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Leading Minds

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SOUTH AFRICAN WINE INDUSTRY BENCHMARKING

DRAFT REPORT

29th February 2008

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WINE INDUSTRY BENCHMARKING[1]

1 INTRODUCTION

1.1 Background

The wine industry forms an important component of the economy of the Western Cape Province. Its role as a consistent and sustained employer along the entire wine value chain as well as forming an integral part of the tourism industry is well-known. The wine industry has been in the vanguard in becoming involved in transformation and was the first agricultural industry to draft its BEE Charter. The Wine Industry Transformation Charter, approved by the SA Wine Council, was submitted in December 2007 to the Minister of Trade and Industry for registration as a Section 12 Charter. The Minister of Agriculture and Land Affairs also approved the Wine Industry Strategy Plan (WIP) in October 2003 with competitiveness, transformation, sustainable resources management and social responsibility as strategic focus points for the industry.

In the light of the above, the Western Cape Department of Economic Development & Tourism requested a Wine Industry Benchmarking report and awarded the tender to Agri-Africa with the following terms of reference:

"(i) A review of the position of South African wine industry within the international environment, including in relation to its competitiveness, market position, size and government assistance.

(ii) A review of the Western Cape's wine industry best practices and experiences in building competitiveness and increasing growth using the framework in **A**, in relation to the items in **B**:

A

a. Current status quo/context in relation to wider national and international/ economic environment, include challenges and opportunities.
b. Detailed description and analysis of current models/value chains/processes and its impact.
c. Organisational and support structures/and role-players.
d. Assessment of models (good and bad) and identification of best practice.
e. Recommendations and lessons for other agri-processing niches.

B

a. Black Economic Empowerment Models.
b. Emerging Black Wine Businesses along the value chain (other than production).
c. Market and Export Development.
d. Current Innovation and R&D and disbursement/distribution thereof into the wider wine industry (including SME).
e. Environment Sustainability.
f. Employment Practices.
g. Community Social Responsibility.
h. Workforce and Skills Development.

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[1] The Study team: Eckart Kassier (Convener, Agri-Africa); Nick Vink (Professor & HoD, Department of Agricultural Economics, University of Stellenbosch); Michael Cherry (Agri-Africa); Gerhard van Wyk (Consultant to the Wine Charter Desk of the South African Wine Industry Council; Stephen Hobson (Chartered Financial Analyst); N. Sefoko (PhD student, University of Pretoria/Antwerpen); Advisor: Johan van Rooyen (CEO of the South African Wine Industry Council).
The project team used the offices of the South African Wine Industry Council as contact point. Relevant wine industry documentation has been considered in the compilation of the report.

l. Investment Growth and Expansion.
m. Linkages with tourism and other sectors/niches.

(iii) An assessment of the needs with respect to regulatory and institutional environment, infrastructure, and other constraints facing the industry.

The service provider will work closely with the stakeholders in the wine industry, as well as other role players active in preparing this study to ensure synergies and avoid duplication with ongoing studies, and to coordinate stakeholder consultations.

1.2 Scope of Work

The service provider will establish a "status quo" benchmark for the South African wine industry related to the following:

1. Design and implement a process of wide consultation, by face-to-face and electronic means, with key policymakers, stakeholders including representatives of industry organisations, development agencies, academia and other institutions actively involved in the wine industry.

2. Evaluate the broader international economic environment in which the wine industry operates and competes with particular attention given to the dynamics of the International markets.

3. Review and assess:

a) Existing reports, studies on competitiveness and initiatives supported by the industry stakeholders, including the broader international community, which focus on the sector development and innovation.
b) Policy reforms undertaken in the wine sector, review the institutional and regulatory environment. Identify strengths, weaknesses and gaps.
c) Wine industry skills availability and skills requirements with reference to investment climate.

4. Identify the primary constraints facing entrepreneurs and innovators in the wine industry, and the opportunities and challenges facing firms and industries as they confront outside competition both locally and globally, this will cover high investment and operating costs, human capital and skills.

a) Determine whether business incubation initiatives aimed at fostering entrepreneurship and private sector development at the local level based on local expertise and comparative advantage would address some of the constraints facing new business development and innovation as identified by the needs assessment.

5. Evaluate the potential role of information as tools of productivity, competitiveness and innovation in key agri-processing sectors.

6. Where and if appropriate benchmark the profitability of the wine industry against the international wine industry;

7. Consider any distinguishing factors that are peculiar and specific to the South Africa wine industry production systems that have relevance to other agri-processing sectors.

8. Finally, sum up a number of ideas to encourage competitiveness in emerging agri-processing niches/sectors.'

1.3 The industry at a glance

The wine industry contributed an estimated R16.3 billion to South Africa's gross domestic product (GDP) in 2003. This figure rises to R20.5 billion when tourism is included. An amount of R4.2 billion per annum (2006) is contributed to government revenue via excise taxes. Producers' income amounts to R2 610.7 million. The industry sustains about 256 000 job opportunities (including 20% through wine tourism), although much of this is seasonal labour. Investment capital is in excess of R50 billion.

In 2006, some 4 360[2] producers and 580[3] cellars in South Africa – mostly in the Western Cape province, with some in the Northern Cape and Free State – produced 927.9 million litres of wine, brandy and grape juice concentrate from a harvest of 1,3 million tonnes of grapes, making South Africa the world's 9th largest wine producer. About 700 million litres of drinking wine were produced from this harvest, of which 36% was red and 64% was white wine, compared to a yield of 12% red wine as late as 1995.

The wine industry entered the global marketplace as major shifts were underway in production and consumption. While global wine production has declined over the past two decades, the share of wine production that is traded internationally has more than doubled. This trend has opened up new opportunities for South African wine exports, provided that they are able to demonstrate a competitive edge in the world market.

South Africa produces 3.1% of the world's wines and exports 38% of its wine production (271.6 million litres in 2006) to the value of R3.85 billion per annum. The UK (30%), Germany (16%) and the Netherlands are currently the major export destinations for South African wines. Per capita consumption in South Africa is 8.6 litres in comparison with 47.6 litres in France, 21.8 litres in Australia, 34.6 litres in Argentina and 9.8 litres in the USA.

A summary of the most important statistics of the South African wine industry is shown below (refer to Annexure 1 for a more detailed statistical overview of the wine industry).

