

9

TAKE INNOVATION UNDERGROUND

You might call it your company's back-end operation, or the backstage exertions that make your company's onstage efforts possible. I call it your organization's underground.

I borrowed the concept of "underground" from the old Disney theme parks. Back in the 1950s, '60s, and '70s, Disney theme parks were an arresting new concept, and customers were entranced by the magic and the fantasy that they enjoyed "above ground." For Disney, the revenues were huge. But a good part of Disney's financial success was due to the magic that went on literally "underground," where a massive inventory of costumes, props, materials, equipment, and back-office services (like laundry, personnel, and maintenance) were managed with exceptional efficiency, yielding lower costs "below" and a better customer experience "above." Back then, the creative attention that Disney bestowed into its underground was unique. We can learn a lot from it today.

The hidden underground is the root system that sustains the mighty oak of your organization and, when nurtured, allows it to flourish. From sales support and procurement to cost accounting and inventory management, the underground has huge impact on the health of your company and its capacity to deliver value to

customers.¹ If your company is to break from the pack, the underground demands not just attention, but innovation. Just ask the makers of Two-Buck Chuck.

Learn from “Two-Buck Chuck”

Fred Franzia’s tractors pick their way through moonlit vines near the foothills of California’s Sierra Mountains, harvesting grapes at their coolest and most delicious temperature. By dawn, up to 120 truckloads of crisp, clean fruit have been collected for crushing, their work completed even before the hand-pickers at other farms start their day. The trucks will eventually make their way to Napa Valley, where the grapes will be bottled into the fastest-growing wines in the industry.

Welcome to Bronco Wine Company, at \$350 million now the fourth-largest wine producer in the U.S. It is the scourge of the industry that it leads in growth. CEO Fred Franzia has committed an unpardonable sacrilege: Since 2002, he has profitably marketed a \$2 bottle of wine. It has become the fastest-growing wine by volume in the history of the industry. As a result, Bronco has assaulted the industry’s entire production, marketing, and pricing structure.

Thirty thousand carefully engineered acres and even more carefully engineered plant facilities guarantee Franzia the low-cost leverage to beat any competitor on price—and then some. His \$1.99 Charles Shaw label has become famous as “Two-Buck Chuck,” an affectionate nickname that originated with incredulous-but-grateful customers of the upscale Trader Joe’s grocery chain, where it is sold exclusively and where a new shipment has been known to cause a stampede on the shopping floor.² While \$2 bottles of wine have long existed (such as Boone’s Farm and myriad box wines), Two-Buck Chuck is a different concoction altogether. So is Napa Ridge, Glen Ellen, Salmon Creek, and the other fast-selling, low-priced Bronco brands that appeal to upscale consumers.

Setting aside for the moment the question of whether Two-Buck Chuck is drinkable, how can a winemaker make a profit on a \$2 bottle of wine?

The answer begins with corks. “I probably spend more time buying corks than anything else,” Franzia says. His commitment to shaving a penny off the cost of each specially designed cork used in the

Charles Shaw label saves the company nearly three-quarters of a million dollars a year. As a nephew of the world-famous Gallo brothers, Franzia knows not just wine intimately, but, more important, from his perspective, he knows the business of wine intimately. He knows the precise cost of juice, glass, cork, and label, and every production step in between. Those are the details that obsess him. Fred Franzia points out that his wines are not “cheap,” but “inexpensively made.” When he says “There’s not a wine made anywhere worth more than \$10 a bottle,” he’s speaking as a businessman, not a gourmet.

Franzia’s obsession translates into every facet of Bronco’s wine operations. To begin with, the efficiencies of the 35,000 (and growing) Bronco acreages allow the company to plant and pick at lower costs. Then there’s the fact that the Charles Shaw wine is filled with 70 percent grape juice from the Central Valley and coastal regions, at a cost of \$100 a ton, instead of solely Napa juice at \$2,000 a ton. The vineyards themselves are laid out in 3-mile-long segments to minimize the need for workers to frequently turn their tractors around. Compared to the typical farm where workers turn their tractors every quarter-mile, Bronco’s layout yields big savings on fuel and tire maintenance.

During the harvest season, trucks filled with Bronco field grapes arrive around the clock at the headquarters in Ceres, California, in the central California valley. The locations of the fields, and the logistics of truck movements, are all carefully planned, timed, and staggered so that the actual picking prolongs the ripening of the grapes and the deliveries avoid any slowdown or congestion—all steps that ensure every ounce of efficiency from facilities and work processes. Deviating from the industry norm, Bronco facilities themselves are built for efficiencies, not show. Don Russell, writing in *SF Weekly*, noted that “Bronco’s sprawling operation on the edge of Ceres has all of the charm of an oil refinery.” Huge white storage tanks hold up to 80 million gallons. The Titan ICBM missile fuel tanks, bought on the cheap from military surplus, will soon be used to produce Bronco champagne. Even the Bronco offices are unpretentious and low cost. Fred Franzia’s presidential suite is a brown-paneled trailer containing little more than a desk, a phone, and a couple of chairs.

From Bronco headquarters, the wine is off to Napa facilities for bottling—at a rate of 250 bottles a minute. Two hundred and sixteen million bottles a year will be produced, twice the annual average produced by all Napa-based wineries combined. And this is just the beginning. Bronco purchases at least 1 square mile of land per year for more planting volume and efficiencies. The company recently

introduced a “high-end” Merlot and Chardonnay under its Napa Creek label for a whopping \$3.99 a bottle. The wines already have a nickname: “Four-Buck Fred.” New ventures include a Salmon Creek label that restaurants can sell by the bottle at \$10, and a series of specialty wines for chains like Wal-Mart and Costco.

But we’re talking wine here, not cable wire or sheetrock. What kind of wine does \$1.99 buy? Even though a rock-bottom price generally dooms a label to the ignobility of the bargain bin, Two-Buck Chuck has gained the reputation—some say notoriety—as the cheap wine that doesn’t taste at all cheap. At the 2004 International Eastern Wine Competition, the 2002 Shiraz from Charles Shaw not only advanced to the finals from a field of 2,300 entries, but as the stunned audience looked on, it snagged the coveted double-gold medal. In other words, four out of five judges in blind tastings had awarded their highest rating to a bottle that retails for \$1.99. And when a prominent industry analyst declared Bronco Wine Company his pick for winery of the year during another gala awards ceremony, the crowd of a thousand industry types were shocked into silence. Many hissed. Meanwhile, in the restaurant world, restaurants are losing their reluctance about selling Bronco’s \$10 Salmon Creek as a premium wine. Customers like it.

Winemakers haven’t exactly embraced the prospect of quality wines being sold at obscenely low prices. More than a few have openly wondered whether Franzia somehow repackages excess inventory from financially troubled wineries. Because Bronco does not own any vineyards in Napa, The Napa Valley Vintners Association went so far as to lobby for a new state law that would prevent Franzia from printing labels with his Napa bottling address (the law passed but was struck down on appeal, and the battle is still progressing in the courts).

I think the antagonism toward Bronco springs from something deeper than a fear of unorthodox competition. After all, Bronco-induced sales cleaned out a lot of excess inventory in the industry and helped boost sales of wine to 280 million cases, which means that the U.S. is on track to overtake France and Italy as world’s top wine-consuming nation within a decade. The tide is lifting the entire industry. Something else is going on that drives a deeper, more pervasive anxiety. In industry after industry, innovation is going underground, and break-from-the-pack companies are leading the charge. While Bronco is unprecedented in the world of wine, parallels can be found throughout the marketplace, from the low-cost, low-price formula of