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Catch Up in the Wine Industry: The Rise of the New World and the Revenge of the Old Guys

Andrea Morrison

URU – Utrecht University and CRIOS – Università Bocconi

Roberta Rabellotti

Dipartimento di Scienze politiche e Sociali - Università di Pavia

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The wine catch up cycle: key findings

- The catch up process is **slow** and **incomplete**:
 - ① Latecomers are catching up with the leaders via **a path-creating strategy** based on **innovation in products and processes** and on the adoption of a **conducive institutional set up** rather than on costs;
 - ② The **incumbents** have initially lost some market shares but instead of disappearing, they **have been able to retain their leadership** by adapting to the new path created;
 - ③ Recently there are **new latecomers** entering into the global market.

Why is the wine catch up different?

- Agriculture reacts more slowly to changes than manufacture due to **geographical, socio-cultural and institutional factors**:
 - **Geographical factors** such as climate, land, soil are fixed or can hardly change in short term (unless a major crisis occurs);
 - **Socio-cultural factors** such as history, culture, family traditions, diet habits also change slowly. In some European countries wine production is strongly rooted in ancient local traditions;
 - **Institutional factors**: wine production (and in general agriculture) has been heavily subsidized in the EU. Since the inception of the European Common Market in 1957, top wine producing countries such as France, Italy and Spain have taken advantage of subsidies and incentives to domestic producers as well as of internal market protection.

Stages of the wine catch up cycle

- **Entry** - From late 1970s: The Judgement of Paris and UK licence reform allowing supermarkets to sell wine;
- **Stage # 1** – From 1995: The rise of NW leaders;
- **Stage # 2** - From 2005: The Old World regaining momentum and some dynamics among the NW;
- **Stage # 3** – From 2010: The new emerging Asian markets: is there a new window of opportunity and a next stage of the catch up cycle?

Stage # 1 - The window of opportunity in the market: new inexperienced consumers

- Steady decline of demand for traditional wine in the market. It in

Quality is not anymore an exclusive domain of producers, strongly influenced by the characteristics of *terroir* but it is increasingly the value perceived by the market.

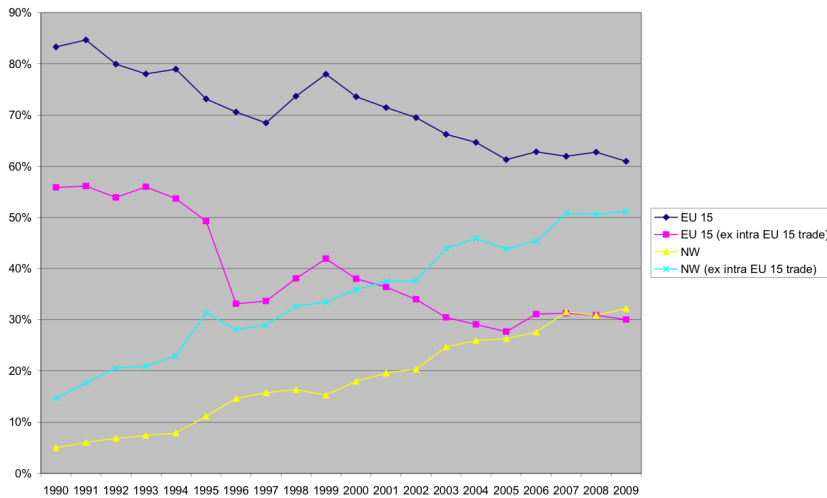
- Increase in wine purchases made in supermarkets and rising importance of large-scale distribution: supermarkets require large volumes of good quality, easy to drink, international variety of wines such as Sauvignon, Cabernet, Chardonnay.

Stage # 1 – The rise of the NW leaders

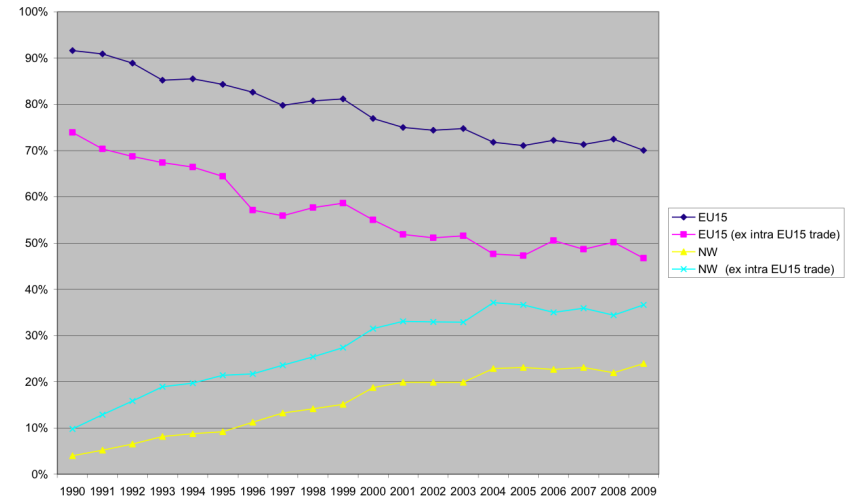
- Due to the strong globalization, the volume of exports as a percentage of world wine production has tripled from 1961 to 2009, going up from 11% to 32%;
- NW countries have contributed the most to the increase of the volume of exports: doubling from 20% to 40% of total wine production between 2001 and 2007, before falling back to 37% in 2009, due to a decrease in Australian exports.

