6. Market attractiveness of Canada

The market attract attractiveness of Canada for Quinta dos Termos arises from four main topics: (i) presence of Portuguese communities, (ii) increasing demand of wine, (iii) increasing brand awareness of Portuguese wines and (iv) exploiting "first" mover advantages due to future regulatory changes.

(i) Portuguese Communities as a helping tool due to saudade market

The presence of a significant Portuguese community in Canada started with the migration waves from the mid 1950s until the mid 1970s, such migrations were mainly composed by immigrants from *Açores* and *Madeira* that looked at Canada as an opportunity to generate better life conditions when compared to Portugal, that was still being ruled under the regime *Estado Novo*.

According to the 2011 census conducted in Canada, there were 429.850 Canadians that declared that they had a Portuguese ancestry, such numbers are impressive when compared to the current population of Portugal (around 10,5 million habitants).

According to the same census the regions with the largest Portuguese communities were respectively: (1st) Ontario with 295.030 habitants, (2nd) Quebec with 59.400 habitants and (3rd) British Columbia with 36.550 habitants.

The high presence of Portuguese communities may constitute a valuable market tool for Quinta dos Termos to enter successfully into the Canadian market. The connection can be exploited through an adequate branding campaign oriented to the *saudade* market that will target the Portuguese communities as a first consumer of Quinta dos Termos. A phased-in strategy first targeting the Portuguese community market seems then appropriate, since it will ease the entrance in a distant market where the brand awareness of Portuguese wines is not strong enough to immediately reach the Canadians.

(ii) increasing demand of wine

Data from several sources confirms that the demand for wine is increasing and gaining pace to other alcoholic beverages that typically had a greater market share in the Canadian market. According to the article “Control and sale of alcoholic beverages, for

the year ending March 31, 2013”, published by Canada Statistics in April 10, 2014, there is a strong evidence of the growing demand. Wine sales registered an increase of 4,9% when compared to 2012, comparing to a smaller growth in spirits (+2,9%) and beer (-0,1%).

The report dedicates a special section to the increasing popularity of wine in Canada, showing data that is clearly a sign of increasing market attractiveness for wine producers. In what concerns wine sales in volume the report states that they increased by 3.9% from 2012 to 2013, achieving a total of 506,6 million liters in 2013. This fact is even more positive from an internationalization perspective since the growth resulted mostly from imported wine (an increase of 4,3%) when compared to a slower growth in domestic production (an increase of 3,3%). The current market share of imported wines (in reds) is at 77% and at 61% in the white wine market, which shows a high level of external dependence to satisfy internal demand. In fact, according to TradeMap, Canada is the fourth largest importer of wine in the world.

Some relevant numbers state that the total consumption of wine per capita in 2013 amounted to 17,4 liters, representing C\$234 per person. The market share of red vs. white wine is balanced, however the red has gained track in the past 10 years representing now 56% of the total volume sold (51% in 2003).

The data shown in Appendix 9, also provided by Canada Statistics, segregates the total volume of sales and the homologous variation by province. When looking at the two regions identified previously as the ones with a higher presence of Portuguese communities (Ontario and Quebec), we can observe that both regions also constitute the provinces with a higher volume of sales, Ontario amounting around 2,2 billion Canadian dollars and Quebec 2,3 billion Canadian dollars, both provinces represent 67% of the total wine sales in Canada. In what concerns the growth of wine sales

Ontario achieved a significant growth of 5,9% from 2012 to 2013, above the national average growth of 4,9%. Quebec achieved a slower growth of 2,8%. Both factors support the idea that both provinces, and mainly Ontario due to the higher consumption growth, are attractive provinces for Quinta dos Termos' purpose.

(iii) increasing brand awareness of Portuguese wines

Furthermore, Portuguese wines are achieving a higher awareness worldwide as an example of superior quality wines. A clear sign of that arises from the Top 100 list of Wine Spectator⁷ for the year of 2014, which awards the title of the best wine in the world to a Portuguese wine; Dow Vintage Port achieved a score of 99 out 100 points. Portuguese wines also achieved the third and fourth places on the list, three other made it to the top 100. This result was the most positive ever for the Portuguese wine industry and constitutes a prestigious value added for the worldwide perception of Portuguese wines.