- 126 419ha cultivated (2006)
- 4 360 (2006) wine grape farmers
- 750 cellars (2007)
- 354 411 773 vines of the vinifera varieties
- 1 301 579 tonnes annual harvest (2006)
- 1 012 980 million litres (2006)
- 70% used for the production of wine
- 1,7% of the world's vineyards
- 1,3% of the world's wines

[2] SAWIS gives the number of registered members as some 4 400. VinPro data show 4 810 registered members, but of these 1 039 produced no grapes, giving 3 771 wine grape producers.
[3] Indications are that more than 170 new cellars were established since 2006.

- 14th biggest producer in the world (area under vines)
- 9th largest producer of wine in the world
- 38% of South African wine is exported
- 271,6 million litres exported in 2006

2 INSTITUTIONS AND STRUCTURES

2.1 The South African wine production structure

The South African wine industry is undergoing three interlinked areas of transition:

- Deregulation and restructuring (since mid 1990)
- Integration into international value chains
- Legislative changes brought about by the democratic government (since mid 1990)

This transition has had complex effects on the production structure. On the one hand, the industry's product mix has changed over the past decade, and this has been accompanied by a sustained rise in exports. On the other hand, many producers have found it difficult to break away from the industry's historic reliance on bulk wine production. In general the industry's production structure has changed since 1994, though it remains labour-intensive and subject to cyclical economic conditions.

The industry has experienced a sustained increase in competitiveness as a result of the opening of global markets, scientific research, and the flow of technical information, high regulatory standards and investment in human resources. These factors are offset by the export-dampening effects of a relatively strong rand, exchange rate instability, lack of sustained R&D and other factors (see section 4).

By and large, farmers are motivated to go beyond management strategies based on expendable, low-wage labour. This has resulted in improved wages, higher levels of training and modernised management approaches, required not only by law, but by the imperatives of survival and the production of quality wine grapes in an increasingly competitive sector. However, selective modernisation and partial compliance with labour laws have resulted in strategies that on average rely on elements of both traditional paternalist and modern management approaches with marked differences evident between produces. This has accelerated the divide between a shrinking core of permanent, better-skilled and better-paid workers and the seasonal, casual and contract workers who form a large part of the rural poor in the producing areas. Research shows that the permanent labour force is almost exclusively Coloured and Afrikaans speaking. Very few African workers are employed on a permanent basis, and Africans feature much more prominently in the seasonal labour force. Women make up a large proportion of the temporary workforce.

Table 1 shows the current production structure of the industry (not including bulk wine buyers) according to the available data. Notably, nearly half of the country's wine farms produce less than 100 tonnes of grapes, while only 294 farms produce more than 1 000 tonnes. This is due to the fact that most commercial farms are small or medium-sized mixed farming enterprises. The 270 largest producers (7.2% of the total) produce 39.6% of the wine grape crop and 56.3% of the producers deliver 95.2% of

the crop. This means 43.7% of active producers produce a mere 4.8% of the total.

Table 1 Structure of the South African wine industry

Primary wine producers	Per production category	
	Tonnes	Number of producers *
	0	1039
	1 – 100	1648
	> 100 – 500	1 421
	> 500 – 1 000	432
	>1 000 – 5 000	265
	> 5 000 – 10 000	5
		4 810
Wine cellars that crush grapes	66	Co-ops
	477	Private wine cellars
	18	Producing wholesalers
	561	

***The 2002 Census of Agriculture shows that half of the commercial farms in South Africa have a turnover of less than R300 000

Source: Adapted from SAWIS, 2006

2.2 Government assistance

Since 1997 the wine industry was largely deregulated from direct government interventions in pricing, production and marketing. A number of legal and regulatory measures however still apply.

An interesting "global" observation is the high degree of government support and "subsidisation" of competing wine industries by many countries in the world. The EU is a major proponent of such subsidisation and direct support with a comprehensive Wine Industry Support Plan which includes items such as market development, the upgrading of vineyards, "green" harvesting to prevent the production of low quality grapes, the mitigation of risk and uncertainty and support to wine farmers to ensure viable rural development. Lesser support by government than in the EU is forthcoming in Canada and the USA. Argentina, New Zealand and Australia record significantly less support. However, even in these countries government often meets their wine industry on a "50:50" basis with growth directed initiatives such as R&D support, export, market development and promotion.

In contrast only limited resources are directly allocated by government to the South African wine industry. These include items such as research support (via the THRIP formula) and export support to BEE companies. Wine certification laboratories and related facilities are provided by government as well as infrastructure such as port and transportation and power networks.

The wine industry on the other hand, through excise taxes, contributes R3 075.6 million per annum directly to the government revenue – this in comparison with producers' income of R2 610.7 million per annum. A more substantive contribution from government is therefore argued for by the industry.

2.3 The legal environment

A large number of laws and regulations govern the industry.

2.3.1 Regulatory measures

The South African wine industry is required to operate largely as a private sector driven initiative with relative limited direct government assistance as indicated to above.

The industry is regulated by the following:

- The Customs and Excise Act, No 91 of 1964
- The Marketing of Agricultural Products Act, No 47 of 1996
- The Liquor Act, No 59 of 2003 and provincial legislation
- The Liquor Products Act, No 60 of 1989
- Competition Act, No 89 of 1998
- Broad-based Black Economic Empowerment (BBBEE)

Labour legislation:

- Labour Relations Act (No 66 of 1995)
- Basic Conditions of Employment Act (No 75 of 1997)
- Employment Equity Act (No 55 of 1998)
- Skills Development Act (No 97 of 1998)

Environmental legislation:

- Conservation of Agricultural Resources Act (No 43 of 1983)
- Environment Conservation Act (No 73 of 1998)
- Cape Nature and Environmental Conservation Act (No 19 of 1974)
- National Water Act (No 36 of 1998)
- National Environmental Management Act (No 107 of 1998)
- Health Act (No 63 of 1977)
- Occupational Health and Safety Act (No 85 of 1993)
- Atmospheric Pollution Prevention Act (No 54 of 1965)
- Fertilizer, Farm feeds, Agricultural remedies and Stock remedies Act (No 36 of 1947)
- Conservation of Agricultural Resources Act (No 43 of 1983)

Biodiversity Act, No 10 of 2004:

- National Veld and Forest Fire Act (No 101 of 1998)
- Protected Areas Act (No 57 of 2003)
- Subdivision of Agricultural Land Act (No 70 of 1970)
- Western Cape Nature Conservation Laws Amendment Act (No 3 of 2000)

Label Requirements:

Wines sold in South Africa, whether certified or not, must comply with a number of mandatory label requirements which must refer to class designations, alcohol content, name and full address, Wine of Origin, cultivar and vintage.