NW caught up OW in volume and is closing the gap in value

Exports in volume



Exports in value



Stage # 1 - A new market-driven scientific approach

- NW countries have been rapid to adapt to the new market requirements in terms of quality consistency, large scale production, easy to drink wines through a strategy based on:
 - ① **Modernization of production processes** introducing new techniques for mechanical pruning and harvesting suitable for adoption in large estates with large investments to improve viticulture and oenological techniques;
 - ② **Domestic scientific and technological capability** aligned with market objectives (universities and PROs);
 - ③ **Openness to foreign knowledge and technology** and I-U linkages (bridging researchers and flying wine makers);
 - ④ **Institutions** supporting the industry (national systems of market-oriented R&D institutions);
 - ⑤ **Industry consolidation**: national and transnational mergers, acquisitions and strategic alliances have intensified (top wine companies in the world market: 1st USA, 2nd France, 3rd Australia, 4th SA, 5th China, 6th Chile).

Stage # 2- The new window of opportunity in the market: the increasing attention to *terroir*

- Consumers are becoming more sophisticated and educated and seek for differentiated products that possess high intrinsic quality, but also specific intangible features, such as history and authenticity;
- OW countries have experienced a growth in the unit value of their exports, while the **NW**, apart from New Zealand and Argentina, hardly had any change;
- Italy and Spain have increased their sales in the **top market segment** (bottled and sparkling wines).

Stage # 2- The modernization of the incumbents

- In OW, idiosyncratic behaviours have been replaced by an increased attention to market requirements both in terms of quality and price;
- More attention to marketing and branding;
- OW producers have also retained (though often in a new fashion) their traditions of wines rooted in old and authentic history and heritage.

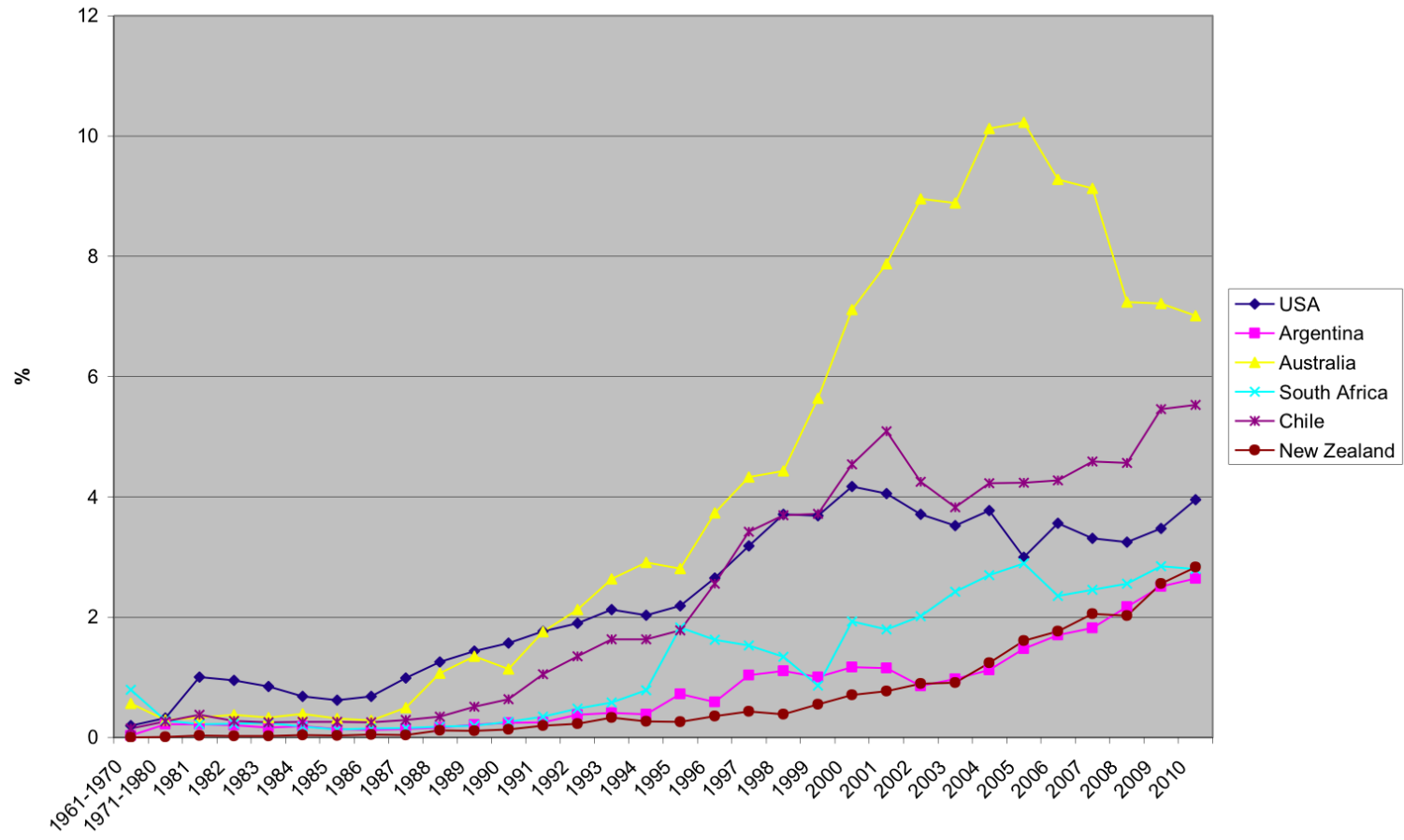
Stage # 2 – The changes in the EU regulatory environment