(iv) exploiting “first” mover advantages due to future regulatory changes

As it will be further analyzed in the implementation plan there are several taxes and tariffs applied to the import of wine products in Canada, which adds an additional bureaucratic and costly process to the already complex process of exporting wines to Canada due to the monopoly regime in force.

However, with the approval of the Comprehensive Economic and Trade Agreement (CETA) nearly 99% of the current tariffs that exist between the European Union and Canada will disappear. According to the European Commission website: “As a strong supporter of free trade, Canada has always been a natural ally and important trade partner for the EU. Strengthening the economic and trade relationship with Canada is therefore an important priority. Once implemented, the agreement is expected to

⁷ One of the most prestigious and influential publications in the topic.

increase two-way bilateral trade in goods and services by 23% or €26 billion, fostering growth and employment on both sides of the Atlantic.”

The final agreement was signed on 26 September of 2014 but still needs to be approved by the European Council and the European Parliament, if approved it will finally enter into force in 2016.

This fact constitutes an opportunity for Quinta dos Termos since if it successfully establishes in Canada, prior to the entrance into force of CETA, it will benefit from a first mover effect since the company will be already in the market, before the expected entrance of other suppliers due to the friendlier tax regime in place. If Quinta dos Termos is already operating in the market, the company will benefit from an acquired knowledge on the relations with Canadian Liquor Boards and from higher brand awareness. Therefore this regulatory change can be seen as an opportunity for Quinta dos Termos in what concerns market competitiveness in the period after 2016.

Summing up the Canadian market offers several factors of attractiveness for Quinta dos Termos, given so it is then necessarily to access how the company should establish itself in Canada. In order to ease the process, and already taking into account the difficulties regarding the process to export for each province (detailed in the implementation part), it is suggested that Quinta dos Termos internationalizes first only to Ontario since it is the province with the biggest presence of Portuguese communities, with an above average growth in the wine consumption and it amounts to 34% of the total sales in the Canadian market.

7. Implementation Plan

As detailed previously, the most attractive strategy in an initial stage will be only focused in the province of Ontario. Ontario is one of the provinces where the import and

commercialization of alcoholic beverages is a monopoly of the state, such regime exists in all the remaining provinces apart from Alberta where distribution is privately controlled.

The product that will be assessed as the first wine to be exported to the Canadian market is Quinta dos Termos Red D.O.C., since it is the reference wine of Quinta dos Termos and the one with the highest annual production (400.000 bottles).

The import and distribution of wine products is monopolized in each province by the Canadian Liquor Boards, Liquor Control Board of Ontario (LCBO) is the one operating in the province of analysis. The association aggregating the interests of each Board is the Canadian Association of Liquor Jurisdictions (CALJ).

Wine producers can get their products sold at the LCBO through a local agent, which is also the proposed mode of entry by AICEP⁸, since the agents will represent the interests of the suppliers and possess a higher knowledge of the specifications of the market. Agents are the ones responsible for making applications to LCBO for the sale of a new product and are the intermediaries in every step of the application process, they are also responsible for the marketing activities of the product and constitute a powerful help in the adaptation of the product to local legislation. The activity of the agents is defined by several rules set by the Alcohol and Gaming Commission of Ontario (AGCO) and with several requirements defined by LCBO.

The supplier must appoint only one agent for their product and thereafter such agent will be denominated as the “Agent of Record” within LCBO. A list of several agents in Ontario can be obtained at the Drinks Ontario⁹, and as a suggestion it is provided in

⁸ *Agência para o Investimento e Comércio Externo de Portugal* – a state agency with the objective of promoting the internationalization of Portuguese companies.