2.3.2 The Wine of Origin scheme

In South Africa wine is classified according to cultivar, area of production or origin and vintage.

Legislation was introduced in the form of the Wine of Origin System (not Scheme) in 1973, in order to provide a guarantee to the wine consumer that statements appearing on a bottle's label are accurate. The Wine and Spirit Board issues an official seal, the so-called "bus ticket", which is displayed on the bottle neck after certifying a wine for origin and/or vintage and/or cultivar. Labels may also reveal the composition of grape cultivars in a blend. The cultivars must be stated in descending order of their percentages. Regulations allow the blending of up to 15% of another cultivar or cultivars in a wine that may still be labelled a single variety (the proportion was 25% before 1 January 2006).

An identification number is placed on the seal to be able to record the history of each wine back to the day it was harvested. Vineyards are subject to inspections and wine to monitoring in the cellar. Certification is approved only after a final, official analysis of tasting. The analysis ensures that a wine complies with legal requirements – for example, sulphur content – and during tasting, the wine is evaluated to ensure a minimum quality standard and varietal character.

2.3.3 Legislation changes

The new proposed provincial Liquor Act for the Western Cape will be circulated soon for public comment. The amended bill of the Liquor Product Act is currently with the National Department of Agriculture.

Plastic containers: Due to initiatives taken by the South African Wine Industry Council and after a three-year consultation period where all internal groups were engaged, the government approved regulations for the use of new higher quality packaging materials in 2007. This legislation effectively "banned" the "papsak" and other inferior and low quality packaging in the wine industry. New packaging standards are now in operation.

2.4 Industry governance and representation

2.4.1 The South African Wine Industry Council and its business units

The South African wine industry is represented by the South African Wine Industry Council with wine grape producers, wine cellars, trade, labour, emerging agriculture and civil society as constituency members. The Council was established on 30 June 2006 to replace the SA Wine & Brandy Company (SAWB).

The SA Wine Council's vision states: "To ensure the South African wine industry is a globally competitive, profitable, accessible and equitable industry, underpinned by its characteristics of meaningful people development, sustainable natural resource usage, ethical trade practices and

responsible business processes that make a significant contribution to poverty alleviation and wealth creation for all."

A number of initiatives by the Council are underway to "making the vision happen." The most important being:

2.4.1.1 **The Wine Transformation Charter:** The purpose of the charter is to fundamentally transform the wine industry within the context of the government's BEE policy framework and codes. The Minister of Trade and Industry was requested to grant a Section 12 status to the Wine Charter. This Charter was accepted by the Wine Council on 30 July 2007 after extensive and representative consultation (four years) with all role-players in the industry (also refer to section 6).

2.4.1.2 **The Wine Industry Strategic Plan (WIP):** The WIP is the approved agreement between all stakeholders in the wine industry and government to pursue:

- Competitiveness and profitability of the industry – globally and nationally
- Black Economic Empowerment (BEE) and Transformation
- Sustainable utilization of natural resources
- Social responsibility

The WIP was coordinated by the SA Wine Council (the then SA Wine & Brandy Company) with full participation of all industry stakeholders (labour, producers, civil society, wine cellars, trade). The plan is based on Vision 2020 (approved by the wine industry in 2000) and the WIP was accepted on 30 October 2003 by the National Minister of Agriculture and provides a strategic framework for industry: government interaction and partnerships, including the approval of the statutory levies. The WIP is currently under review.

2.4.1.3 **The Wine Industry Advisory Forum:** This representative forum is open to all wine interest groups and meets regularly to engage role-players on policy and strategy matters. The forum then advises the South African Wine Industry Council.

2.4.1.4 **The annual Wine Industry Freedom Day Lecture:** The first lecture was presented at the historical venue of Groot Constantia in 3 May 2007. The Minister of Finance presented the lecture, with the Chairperson of SAWIT responding. The chairperson of the Wine Council chaired the meeting, attended by 223 invited guests from all walks of society.

2.4.1.5 **The Biodiversity & Wine Initiative (BWI)** (also see section 2.5): The BWI is a pioneering partnership between the South African wine industry and the conservation sector. The goals are to minimise the further loss of threatened natural habitat, and to contribute to sustainable wine production through the adoption of biodiversity guidelines by the South African wine industry.

2.4.1.6 **The wine industry levies and funding of wine industry business units:** The Board of the Wine Council recommends the required statutory levies to be paid by industry role-players (see section 2.9) for approval by the Minister of Agriculture and Land Affairs. The Council is also accountable for the roll-out process. The four industry business units, the South African Wine Industry Information and Systems (**SAWIS**) - R6.8 million, Wine Industry Development Association (**WIDA**) - R2 million, the Wine Industry Network for Expertise and Technology (**Winetech)** - R13.8 million and Wines of South Africa (**WOSA**) - R22.28 million are funded by these levies, with R1.0 million allocated to the budget of the Office of the CEO of the Wine Council.

2.4.1.7 **Representative structure, organisation and functions:** The members and organisational structure of the Wine Council is shown in Figure 1:

