A Strategic Approach to Understanding the Australian Wine Industry Crisis

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Abstract for the AAWE annual conference, 2013

"Those who cannot remember the past are condemned to repeat it."
George Santayana (1905) Reason in Common Sense, Vol. 1 of The Life of Reason

The purpose of this paper is to gain a deeper understanding of the recent crisis in the Australian wine industry (Winemakers Federation of Australia et al., 2009) based on an analysis of imports into the two major markets of the U.S. and the U.K. While the boom leading up to the recent crisis has been the subject of academic study (e.g., Anderson, 2000; Marsh and Shaw, 2000), the causes of the crisis have been explored primarily anecdotally by industry practitioners (e.g., Anonymous, 2012), with only limited academic study (Spawnton, 2009). In fact, there are suggestions from industry bodies that such analysis would be “largely academic and irrelevant” (Clancy, 2010: 9). We believe, however, that ignoring the lessons of the past may result in the same strategic mistakes being repeated by Australian wine companies and, potentially, the wine producers of other countries.

We bring a business strategy perspective to the issue and hence a primary concern with the competitive positioning of Australian wine in the key markets of the U.S. and the U.K. The value, volume and, importantly, the unit value of imported wine is a function of an exporting country’s competitive advantage in a particular market. Hence, we collected data from databases (ITC for the U.S. and Eurostat for the U.K.) on imports from ‘New World’ countries (Australia, Chile, Argentina and the U.S.) and ‘Old World’ countries (France, Italy, and Spain). The data (volume and value of imports) were collected from the late 1980s, prior to the export-driven fifth Australian wine industry boom (Osmond and Anderson, 1998), to the most recent data available (2011 or 2012). Unit values were calculated in local currencies (US$ and Euros) to avoid foreign exchange effects. We took a granular approach by breaking down the imports into separate wine categories to differentiate between bottled, sparkling and bulk wine. The most significant findings are reported below.

1. The U.K. market
1.1 All Wine (HTS code 2204)

The total volume of French imports experienced a sharp decline since the late 1990s, coinciding with the boom of imports from Australia, which started in the early 1990s. The value of French imports fell for a short period (in the late 1990s), but continued to climb, and the unit value increased steadily from €2.41/L in 1988 to €6.43/L in 2009. Meanwhile, while declining volumes of French wine were imported, Australian unit value continued to decline. 1999 appears to be a turning point for the Australian wine industry, when it was approximately in the same position as France in terms of per unit value (€3.72/L for France and €3.64/L for Australia). Italy, the third most important competitor in the market, increased volume, value and unit value of imports, and while the unit value also declined starting in 2008, in 2011 it was significantly higher (€2.33/L) than Australia’s (€1.44/L). These aggregate numbers show clearly that Australia used low prices to drive volume until the late 1990s-early 2000s, which, we argue, led to commoditisation and a collapse of the value of wine imported after 2008.
1.2 Sparkling wine (HTS code 220410)
This wine category has always been a small percentage of the Australian imports into the U.K. market. The last decade has seen some increase in Spanish sparkling imports, and a dramatic increase in the last year (from 29.4 ML in 2010 to 77.6 ML in 2011), when Spain outpaced France by volume (30.6 ML). While the volume of French sparkling imports has dropped since 2008, the per unit value has, nevertheless, increased steadily. It would seem that the Spanish producers have been using price as a way of driving volume, while in the process opening up a new market for low priced sparkling wine. This, however, has not had a significant effect on the total value of French imports. While the 20-year trend for France, Spain and Italy in value is upwards, Australia has been losing out. The unit value of Australian sparkling imports started to decline after 2001 (as with the total wine category), and is, in 2011, at €3.05/L, well behind France (€14.07/L), the clear category leader, Chile (€3.34/L), Italy (€4.06/L) and Argentina (€4.16/L). Overall, the sparkling wine category is very important for France in the explanation of its overall success in the U.K. market. This segment (in terms of both value and volumes) appears to be quite volatile, generally following overall economic trends.

1.3 Bottled wine (HTS code 220421)
The unit value of Australian imports of bottled wine shows a shallow decline since the early 2000s until 2011, with a slight upturn in unit value from €2.48/L (2010) to €2.90/L (2011), which is also characteristic of some other importers (Chile, Italy) but not France. French imports increased steadily until the late 1990s, when the total volume went sharply down and only started to recover in 2011, while per unit value decreased from its peak of €5.32/L (2008) to €4.31/L (2011). It would seem that in the early 2000s Chile, Argentina and Australia were taking share of value from France and Italy. France now appears to be using price to recover volume; in 2011 it became the largest source of imported bottled wine in value (and second largest in volume) ahead of Italy. It noteworthy that in 1992 and 1996, the per unit value of Australian and French imports were similar (about €2.26/L and €2.20/L, and €2.31/L and €2.22/L, respectively), while by 2010 they had diverged dramatically (€4.31/L for France and €2.90/L for Australia). It should be noted that the recent shift to importing bulk wine for bottling in the U.K. may be masking the per unit value.

1.4 Bulk wine (HTS code 220429)
The data show an increase in per unit value for all importers (with the exception of Spain and Italy) in 2010-2011. The value of Chilean imports increased somewhat steadily until 2007 and then declined in 2011. The unit value of Italian bulk imports dropped in 2009 to €24.3M. France was able to increase per unit value in the mid 2000s, peaked in 2008 and then declined by 2010. For more than a decade (1999-2009), the Australian bulk imports continued to decline in per unit terms from its peak of €2.30/L in 1999, and recovered slightly in 2010-2011 (€0.81/L). By contrast, the volume and total value of bulk wine from Australia increased more than three-fold since 2008.