⁹ “Drinks Ontario is the provincial trade association representing the interests of manufacturers, agents, importers, marketing groups, trade offices and distributors of beverage alcohol products in Ontario” as stated in the Drinks Ontario website.

Appendix 10 a list of all the agents that represent Portuguese wines in Ontario (it is important to note that Drinks Ontario is an association of voluntary participation, therefore other agents representing Portuguese wines and with presence in Ontario may exist).

The choice of the Agent must be communicated in written form to LCBO, a template for this purpose is available in the LCBO website (Appendix 11). Once an agent is appointed, then the next step would be to submit the wine for evaluation by the LCBO.

A flowchart of the process can be seen below¹⁰:

Phase 1: PRODUCT NEEDS	Phase 2: PRE- SUBMISSION	Phase 3: INITIAL DECISION	Phase 4: PRODUCT ASSESSMENT	Phase 5: FINAL DECISION
<ul style="list-style-type: none"> Product needs are established by each Category and published online on LCBO's Trade Resources and also available in our New Item Submission System (NISS) 	<ul style="list-style-type: none"> Applicants are required to submit a: <ul style="list-style-type: none"> Presubmission application Marketing Plan Picture of the bottle/label 	<ul style="list-style-type: none"> Applicable Category evaluates pre-submissions based on best fit to the Product Needs criteria and factors A decision is made either to proceed with further evaluation or to decline the submission 	<ul style="list-style-type: none"> For products that have been accepted to proceed, several types of evaluations are performed, including: <ul style="list-style-type: none"> Organoleptic assessment Sales and Marketing plan reviews 	<ul style="list-style-type: none"> A decision is made to purchase the product or to decline the submission based on the results of Phase 4 Product Assessment pending <ul style="list-style-type: none"> Initial chemical analysis Label & shipping carton reviews

Flowchart 1: Process of selection by LCBO.

The Phase 1 is heavily dependent on the defined needs for the year by LCBO, however several “Product Needs” are published during the year, another possibility arises with the Ad hoc submission. Either ways, both forms can be exploited and better evaluated by Quinta dos Termos at the New Item Submission System (NISS) available at the LCBO website.

The evaluation phases from the initial submission until the final decision (phase 5) will take approximately 9 weeks and during the period several tests and evaluations will be performed to the submitted wine, which are detailed in Appendix 12.

¹⁰ Available at the Product Management Policy and Procedure manual of LCBO.

After all the process the decision of LCBO will finally be made through the Agent and detailed in the NISS.

8. Pricing and marketing decisions

The pricing decisions of Quinta dos Termos in Canada are highly limited by the provincial monopolies that control wine distribution. Ontario is no exception to this fact; all the material detailed below respects the rules in place in Ontario and is in accordance with LCBO requirements. The role of the Agent is also relevant in what concerns pricing since he can be authorized to negotiate pricing matters with the LCBO if the Supplier approves so.

The price of Quinta dos Termos in the LCBO cannot be accurately predicted, however an approximation by comparison can be done as seen later in the document, since the retail price is computed with LCBO standardized pricing formulas that are applied to the wholesale price set by the Supplier. Such price will be the only one applied by LCBO in all the distribution channels it operates and will be the one in place during the first year of the product at LCBO, after the first year price changes may occur with negotiations between the supplier and the LCBO.

In order to have a comparison reference for the final retail price the tables in Appendix 13 show the prices for reds and whites imported from Portugal that are available for sale in the online store of LCBO. Data analysis summarizing both results can be observed at the same Appendix.

Due to the impossibility in computing the final retail price for wine, an approximation will be made based on the most direct competitors of Quinta dos Termos Red D.O.C. present in the list. The closest competitors are Tons De Duorum Douro Red (C\$12,30), Quinta dos Carvalhais Colheita 2010 (C\$17,95), Crasto Vinho Tinto (C\$15,95), Quinta

de Foz de Arouce Red 2008 (C\$14,75), Quinta de Cabriz Seleccionada Colheita 2011 (C\$15,95), Ninfa Touriga Nacional/Syrah 2010 (C\$16,25), Ramos Pinto Duas Quintas 2011 (C\$17,95). Based on that information an approximate retail price to be assumed is around C\$14.

