Management Control and Intangibles in the Italian Wine Industry. The Villa Banfi Case Study

RESEARCH AIMS AND STRUCTURE

- Research aims
  - Are intangibles so important for wine companies? Why?
  - What is the role of intangibles in the management control system of wine companies?

- Key points
  - Theoretical Framework
  - Research Questions and methodology
  - Presentation and analysis of results
  - Conclusions and future directions

- Acknowledgements
  - Thanks to the Banfi Group CFO Dr. Gabriele Mazzi

RESEARCH AIMS AND CONTRIBUTION


Innovative contribution: The survey improves the understanding by providing a first-ever analysis focused on intangibles after the paper presented by Amadieu and Viviani in 2007. Unlike the other surveys, it focuses on the relevance of intangibles and their measurement in the management control system in relation to the industry and business model. Focusing on brand and marketing intangibles, this survey represents a further opportunity for innovation, since the literature on accounting and management control contains more contributions regarding other categories of intangibles (R&D, and goodwill).

An analysis of national and international literature allowed us to formulate 2 research questions tested in the subsequent case study.

MANAGEMENT CONTROL AND INTANGIBLES IN THE ITALIAN WINE INDUSTRY

- THEORETICAL FRAMEWORK AND ASSUMPTIONS: First Research Question

Intangibles are the main drivers of performance in many industries
- A primary interest is to improve their correct measurement to ensure more effective management
- All this must be placed in the proper context with reference to specific industries
- Some empirical studies arrive at ambiguous conclusions regarding the relevance of intangibles in the general industries of beverages and agricultural food products
- Depending on the characteristics of the industry and business model of the company, different types of intangibles are important in different ways and to a different degree
- The difficulties of the market translate into a rising demand for control
MANAGEMENT CONTROL AND INTANGIBLES IN THE ITALIAN WINE INDUSTRY

THEORETICAL FRAMEWORK AND ASSUMPTIONS: First Research Question

• The threats connected with extended competition induces the companies to seek an advantage based on intangibles (such as territorial brands and guaranteed origin) (Cesaretti and others, 2006; Zanni and others, 2005).

• an empirical study show a polarisation of the Italian wine companies in terms of growth, earning power and internationalisation, distinguishing between companies oriented toward constant research in the effort to achieve absolute quality and the intangible values of tradition for high level or "luxury" wines and those oriented toward low cost products. From high quality to basic wines the role of intangibles tends to decrease. (Wine News, 2008a)

• we can identify several clusters with specific business models, critical success factors, winning strategies. The winning strategy, in high quality wines case, is to highlight the value of brand’s heritage and to become a niche leader (WineNews, 2008b)

• Megna and Mueller, 1991, show that advertising costs are important in distilled beverages and cosmetics, while research and development are important in the pharmaceutical industry.

• the threats connected with extended competition induces the companies to seek an advantage based on intangibles (such as territorial brands and guaranteed origin) (Cesaretti and others, 2006; Zanni and others, 2005).

• the management control system have peculiar aspects that reflect the features of the industry and the business model of the company (Cramer and others, 2002; Erickson and others, 2002)

• intangibles are the subject of measurement and management. They are also subject to direct and indirect control (Olivo, 1999; Halberdan, 2004)

• in the absence of generally accepted methods, to measure their value two main approaches are possible (measurement based on cost and measurement based on economic capital valuations (Weston 1986, Waldorf 2004, Reilly Schweis 1999, 2004, Murphy 1993).
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RESEARCH AIMS AND METHODOLOGY

• Q1: Are intangibles so important for wine companies? Why?
• Q2: What is the role of intangibles in the management control system of wine companies?

METHODOLOGY and COMPANY SELECTION

• methodology: Case Study
• company selection
  - Companies active on the market for at least 3 years
  - Companies participating at Vinitaly 2008
  - Companies that have a complex business model based on the management of a wide range of products through strategies of differentiation and strategies of cost leadership

PRESENTATION and ANALYSIS OF RESULTS

FIRST RESEARCH QUESTION: Are intangibles so important for wine companies?

