

# **The Australian Wine Industry: An unsustainable boom and the inevitable bust**

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## **Abstract**

The Australian wine industry is in crisis as it experiences its fifth 'bust' following more than a decade of boom. The purpose of this paper is to explain the latest boom and bust from a strategic perspective, using empirical data and drawing on the concepts and frameworks from economics and strategic management.

The current boom-bust cycle started in the early 1990s and was primarily driven by the growth aspirations of the large, corporate producers<sup>i</sup>, who exploited opportunities in overseas markets. These aspirations were formally articulated in the 1996 industry plan – *Strategy 2025*<sup>ii</sup>. Important elements of the plan's approach to internationalization included a focus on premium table wines, building 'Brand Australia', establishing distribution networks, and developing brands specifically targeted at the international consumer. In terms of export growth, *Strategy 2025* outlined three stages: Volume growth (1996-2002), during which rapid vineyard expansion would overcome product shortages, thereby enabling expansion in existing markets and penetration of new markets; Value growth (2002-2015), which would place increased emphasis on building brand strength, market share and margins; and Pre-eminence (2015-2025), when Australia would have established brand leadership in specific market segments. The plan was enthusiastically embraced by the Australian industry bodies, despite the voices of caution that argued winning on the basis of price in international markets would be a Pyrrhic victory<sup>iiiiv</sup>. By 1999, Australia had established itself as the fourth largest exporter of wine in the world. The large wine companies drove *Strategy 2025* with such enthusiasm that the target of \$4.5B in annual sales by 2025 was surpassed in 2005, two decades ahead of the plan. During the new century export volumes continued to rapidly grow and by 2006 exports exceeded domestic market volumes. In the second half of the first decade of the century, unit value in export markets was in decline and, combined with a strengthening Australian currency, the industry tipped into economic

unsustainability. By 2008 both export and domestic volumes were in decline, throwing the industry into crisis.

The highly-regarded international wine authority Jancis Robinson observed that the “Australian wine industry is in recriminatory mood”<sup>v</sup> when referring to the lively debate taking place in Australia regarding the causes of the current crisis. Two conflicting ‘frames of reference’ have polarised the discussion resulting in contradictory remedies. The first adopts essentially an industry level approach and diagnoses the problem in terms of agricultural economics<sup>vi</sup> and focuses on the supply-demand balance. This perspective naturally leads to the conclusion that the response to the problem should be a reduction in supply through the removal of a significant proportion of Australia’s vineyards. This approach has been embraced by the industry bodies<sup>vii</sup> who, on November 10, 2009, issued a joint statement – the ‘Wine Restructuring Action Agenda’. The statement diagnosed the problem in the following terms:

Structural surpluses of grapes and wine are now so large that they are causing long-term damage to the industry by devaluing the Australian brand, entrenching discounting, undermining profitability, and hampering its ability to pursue the vision and activities set out in *Directions to 2025* industry strategy.<sup>viii</sup>

The industry bodies implied the over supply was driven by warm/cool climate plantings and it is primarily in these areas that vines should be removed. This approach was supported by marketing academics who promoted the idea that the industry has ‘mismanaged its brands’<sup>ix</sup> and that better marketing of Australia’s branded commodity wine will go some way to alleviating the oversupply situation.

The contra view was presented by fine wine producers, notably Brian Croser, a leading figure in the Australian wine industry, who argued that while the large producers and branded commodity wines have played a vital role in the development of the industry, the explosive growth of that sector has had the negative consequence of damaging the image of Australia’s as a producer of fine wines.<sup>x</sup> While the industry bodies also acknowledged that Australia’s image as a low-cost producer made it hard for ‘premium’ wines to gain recognition, Croser’s distinction between fine wine and branded commodity wine was an important point of difference. The ‘fine wine’ perspective argued that Australia’s warm/cool climate vineyard stock is the base for terroir-driven fine wines that they are the key to a sustainable industry.

In this paper we examine these two perspectives in order to gain a better understanding of the causes of the crisis. We trace the antecedents of the current crisis and use empirical data to support the contention that the ‘bust’ was built into the 1996 industry plan. That the boom turned in to a self-inflicted disaster was, we would argue, predictable. Exploring the multiple reasons leading to the boom and subsequent bust are at the heart of the study. First and foremost, but largely overlooked by both the economists and fine-wine proponents, is the issue of strategic positioning of the firms in the industry. The value proposition, which drives buyer willingness to pay, and supplier opportunity costs, of the large producers was built around branded commodity

wines and hence doomed to price-based competition. This set up an industry dynamic whose consequences were inevitable.