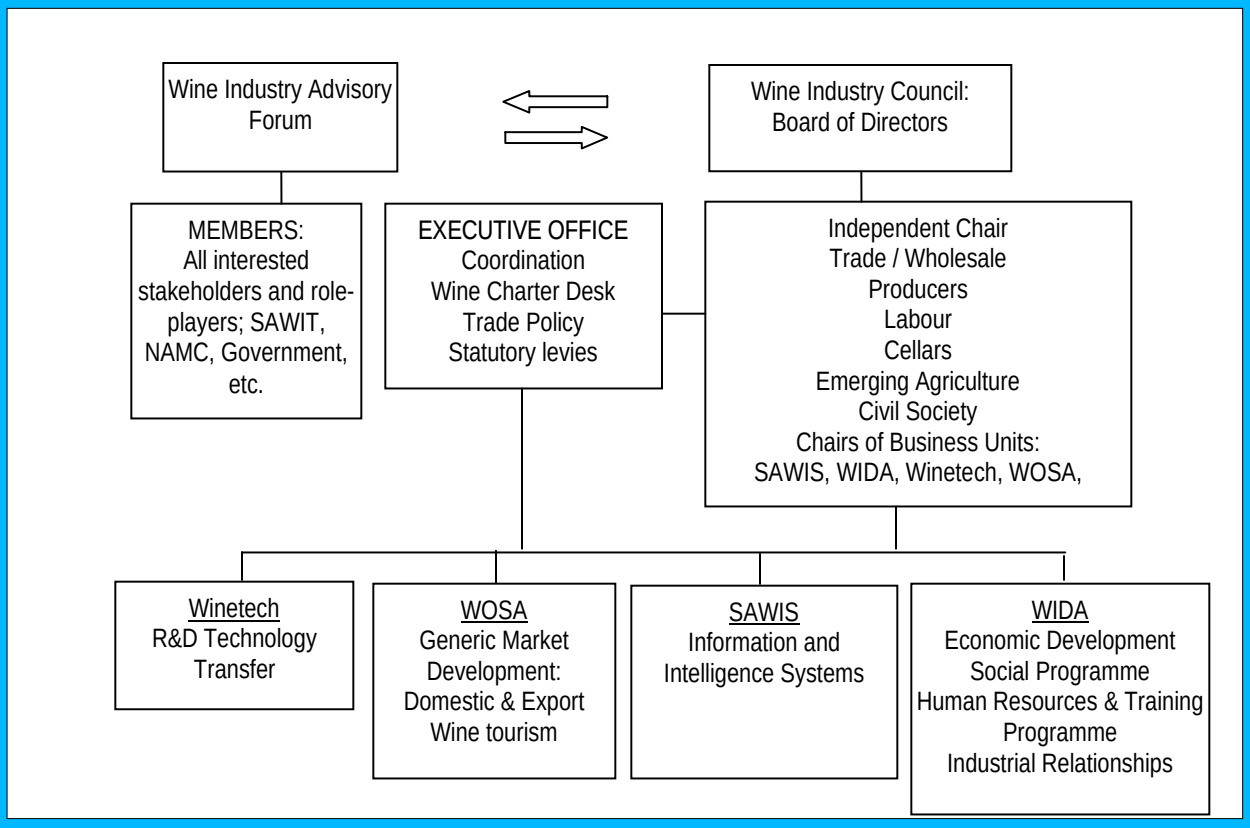

Figure 1: The organisational structure of The South African Wine Industry Council

2.4.2 The Wine and Spirit Board

This is a statutory body, independent from the SA Wine Council, reporting to government and funded by the industry. The Minister of Agriculture and Land Affairs appoints the Board and Chairperson. The focus of the Board is to administer the Wine of Origin System introduced by government in 1973. The Board also administers the Estate Brandy and Integrated Production of Wine (IPW) Schemes and advises the Department of Agriculture on technical issues

concerning liquor products. An information service regarding wine law is also provided to participants of schemes and other interested parties.

Tasting committees are nominated by the Board to judge the wines before the Board grants the official seal. Following wine producers' request that tasting be decentralised and performed by a Wine and Spirit Board tasting committee comprising members of a specific region, there are dedicated tasting committees for Robertson, Stellenbosch, Paarl, Worcester and Klein Karoo. When judging the soundness of wines, tasters look specifically for clarity, colour, aroma and taste.

2.4.3 The South African Wine Industry Trust (SAWIT):

The South African Wine Industry Trust (SAWIT) was established in 1999 as an arrangement between government and the KWV, the funding body. SAWIT focuses on the transformation of the industry, supports the establishment of new farmers from historically disadvantaged backgrounds, supports and uplifts farm workers and their communities in the wine industry and assists new wine grower entrants with marketing and access to related services.

This is accomplished through its Wine Industry Business Support Company (BUSCO), Wine Industry Development Company (DEVCO) and Wine Industry Empowerment Company (WIECO). The Trust guides these three companies to ensure that designated grants are used as set out in the Trust Deed. The Trust also supports the Wine Council.

These trustees are appointed and are accountable to the Minister of Agriculture

2.4.4 Other wine organisations and interest groups:

Government agencies directly involved in the wine industry include a number of provincial departments in the Western- and Northern Cape provinces, the National Department of Agriculture, The Department of Trade and Industry (dti), the Agricultural Research Council (ARC) at Nietvoorbij, the Council for Scientific and industrial Research (CSIR) and training activities at Elsenburg.

A large number of independent representative bodies is also active and focuses on particular wine interests – locally and internationally. For a comprehensive description of such bodies and groups, see the South African Wine Industry Directory (2007).

2.5 Environmental sustainability

Farm level production and cellar activities in the wine industry are directed to be environmentally sensitive through the Integrated Production of Wine Scheme (IPW). Participation levels are over 90%. A recent important initiative in this context (as referred to in 2.4.1.5) is a partnership between the wine

industry and the conservation sector i.e. the Biodiversity & Wine Initiative (BWI). The Codes of the BWI are included in the IPW.

Approximately 90% of wine production occurs within the Cape Floral Kingdom, the smallest yet richest plant kingdom on earth. The Cape Floral Kingdom is globally recognised as a biodiversity "hotspot" and holds World Heritage Site status, as a home to 9 700 plant species and tens of thousands of animal species.

Due to the rapid loss of natural habitat through urban development, agriculture, invading alien vegetation and frequent uncontrolled fires, only 8% of the original renosterveld and lowland fynbos ecosystems remain in the Western Cape. Many of these species are so specialised that they are commonly confined to one particular farm or patch of vegetation - and can be found nowhere else in the world. The climate, soil structure, plant and species diversity results in varying terroirs that reflect the biodiversity of the Cape's flora; the unique and phenomenal diversity of the Cape Floral Kingdom is therefore also partly responsible for the variety and unique flavours of South African wine.

Launched in 2004, the BWI operates at two levels on producer engagement: BWI members (entry level) and champions (exemplary level). Membership status requires that local producers make a commitment to conserve remaining priority natural habitats on their farms and to implement the programme's comprehensive biodiversity guidelines, as part of the industry's IPW scheme, the accreditation process is intended to ensure the ecologically sustainable production of wine.