Group profile

- The Banfi Group is a multibusiness group

<table>
<thead>
<tr>
<th>Group Profile</th>
<th>Banfi Group</th>
<th>Product Profile Segmented on the Basis of Guaranteed Origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>grape-growing</td>
<td>+</td>
<td>drop 3</td>
</tr>
<tr>
<td>packaging</td>
<td>-</td>
<td>doc 14</td>
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<td>storage and logistics</td>
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<tr>
<td>marketing and sales</td>
<td>-</td>
<td>table wines 0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>other (e.g., varietal wines) 15</td>
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</tbody>
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\[
\begin{align*}
\Sigma \text{Intangible costs} &= (GpC + GrpC + WPC + Am) \quad (R1) \\
\Sigma \text{Tangible costs} &= (PPPS + PPRC + Ot) \quad (R2) \\
\Sigma \text{Intangible assets} &= \Sigma \text{Tangible assets} \quad (R3, R4)
\end{align*}
\]

\[
\begin{align*}
GpC &= \text{grape purchase costs} \\
GrpC &= \text{grapes production costs} \\
WPC &= \text{wine purchase costs} \\
Am &= \text{Amortization costs}
\end{align*}
\]

\[
\begin{align*}
PPPS &= \text{Advertising on the point of sale} \\
PPRC &= \text{Advertising, public relations, communication} \\
O &= \text{Other costs}
\end{align*}
\]
• product portfolio segmented on the basis of price level

<table>
<thead>
<tr>
<th>Red wines</th>
<th>White wines</th>
<th>Rosé wines</th>
<th>Sparkling wines</th>
<th>Sweet wines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ultra premium</td>
<td>6</td>
<td>5</td>
<td>2</td>
<td>1</td>
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<tr>
<td>Super premium</td>
<td>4</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Premium</td>
<td>8</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Popular premium</td>
<td>6</td>
<td>4</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>2</td>
<td>2</td>
<td></td>
<td></td>
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</tbody>
</table>

• competitive strategy main competitors: Antinori and Frescobaldi

<table>
<thead>
<tr>
<th>Wine</th>
<th>Ultra premium</th>
<th>Super premium</th>
<th>Premium</th>
<th>Popular premium</th>
<th>Basic</th>
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<tbody>
<tr>
<td>Black</td>
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<td>White</td>
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<tr>
<td>Red</td>
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<td>C</td>
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</tr>
<tr>
<td>Rosé</td>
<td>C</td>
<td>C</td>
<td>C</td>
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</tr>
</tbody>
</table>

• the different product lines are managed independently through specific sub-SBUs (Brusa 2000)
• the group’s strategies aim to increase market shares by opening to the global market and to the strategies of differentiation and geographical marketing
• the opportunities for differentiation are mainly based on different brands, applied to different price segments

Intangible resources:

- we compare the two main categories of intangibles (marketing and technological-manufacturing resources)
- results seem to confirm the literature

Intangibles

Strategic role and performance drivers: Why?

- extensive recognizability
- high quality
- reputation and position of the group as a leader at the local or international level
- the territorial brands are an opportunity for differentiation of the wine. It is of particular interest for quality wines, the superior premium category and higher price ranges
- the guaranteed origin, and the territorial brand, is important in segments such as the Ho.Re.Ca. channels and the presence on the wine list of the top restaurants plays a major role in terms of sales
- these results are the product of the Banfi business model
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Intangibles: Strategic role and performance drivers: Why?
- Quantitative measurement of the intangible efforts of the Banfi Group

<table>
<thead>
<tr>
<th>Intangibles</th>
<th>Strategic role and performance drivers: Why?</th>
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<tbody>
<tr>
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Performance indicators - Banfi

<table>
<thead>
<tr>
<th>Year</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Margin</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Ebitda/total assets</td>
<td>4</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Ebit/total assets</td>
<td>7</td>
<td>8</td>
<td>9</td>
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</tbody>
</table>