In Ontario the requirements concerning advertising and promotion of alcoholic beverages are set by the Alcohol and Gaming Commission of Ontario (AGCO), in accordance with the Liquor Licence Act (LLA). Such requirements can be consulted at the “Liquor Advertising Guidelines: Liquor Sales Licensees and Manufacturers”¹¹. The compliance with such guidelines is a mandatory factor in order to maintain the product at the LCBO’s portfolio. The Canadian requirements concerning packaging and labeling are defined in the Consumer Packaging and Labelling Act.

9. Financial Analysis

Before proceeding to the financial analysis of the internationalization project to Canada it is relevant to state that LCBO defines yearly objectives for the products it commercializes. LCBO defines quotas for suppliers and agents concerning sale expectations for the different categories of wine. In Appendix 14 one can observe the sales targets defined by LCBO for 2014/2015 for European Wines¹².

As stated in the letter to the Trade Partners¹³ such targets are set in order *“To ensure your product remains in good standing at the LCBO, we continue to require that your product(s) meet or exceed this target”*.

Quinta dos Termos Red D.O.C., which has an expected retail price around C\$14, will be subject to sales objectives of C\$250.000, which implies a minimum number of 17.850

¹¹ Available at the website of Alcohol and Gaming Commission of Ontario.

¹² Available at the Doing Business with LCBO website.

¹³ Available at the Doing Business with LCBO website.

bottles sold. The financial analysis stated in Appendix 15 takes that number of bottles as an objective to be achieved during the first year. However, the target might be hard to achieve during the first year for a new product in the market but that is also taken into account by LCBO, so it is not necessarily an excluding factor for Quinta dos Termos.

The financial analysis and the assumptions used are detailed in Appendix 15. The most relevant assumptions include an ex-cellar¹⁴ price of 3,50€ (equal to the average price of D.O.C. wine exported to Canada) and a growing trend in bottles sold (from 20.000 in 2015 to 60.000 in 2017).

When looking at the costs incurred, the average cost per bottle is €1,44¹⁵, costs with the Agent represent 15% of revenues during 2015, due to the higher involvement of the Agent during the application process, and decrease to 10% in 2017. Shipping costs were estimated at 4% of revenues. In what concerns tariffs, the Market Access database¹⁶ was used and Quinta dos Termos Red D.O.C.¹⁷ would be subject to Harmonized sales tax (HST) of 13% of revenues and to a Most Favoured Nation (MFN) duty of C\$1,44 per liter. However, these tariffs will only be applied during 2015 as with the entrance of CETA in 2016 such tariffs would be eliminated from that year onwards. Other costs were accounted at 10% of revenues that include mainly other activities regarding promotion, travel trips to Canada and other costs that may be incurred.

As it is visible from the analysis of Appendix 15, the internationalization to Canada is attractive to Quinta dos Termos mainly due to the high Gross Margin that the company achieves (59%). Such margin, resulting from the high difference between the average

¹⁴ Price at which the supplier sells the wine to LCBO.

¹⁵ Information provided by João Carvalho.

¹⁶ A tool provided at the European Commission website that identifies the tariffs applied to the export of specific products to a specific market.

¹⁷ The code used in Market Access database is 2204.21.10.92.

cost and the ex-cellar price, provides to Quinta dos Termos a sustainable perspective for the profitability of its international strategy to Canada in the future.

When looking at the Net Present Value of the project for the first three years, a low interest rate of 3%¹⁸ was applied, it amounted to 115.615,04€.

Despite the positive result, one can argue that the project is even more attractive in a medium/long term perspective since the elimination of import tariffs will result in a growth of the incremental EBITDA from 16,57% in 2015 to 34,86% in 2017, which is expected to last in the upcoming years.