"Championship status" is conferred only on exemplary producers who have made outstanding progress in the conservation or restoration of the natural habitat, wetlands and river systems on their property. They need to conserve at least 10% of the total farm area in terms of natural habitat set aside in a conservation agreement and develop a conservation management plan and demonstrate progress in implementing of this plan.

Progress to date: Since inception in 2004, the BWI has made excellent progress with industry uptake and commitment surpassing all expectations. To date, 108 of the Cape's wine producers have joined the Initiative and the area conserved collectively amongst all the members and champions (63 262ha as of January 2008) represents just over 63% of the 100 000ha vineyard footprint in the Cape Winelands. For every 2ha of planted vines, the Cape Winelands now has a further 1.5ha under conservation – a commendable achievement in just three years.

Many of the BWI members have incorporated biodiversity experiences into their visitor offerings with eco-tourism activities ranging from vineyard hiking trails, guided tours, biodiversity information centres, bird hides and the chance to see many indigenous plant and animal species now thriving on numerous wine estates. The BWI project has used various business strategies to incorporate the South African winelands unique biodiversity into a competitive advantage in the global market, providing the producer with a further incentive to conserve their natural areas and farm in an environmentally sensitive manner.

The first business strategy focused on integrating the biodiversity theme as a unique selling point and integral component of the South African wine industry's marketing message, by way of a campaign launched in 2006 entitled: "*Variety is in our nature*" (see www.varietyisinournature.com).

Furthermore, the project drives a demand for eco-friendly products by engaging with the retail sector and consumer to establish an awareness of the industry's environmental philosophy and thereby develop a demand for such products and access new niche markets. The producers are able to use their conservation efforts and achievements as a competitive advantage and unique selling point in order to differentiate their products in a globally oversold wine market.

The second key strategy focuses on incorporating the biodiversity theme into South African Wine Tourism through the development of biodiversity routes which tells the conservation story of each producer. The expansion of this category of wine tourism encourages producers to provide additional eco-tourism activities and product offerings, promoting BWI farms as eco-tourism destinations to attract eco-tourists, outdoor adventurers and general tourists along with the traditional wine lovers. The farms could then benefit from increased revenue and additional product offerings to supplement their income from wine sales.

The world's first Biodiversity Wine Route - the Green Mountain Eco-route in the Grabouw–Elgin region, was established under the auspices of this project in 2005 and provides the opportunity for both wine enthusiasts and nature-lovers to explore and enjoy the natural and cultural heritage of the Cape Winelands.

The industry's Integrated Production of Wine Scheme has been accepted by the OIV[4] as the guideline for international sustainable production for the global wine industry.

Future focus: The wine industry, through the IPW and BWI,[5] will continue to raise awareness and support for conservation within the winelands, growing the membership base and spearheading a process of continual improvement with existing members, to be audited on a biennial basis. The BWI's objective is to set aside 100,000ha or more in conservation by 2010.

2.6 Technology innovation, research and development

The long-term global competitiveness of the South African wine industry depends on its ability to learn and innovate faster than its competitors. This implies that the industry's research and technology development (R&TD) programme should be clearly focused on the kind of activities that hold the best promise in this respect. Research and technology development is one of the strategic programmes activated through the WIP.

The wine industry spends directly over R16 million or 0,001% of its contribution to the GDP on research and development. After taking the leveraged funds from the ARC and THRIP into account the total spend of its GDP contribution is 0,002%. This is far from the general norm of 2%.[6]

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[4] International Organisation of Wine and Vine, head quarters in Paris, France.
[5] For further information on the BWI or an updated list of participating wine producers, please see www.bwi.co.za.
[66] The National South African Research Development survey of 2003/2004, puts the gross expenditure on R&D (GERD) at R10,1 billion which translates to ~0,81% of GDP. Korea and Germany maintains a high level of investment in Research and Development, spending respectively 3% and 2.5% of GDP. Australia spent 1,5% of GDP and Brazil 1,1% of GDP.

The South African wine industry clearly needs to mobilise a larger spend on research and technology in order to:

- remain internationally competitive
- leverage matching funds from government (THRIP, ARC) (see Table 2)
- sustain and expand capacities at institutions like the ARC and universities
- sustain economically viable production and in particular enable the historically disadvantaged people to gain access to viable economic opportunities

The major R&D programmes supported through a statutory levy of R13 500 000 (2007) are: viticulture, oenology, technology transfer and scientific training. In total, R29 423 425 (2007) was spent on wine industry R&D projects.

2.6.1 Funding cuts

Proposed Funding cuts are currently implying a dramatic reduction in R & D expenditure in the wine industry. Consider the following:

- The South African Wine Industry Trust (SAWIT) has funded much less during 2006 and 2007 than the long-term agreement proposed; for the present funding has been suspended. This is a serious matter for Winetech from a funding and possible leverage viewpoint.

- THRIP, through the Department of Trade and Industry as managed by the National Research Foundation, has classified Winetech as a “large company” which implies that for every R3 spent by Winetech on a THRIP approved project THRIP now contributes R1, while the funding ratio in the past was 1:1. This has a considerable impact on how much Winetech can leverage for its research partners and this will consequently have a negative effect on the wine industry as a whole.

- Winetech considers this classification as a “large company” as unfortunate, as Winetech is an administrative association and not a business enterprise and functions as a small institution (operational budget less than R2 million per annum) coordinating a broad-based enterprise network which ultimately benefits a number of large, medium and small businesses in the wine industry.

- Winetech estimates that about 50% of current technology development and transfer activities will be affected, and no new project is able to be introduced over the next few years. One of the many negative impacts of a reduction in planned research activities will be the reduced employment of young researchers, in particular young black scientists recently trained by the Winetech system.