SECOND RESEARCH QUESTION: What is the role of intangibles in the management control system of wine companies?
- the reporting is based on an integrated system of financial indicators, and indicators of a physical and technical nature
- many of the economic results are based on management costs and revenues classified in the economic report on the basis of the destination and activity (grape-growing, winemaking, logistics, marketing, etc.)
- the margins and economic indicators are the sales and industrial margins (the Ebit, the ROI of the product lines, all broken down to the maximum detail - by product)

PRESENTATION and ANALYSIS OF RESULTS

The "content analysis"

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Banfi indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Analysis of sales</td>
<td>11</td>
</tr>
<tr>
<td>Analysis of production</td>
<td>5</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>5</td>
</tr>
<tr>
<td>Marketing channels</td>
<td>1</td>
</tr>
</tbody>
</table>

| Total indicators | 37 |
| Banfi indicators | 15 |

(1) indicators R&D, human resources, logistics channels, etc.

Relative score (total indicators intangible efforts/total indicators) = 41%
Score relative marketing intangibles (total indicators intangible efforts of marketing) = 27%
Score relative R&D intangibles (total indicators intangible efforts of R&D) = 3%

The importance of the intangible indicators is clear in the winemaking area of the production report, with the dominant role of indicators of intangible marketing efforts.

PRESENTATION and ANALYSIS OF RESULTS

CONCLUSIONS and FUTURE DIRECTIONS

Results Q1: The qualitative results confirm (at least as regards the Banfi group) that intangibles, and marketing intangibles in particular, represent an important resource from a strategic viewpoint. Moreover, brands are also considered an important resource (especially for the higher-priced ranges), as they are stable elements of differentiation, beyond the variability of tastes and the market.

The quantitative results, however, while in the first analysis seeming to confirm the relevance of the company’s intangible efforts, when compared with the economic and sales performance apparently contradicted that conclusion, indicating a negative impact of intangibles on economic performance and a positive impact on sales performance.

The negative effect observed could be explained by investments intended to reduce the business risk and stabilize cash flows, decisions errors that led to additional costs and useless intangible investments, or the need at a time of weak performance to invest to reduce competitive difficulties.

This result, that does not permit any generalization, could be due to the fact that we are investigating the impact of intangible investments in the year X on the performance of the same year, forgetting that investments in intangibles have an impact only on future performance.

To shed more light on this point, additional research will be necessary, of which this paper can only be considered a first step.
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CONCLUSIONS AND FUTURE DIRECTIONS

Results Q2: It is necessary to specify that the relationship between intangibles and reporting system is one of the most qualifying elements of the management control system implemented by Banfi. The need to make forecasts deriving from the recognized and shared strategic relevance of intangibles, especially brands, in the plans and budgets approved by the management, implies the existence of specific measures in the internal management control system.

The analysis highlights the fact that the indicators of the company’s intangible efforts contained in the reports refer mainly to the marketing area (indicators of marketing intangible efforts). These are generally indicators of a technical and physical nature, not financial, as in most cases they contribute to explaining the causes of corporate performance.

SUGGESTIONS AND NEW DIRECTIONS

1. No generalization: The results refer to a single case, but they agree with those found by Amadieu and Viviani in 2007. We are waiting for a CFO interview (additional answers and new directions of the survey)

2. It should be interesting an extension of the survey to more cases to test the influence of the business model on the importance of intangibles with a larger sample of companies, in order to clarify whether this variable must be considered when performing empirical studies.
GLI INTANGIBILI DI MARKETING: RUOLO, COMUNICAZIONE E VALUTAZIONE (IV)

LINEE GUIDA PER IL REPORTING SUGLI INT. DI MKT

- Linee guida del Ministero dell’Economia giapponese

Strumento di politica economica:
- definire metodi oggettivi di valutazione dei marchi

Per:
- eliminare la sottovalutazione delle imprese, migliorare le previsioni dei flussi attesi, rendere consapevoli le scelte degli investitori e ridurre l’asimmetria informativa
- recupero della competitività del sistema economico

- altre iniziative nazionali ed internazionali (Svezia, Danimarca, Inghilterra, OCSE, ecc.)