2. The U.S. market
2.1 All Wine (HTS code 2204)
Since the late 1990s, the data show a steady increase in both the value and volume of Australian imports into the U.S., even though volume increases have been highly volatile in recent years. Australia remains the second largest importer in terms of volume (behind Italy), but not in terms of value (with France and Italy the leaders). France has been steadily increasing total value and per unit value, and although its total value declined between 2008 and 2012, this decline is less dramatic than Australia's. While Australia was catching up with France on a per unit value basis until 1997, when the gap between the two competitors narrowed ($5.47/L for France and $4.81/L for Australia), by 2012 France outpriced Australia by a wide margin ($11.96/L vs. $2.60/L, respectively).
2.2 Sparkling wine (HTS code 220410)
As with the U.K. market, this category is very important for France and much less so for Australia, Argentina and Chile. Again, France is a clear category leader in 2012, with per unit value of $24.55/L, compared with $4.44/L for Australia, $4.88/L for Chile, $5.87/L for Italy and $4.73/L for Spain. Consistent with the findings for the U.K. market, the sparkling segment for France is highly volatile and appears to mirror the general economic conditions, with significant declines in volume and value in 2001 and 2008.

2.3 Bottled wine (HTS code 220421)
While all competitors have increased both volume and value of their imports of bottled wine since the late 1980s (with the exception of France, whose volumes increased only marginally), in per unit value terms France has maintained its leadership over the entire period under investigation. Italy is the volume leader in this category as of 2012, and has dramatically increased the bottled wine value since the late 1990s. Australia, with a unit value of $3.72/L in 2012, is losing out to all competitors in terms of unit value. 2007 was the beginning of a steep decline in both volume and value of Australian imports in this category, while the trend to lag behind France and Spain on a per unit value basis started even earlier, in 2000 (from $5.22/L).

2.4 Bulk wine (HTS code 220429)
This segment of the market is highly volatile, with volumes, value and unit value fluctuating widely. The data show a rapid increase in volume for Australia in the late 1980s, from a low base, relative to France. Since 1997 France has not been a significant player in this segment, even though it managed to increase its unit value from a low of $1.39/L in 2006 to $3.18/L in 2011, followed by a sharp drop to $1.51/L in 2012. Australia continued to increase its total value, but by 2011-2012 has been overtaken by Chile and Argentina. Its per unit value experienced a steep decline since 1996 ($5.03/L) to $0.97/L in 2012, behind Chile ($1.07) and Italy ($1.74/L). Chile and Argentina seem to have followed a similar pattern to Australia – lowering price and increasing volumes.

Conclusions. In summary, France is leading in bottled wine in both the U.K. and the U.S. and is outperforming the other competitors, particularly in the sparkling category. It seems to be playing the classic luxury goods game, by restricting volumes to maintain and high per unit value. Australia has lost its competitiveness since the early 2000s and is now being outperformed (in per unit value terms) by every other competitor (except the U.S. in the U.K. market). Its appears to have positioned itself differently from other competitors, essentially as a commodity wine producer.

The decline in the per unit value for Australian wine can be directly attributed to the ‘commoditisation doom loop’, as exporting companies struggled to continue to increase market share in selected key markets. Investment in large-scale production resulted in cost advantages, but required huge volumes of wine to be sold through the only available channel, the mass retailers. As the major Australian wine producers kept lowering their prices to provide sufficient consumer surplus (the difference between consumer willingness to pay and price) to increase market share, and under the increasing pressure from the mass retailers on whom they were dependent, price became the dominant component of the value proposition. This ‘commoditisation’ of Australian wine resulted in a progressive erosion of consumer willingness to pay and with it, declining consumer surplus. With reducing willingness to pay, prices had to be further lowered to maintain consumer surplus and sales volume, resulting in a continuing margin squeeze. In response, the wine producers sought ways to further reduce costs, and this had the result of lowering wine quality (Smart, 2010) further damaging consumers’ perception of Australian wine and further eroding consumers’ willingness to pay. This is a classic commoditisation trap (D’Aveni, 2010) with failing willingness to pay, prices and margins.

It is important to recognise an industry-wide commoditisation dynamic when willingness to pay
declines because price is used as primary competitive weapon. Even though Producer A may not be using price as the basis of competition, if Producer B is, the commoditisation effect may flow on to Producer A because of a halo effect around Australian wine. The halo effect in likely to be exacerbated by the generic country branding like ‘Australian wine’.

We speculate that he French wine producers may have created interacting loops, but in the opposite direction; namely, using high price cues as signals of value to push willingness to pay upwards. Given that the average consumer cannot make independent judgements based entirely on the intrinsic quality of wine, and even wine experts disagree on wine quality (e.g., Weil, 2001; 2005; Ashton, 2012), willingness to pay is driven by ‘objective’ characteristics, including price. A recent study has confirmed empirically that price of wine influences willingness to pay more strongly than subjective enjoyment of wine (Lewis and Zalan, 2012).

The findings of this study are important for the Australian wine industry and address the concerns of some industry observers, who call for a detailed analysis of the reasons why Australia lost its competitiveness and what may be needed to re-establish its competitive position (see Smart, 2010). The Australian wine industry (or at least its industry bodies) currently seem eager to shift their focus to the next big opportunity – China – without a clear understanding of the past problems, creating the danger of repeating the mistakes made in the U.K. and the U.S. The findings may also be of practical significance to other wine exporting countries, and particularly New World exporters, who are pursing strategies aimed at rapidly increasing the value of their exports.

References