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Table 2. Wine Industry research funds

SUMMARY OF WINETECH FUNDING/LEVERAGE										
YEARS	FUNDING					LEVERAGE				TOTAL ACTUAL
	STAT. LEVY	SAWIT		Western Cape Department of Agriculture	TOTAL FUNDING	THRIP		ARC	TOTAL LEVERAGE	
		Long-term Agreement	Actual			Budget	Actual			
1999	8789007	3800967	3800967		12589974	1949320	1949320		1949320	**14539294**
2000	8164006	3684210	3684210		11848216	2346949	2346949	4642772	6989721	**18837937**
2001	8199792	2720558	2720558		10920350	2676047	2676047	8665580	11341627	**22261977**
2002	8674867	4451696	4451696		13126563	4242758	4242758	9178859	13421617	**26548180**
2003	9038593	5379655	5379655	500000	14918248	4822832	4822832	8056244	12879076	**27797324**
2004	12010995	5531447	5531447	500000	18042442	4469172	4469172	8872922	13342094	**31384536**
2005	13059090	6025633	6025633	500000	19584723	7147941	5366333	6258427	11624760	**31209483**
2006	13500000	7010000	3203247		16703247	7484896	6544478	7783349	14327827	**31031074**
2007	13500000	7950000	3131579		16631579	8007870	7771831	5020015	12791846	**29423425**
2008	13500000	8500000	n/a		13500000		n/a		n/a	**13500000**
2009	13500000	5060000	n/a		13500000		n/a		n/a	**13500000**
TOTAL	**121936350**	**60114166**	**37928992**	**1500000**	**161365342**	**43147785**	**40189720**	**58478168**	**98667888**	

n/a: Not available

2.7 Wine industry information and intelligence systems

Comprehensive wine industry statistics and business intelligence are kept by the South African Wine Industry Information Systems (SAWIS), the responsible industry business unit. Regular reports are provided and a library service is available. Industry information gathering is supported by the statutory inspection services on wine farms and cellars.

Recent additions to wine industry information and intelligence systems are the use of the PROVIDE Social Accounting Matrix (PROVIDE – SAM), housed in the Western Cape Department of Agriculture, and the Bureau of Food and Agriculture Policy Analysis (BFAB), a programme supported by Winetech and SAWIS, housed at the Universities of Stellenbosch and Pretoria. The Wine Foresight[7] project was recently approved by the SA Wine Council and will be implemented by SAWIS and Winetech. The establishment of a "Centre for Wine Marketing and Product Development" is being considered by the University of Stellenbosch with the full support of The South African Wine Industry Council.

2.8 Industry levies and funding

The wine industry applies statutory levies, granted by the Marketing of Agricultural Products Act, to collect funds from all the participants in the industry. The current statutory levy amounts to R45 million (2007) per annum which is paid by wine grape producers, wine producers and wine merchants and is directed by the SA Wine Council with the full approval of the Minister of Agriculture and Land Affairs The funds are used for industry information systems, export promotion, transformation support and research and technology development. At least 20% of the levies (R9 million) is directed to transformation and BEE initiative.

Voluntary levies are collected from the industry for the promotion of responsible alcohol use and for the introduction and maintenance of the electronic Wine-Online Scheme, supporting wine exports. The Wine and Spirit Board with the Wine of Origin scheme and the Integrated Production of Wine Scheme is funded through a "user pay" system.

The South African Wine Industry Trust (SAWIT) contributes to certain activities of the SA Wine Council. SETAs and other government departments (The dti, Department of Science and Technology, Department of Agriculture) also support the Wine Council and its business units.

[7] An integrated wine information system, serving all stakeholders in the value chain.

3 ECONOMIC BENCHMARKING

3.1 Overview

The primary aim of this section is to provide a benchmark of profitability in the South African wine industry, focussed on primary producers of wine grapes and producer cellars. Information on non-producer cellars was not readily accessible and has therefore only been included in the broader international overview.

A secondary aim is to provide a brief comparison of the local industry to the international industry. A survey of the Australian wine industry is used as a benchmark in this regard.

The use of industry averages throughout this section, while illuminating, can be misleading. The key reason is that in any industry and at any one time there are both profitable businesses and businesses heading for bankruptcy. The average therefore tends to provide a composite profile in which relatively few businesses actually operate. A snapshot of underlying profitability can also vary dramatically from year to year ; it is essential therefore to also look at trends.

As will be seen, this section confirms an industry trend ending with the current low levels of profitability - at both the primary producer and winery levels. A comparison to the Australian wine industry reveals a similar state of financial profitability.

3.1.1 Profitability at the primary producer level:

The section is largely based on the VinPro/Winetech producer surveys which extract information from a sample of primary grape producers on an annual basis[8]. The survey covers all nine wine producing regions in South Africa[9]. The Malmesbury region is predominantly rain fed with abnormal cost structures and has been excluded from the averages. The survey of the 2007 harvest includes 205 participants with average farm size of 76 hectares. The typical age profile of vineyards was as follows: < 3 years (15.2%); 4-7 years (27.7%); 8-15 years (35%); 16-20 years (13.7%); >25 years (11%).

As observed, averages hide substantial variations between regions. The most important variations that influence profitability include the characteristics of the different geographical areas; size of units (economies of scale); tonne per hectare produced; the age and composition of cultivars and the split between red and white wine; and very importantly the influence illustrated in the results of producing for a specific market and specific “price point”. It should

[8] See www.vinpro.co.za. Information provided by Gert van Wyk, VinPro Agricultural Economist.
[9] Klein Karoo; Robertson; Worcester; Breedekloof; Olifants River; Orange River; Paarl; Stellenbosch and Malmesbury (dryland).

also be noted that the study group probably focuses on the top third of producers with above average management and technical skills.

Standard financial statements and ratios are used as a basis to benchmark profitability. While information was readily available on the operating side of the businesses, certain assumptions had to be made regarding depreciation, interest, tax and the balance sheet as a whole.[10] An average income statement and balance sheet expressed on a per hectare basis for an average producer of wine grapes is set out in Table 3.

The three most important components of profitability at the primary level are: price per tonne, yield per hectare and cost per hectare. The price of red wine grapes has decreased dramatically over the past 3 years. White wine prices have remained relatively stable (see Figure 2). In contrast, whilst direct costs have remained relatively stable, all other cost categories have increased year on year (see Figure 2). This has resulted in the fairly substantial decrease in all levels of profitability as illustrated in figures 4. The biggest drop occurred between 2004 to 2005. The situation worsened gradually thereafter resulting in primary producers of wine grapes (on average) currently being under severe financial pressure. Over this brief period the net profit for an average farm of 76ha decreased from R485 000 to R21 000 per year.

A relatively conservative debt ratio of 33% was assumed. A higher ratio would imply higher interest cost and an even lower net profit (possibly loss).

Return on investment (ROI) has decreased from 12% (2004) to levels of around 5%. Return on equity (ROE) has decreased from around 8% (2004) to levels of below 1%. These ratios are obviously directly influenced by the balance sheet assumptions made earlier.