- In the EU, the wine sector has been historically strongly regulated:
 - This has prevented experimentation and diversification to respect severe codes in winemaking and planting;
 - The system has helped to convey the idea to consumers that quality was tied to the geographical origin of the wine;
- In 2008 with a major reform drawn by the idea that consumers have to decide what quality is, policy interventions have shifted from regulating the supply towards incentives to promotion and marketing:
 - Lifting of the ban on specific oenological practices;
 - Simplification of the appellation of origin system;
 - Strong financial support for promotion and investments.

Stage # 2 - The NW dynamics: the (temporary) fall of Australia and the surge of Argentina and New Zealand

- **Australia** has suffered because of:
 - Exchange rate appreciation;
 - Locked in a model of production based on centralised R&D, rather standardised and homogeneous wines and large firms;
- **Argentina and New Zealand** came to the fore as the fastest growing exporters and in some markets (i.e. USA) they have been able to challenging the position of some established OW and NW producers such as Spain and Chile:
 - The strategy of both countries has been to target the upper segment of the market;
 - New Zealand production is almost completely in the premium and super premium categories. New Zealand is ranked third in the category of top exporters of super-premium still wines with 7% of the world total market, ahead of Australia and Spain with only 3%.

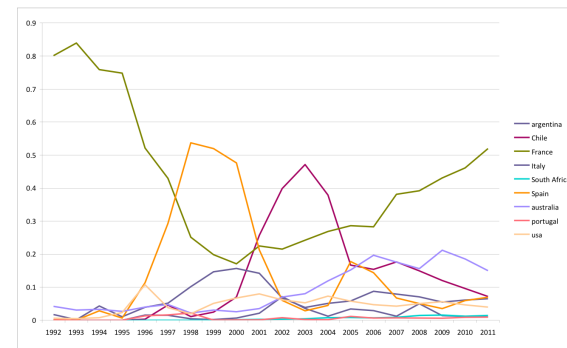
The dynamics of the catch up among NW exporters (export market shares US\$)



Stage #3 ? - The new emerging Asian markets

- Asian markets are the new frontier for both OW and NW wine producers;
- China might become also a main competitor in wine production;
- Yantai Changyu Pioneer Wine has suddenly climbed up to the 5th position among the largest wine companies in the world;
- Several Chinese acquisitions of French *châteaux* as well as investments in US and Australian wine companies;
- **Will the global wine industry shift its barycentre towards the East?**

Figure 6 Exporting countries to the Chinese wine market (% share, value)