Phase 1 of *Strategy 2025* anticipated a rapid increase in wine volume and the large producers ramped up volumes by expanding their own vineyards and used long-term contracts to induce independent growers to expand and new players to enter the winegrape industry. Promoters of tax-effective Managed Investment Schemes further accelerated the rate of planting. The volumes of wine that needed to be sold put the Australian wine producers at the mercy of the large, concentrated grocery retailers (domestically and internationally), who were the only route to market that could move wine in these volumes. Export success led to further increases in plantings and wine volumes, which forced price reductions that compromised consumer perception of quality. Actual wine quality also suffered as volume was ramped up by increasing yields from existing vineyards and the proportion of grapes coming from new vineyards. This put further downward pressure on prices and so the industry became caught in a dynamic that took the form of a strategic 'doom loop'. Fundamental industry economic characteristics – high fixed costs, asset specificity and exit barriers – exacerbated the problem.

The solutions currently being recommended by the Australian wine industry bodies do little to deal with the underlying strategic problem. Reducing the volume of commodity wine – wine that is simply not cost competitive with other New World wine producers – will do nothing to enhance the economic sustainability of the Australian wine industry. The restructuring required must be more strategic and aimed at the firm, rather than industry, level – it must address the issue of what must be done by individual producers to position themselves to open up a wedge of competitive advantage<sup>xi</sup>.

## References and endnotes

<sup>i</sup> Southcorp (later acquired by Foster's), Foster's, BRL Hardy (later acquired by Constellation), Orlando (Pernod Ricard), Rosemount and later Casella.

<sup>ii</sup> AWF (1995) *Strategy 2025. The Australian Wine Industry*, Adelaide: Winemakers' Federation of Australia for the Australian Wine Foundation.

<sup>iii</sup> Croser, B. (2005) "The idea of Quality – Creating Sustainable Competitive Advantage." [http://www.finewinepress.com/modules.php?op=modload&name=PagEd&file=index&topic\\_id=32&page\\_id=161](http://www.finewinepress.com/modules.php?op=modload&name=PagEd&file=index&topic_id=32&page_id=161) accessed on 15 December, 2005

<sup>iv</sup> Lewis, G. & Zalan' T. (2007) "The wine industry", in D.Merrett & H.Dick (eds), *Internationalisation Strategies of Small Country Firms: The Australian Experience of Globalisation*, Cheltenham, UK/Northampton, MA, US: Edward Elgar, pp. 195-214.

<sup>v</sup> Robinson, J. (2010) "Hooray for Australian Chardonnay" FT.com, February 20, [www.ft.com/cms/s/2/53b7da26-1ce2-11df-aef7-00144feab49a.html](http://www.ft.com/cms/s/2/53b7da26-1ce2-11df-aef7-00144feab49a.html) accessed 23 February 2010.

<sup>vi</sup> See, for example, Anderson, K. (ed) (2004) *The World's Wine Markets. Globalization at Work*. Cheltenham, UK, Edward Elgar.

<sup>vii</sup> Winemakers' Federation of Australia, Wine Grape Growers' Australia, the Australian Wine and Brandy Corporation, and the Grape and Wine research and Development Corporation.

<sup>viii</sup> Anonymous (2009) "Industry called to action to eliminate over-supply," *Australian and New Zealand Wine Industry Journal*, 24(6): 4.

<sup>ix</sup> Spawton, T. (2010) "Brand competitiveness and wine industry recovery," *Australian and New Zealand Wine Industry Journal*, 25 (1): 44.

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<sup>x</sup> Croser, B. (2010) "Prospects for Australian Smaller 'Fine Wine' Producers," Pre-AARES conference workshop, *The World's Wine markets by 2030: Terroir, Climate Change, R&D and Globalization*, Adelaide, South Australia, 7-9 February.

<sup>xi</sup> Ghemawat, P. & Rivkin, J. (2005) "Creating Competitive Advantage." HBS 9-798-062.