[10] The most important assumptions include: **Income statement:** NPAT does not include remuneration to the owner; interest on liabilities at 12,5%; tax at 29%;
Balance sheet: Assets assumed to equal replacement cost of vineyards, movables & buildings; note: cost of land not included; liabilities assumed to = 33% of assets.

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Table 3. Financial statements for average primary grape producer (per hectare)

INCOME STATEMENT	2004	2005	2006	2007
Average price per tonne (Rand)	2 382.61	1 916.17	1 762.91	1 766.00
Average yield per hectare (tonnes)	13.11	13.79	15.34	15.58
INCOME	31 236	26 424	27 043	27 514
Direct costs	2 459	2 426	2 391	2 482
Labour	6 317	6 590	6 878	6 949
Other overheads	5 445	5 994	6 330	6 586
EBITDA	17 015	11 414	11 444	11 497
Provision for replacement	4 779	5 633	5 733	6 108
EBIT	12 236	5 781	5 711	5 389
Interest paid	4 205	4 474	4 617	4 992
EBT	8 031	1 307	1 094	397
Tax	2 329	379	317	115
NPAT	5 702	928	777	282
Average farm size (ha)	85	73	75	76
Net profit per average farm	484 683	67 732	58 280	21 422

BALANCE SHEET SUMMARY	2004	2005	2006	2007
Total assets	101 935	108 465	111 917	121 025
Total equity	68 296	72 672	74 984	81 087
Total liabilities	33 639	35 793	36 933	39 938

RATIOS				
EBITDA profit margin	54.5%	43.2%	42.3%	41.8%
EBIT profit margin (operating)	39.2%	21.9%	21.1%	19.6%
Net profit margin	18.3%	3.5%	2.9%	1.0%
ROI / ROA (EBIT/Assets)	12.0%	5.3%	5.1%	4.5%
ROE (N/Equity)	8.3%	1.3%	1.0%	0.3%
Total debt to equity ratio	49.3%	49.3%	49.3%	49.3%
Debt ratio	33.0%	33.0%	33.0%	33.0%

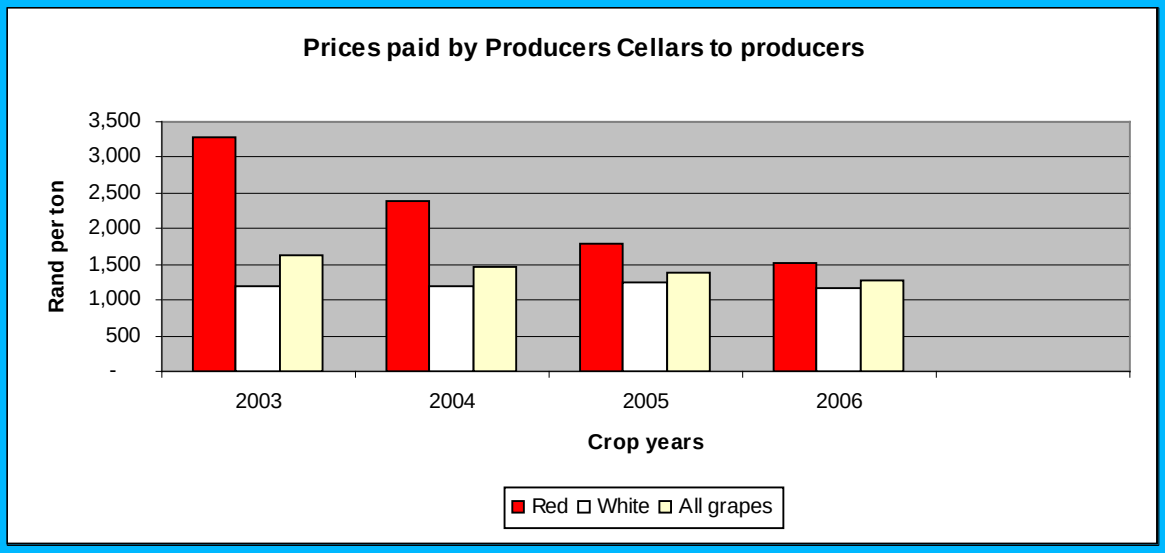

Figure 2: Grape prices per tonne

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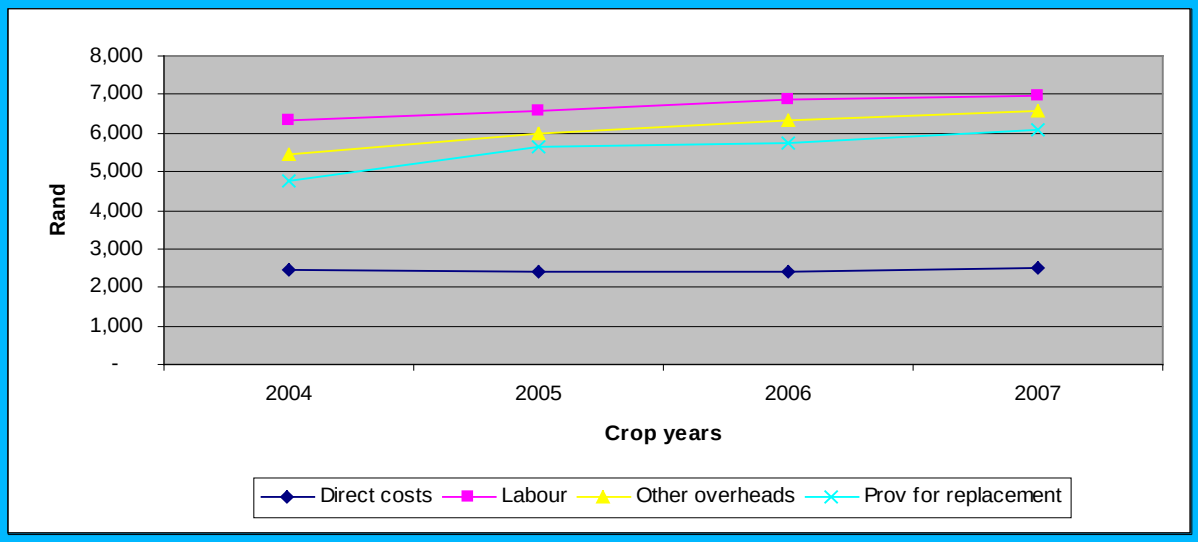