10. Competitive analysis for the enterprise in the market/good of destiny

Since the mode of entry in the Canadian market is already accessed, it becomes now key to perform the competitive analysis of Quinta dos Termos in the Canadian market, and more specifically in the Ontario province. This process could be done previously to the implementation plan, however and taking into account the peculiarities of the market, it was agreed that such details where relevant to be specified prior to the competitive analysis. A SWOT analysis will be followed.

When looking at the **strengths** of Quinta dos Termos in the internationalization strategy to Canada one must look first to the main requirements that are evaluated by LCBO as detailed in Appendix 12. The examinations concerning the quality of the wine (namely, the organoleptic assessment (tasting) and the price/quality ratio of a product) are highly expected to be surpassed by Quinta dos Termos due to several awards attributed both from national and international entities (Appendix 3). Other strengths of Quinta dos Termos in this process concerns the evaluation of product differentiation, innovation, responsible consumption usage, environmentally friendly packaging, sustainable

¹⁸ A low interest rate was used due to the low interest rate environment currently in place at the financial markets.

agriculture and production practices. These factors are clearly achieved by Quinta dos Termos due to the Certification in Integrated Crop Management already mentioned and the traditional production method that the winery promotes in order to produce the ecological wines.

Other strength attributed to Quinta dos Termos concerns the expertise of the current management in exporting due to the involvement in the internationalization processes of another industry.

The main **weaknesses** that can be appointed to Quinta dos Termos in Canada concern the low awareness that the brand has in Canada, associated with the fact that it is not located in the most typical wine producing regions of Portugal (*Douro* and *Alentejo*).

Another relevant weakness relates to the lack of experience in the relations with the agents and Canadian Liquor Boards, such fact is relevant due to the complex regime in place in Canada for the imports of alcoholic beverages.

The main **opportunities** in the Canadian market are highly related to the growing demand and interest in the wine industry. Such factor, associated with the dimension and the purchasing power of Canada, constituted a clear interest as an export destination for Quinta dos Termos. Other factor adding to this is the high international dependence of Canada in the wine industry (imports represent 77% of consumption in the reds market) and the increasing brand awareness of Portugal as a producer of high quality wines.

Another opportunity of the market relates to the entrance into force of CETA, if Quinta dos Termos is able to create brand awareness in the meantime it will then be able to profit from a lighter tax regime and benefiting from a higher experience in the market, therefore becoming more competitive.

Some of the **threats** present in Canada for Quinta dos Termos relate to the adaption of the firm to the complex importing scheme in place for alcoholic beverages. Difficulties may arise in what concerns the relations with the Canadian Liquor Boards and in finding an Agent that will commit to promote and to work for the success of the company in Canada. Another threat may result from the lack of interest by LCBO if it does not issue new “Product Needs” for Portuguese red wines. Other relevant threat concerns the difficulties in achieving the sales targets defined by LCBO in the short/medium term.

11. Conclusions and Recommendations

In conclusion, the Canadian market constitutes a great opportunity for Quinta dos Termos in its strategy to internationalize to new markets. Canada is in the list of suggested countries for export by ViniPortugal, the demand for wine is clearly on the rise and the country is highly dependent on imports in order to fulfill that demand. Canada, and more particularly Ontario, is a region where the presence of Portuguese communities is still significant, which creates an entrance door in the country due to the connections that such communities feel with Portugal and Portuguese products. Also adding to the attractiveness of Canada to Quinta dos Termos is the increasing worldwide recognition and awareness of the Portuguese wines as a top quality product.

In what concerns the recommendations that Quinta dos Termos must take into attention in its expansion to Canada the most critical one relates to the ability to enter into the provincial monopolies that control the imports and the distribution of alcoholic beverages, such step is very dependent on the choice of the Agent that will represent the winery in Canada.

The juridical regime in Canada clearly constitutes a barrier and a difficulty for a SME but still, the mentioned advantages of the market and the upcoming entrance into force of CETA, provide support for a profitable medium/long term activity in the Canadian market.

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