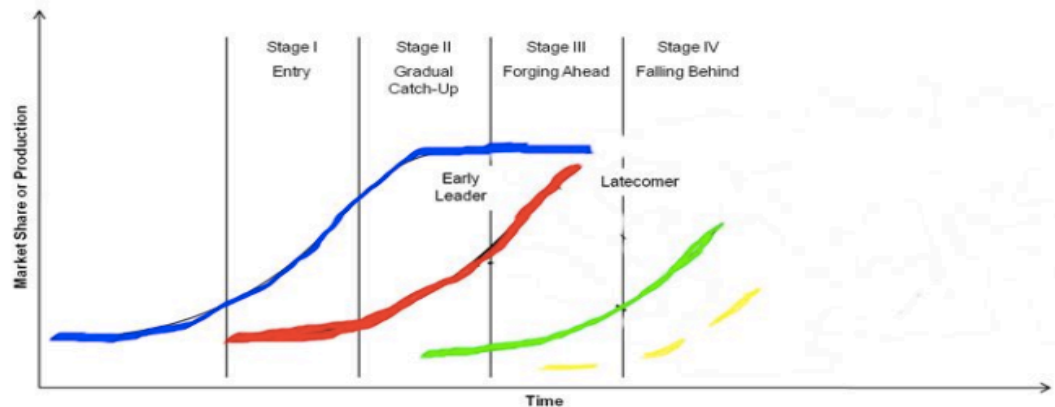


Source: Comtrade

Summing up:

Is this the slow and incomplete wine catch up cycle?

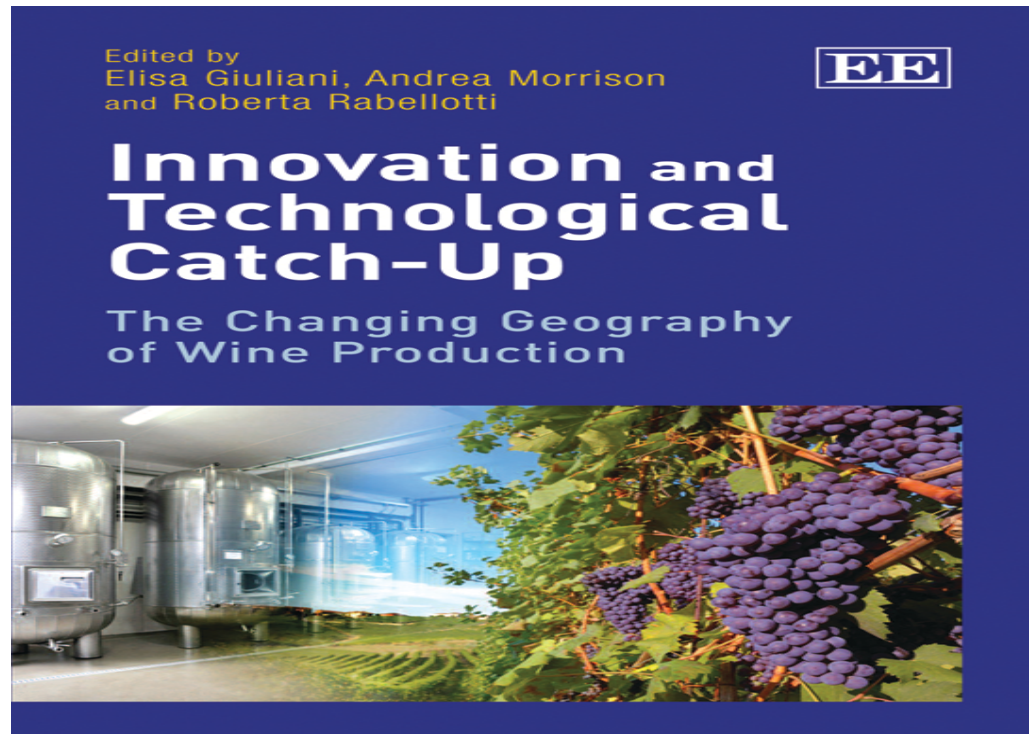
- Italy, Spain and France are in blue;
- Australia, California, Chile and SA are in red;
- Argentina and New Zealand are in green;
- China is in yellow.



Concluding remarks

- **The wine catch up cycle peculiarities:**
 - **Latecomers** are **path creating**: their competitive advantage is not on costs but on **innovation in products, processes and institutional organizations**;
 - **Sustained catch up of incumbents** adapting to the new path;
 - Despite the temporary decline of some latecomers, the wine story is not necessarily one of aborted catch-up;
 - **Changes in agriculture are very slow** therefore in the long run NW producers have still the opportunities to challenge European producers and some recent market developments seem to support this consideration;
- **Key open questions:**
 - There is an undergoing shift of wine consumption towards non-traditional consuming countries, such as Asian countries– and more specifically China: **Which countries will can gain the most from such a shift?**
 - A new regulatory environment has been recently implemented in the EU: **what consequences will have on OW producers traditionally founding their competitive advantage on *terroir* and geographical origin?**

THANK YOU



roberta.rabellotti@unipv.it

<http://sites.google.com/site/robertarabellotti/home>