Figure 3: Cost trends

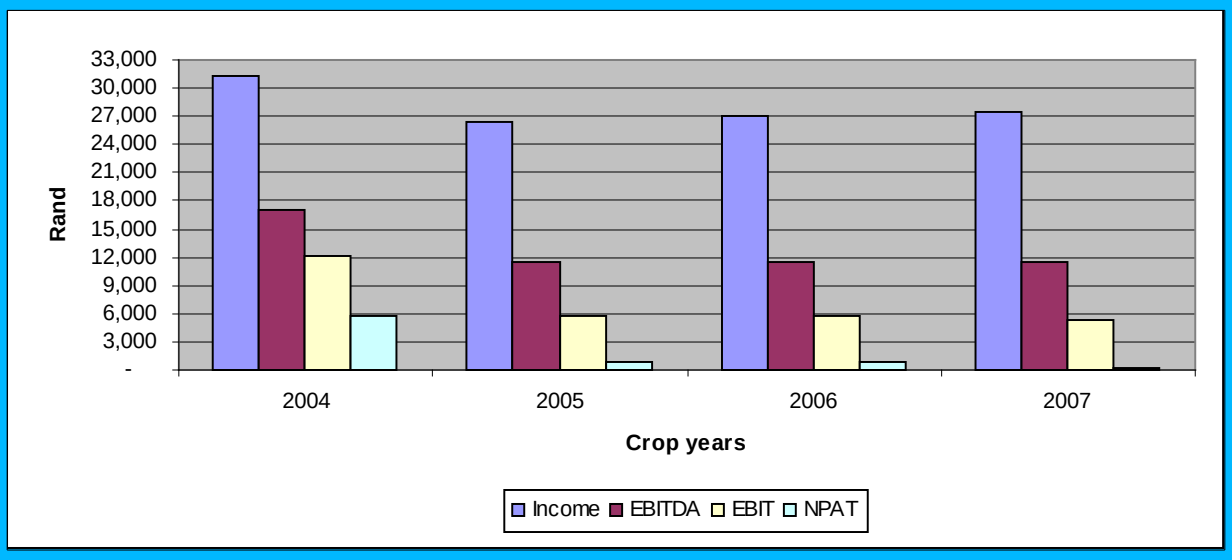

Figure 4: Profitability indicators

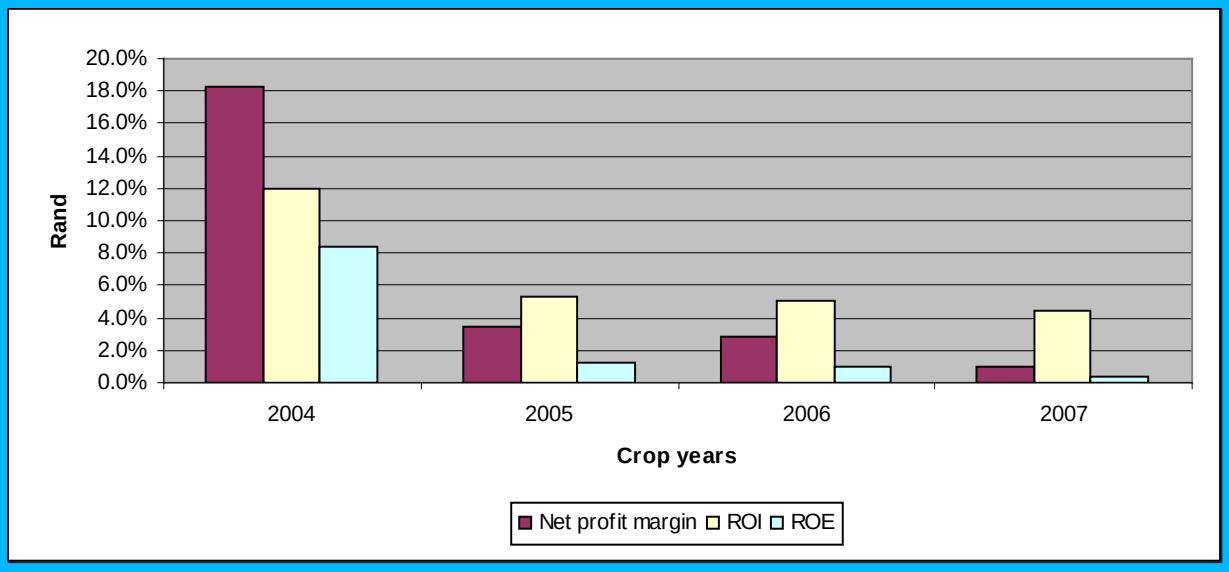

Figure 5: **Profitability ratios**

3.1.2 Producer Cellars:

PriceWaterhouseCoopers (PWC) carries out a detailed annual survey of the profitability of Producer Cellars in South Africa[11]. The survey is comprehensive in that 54 producer cellars participated (2005) representing 93% of cellars and around 73% of the total wine grapes pressed in South Africa.

Note that most of these cellars are cooperatives (or operate on cooperative principles) and do not therefore necessarily strive for internal profit maximisation but rather try and maximise returns to their primary producer members. Any lack of profitability in this segment should therefore be reflected in improved profitability at producer level. The main performance drivers for cellar profitability include: volume; litres recovered per tonne; the effect of international markets on prices; and the management of inventory as this is generally the largest asset on the balance sheet.

A summary of the financial statements and ratios for an average producers' cellar is shown in Table 4. Sales have remained relatively constant over the four years. The worsening financial position in the industry is reflected in the decrease in the earnings before interest and tax (EBIT) from around 2.5% in 2003 to less than 1% in 2006. The decrease in earnings before tax (EBT) is even more pronounced given the very high debt structure and related fixed interest obligations of the average cooperative (see Figure 6). Debt ratios are generally above 70% with only 30% of the capital coming from own contributions. The net profit after tax (NPAT) of around R1 million (margin of 2%) in 2003 and 2004 decreased to R500 000 in 2005 and under R100 000 in 2006 (profit margin of 0.2%).

[11] Information obtained from PWC surveys covering 2003; 2004; 2005 and 2006 (provisional).

The ROI dropped from a relatively acceptable 6.3% on 2003 to close to 0% in 2006. The ROE likewise dropped from 9.4% to 0,5% (see Figure 7).

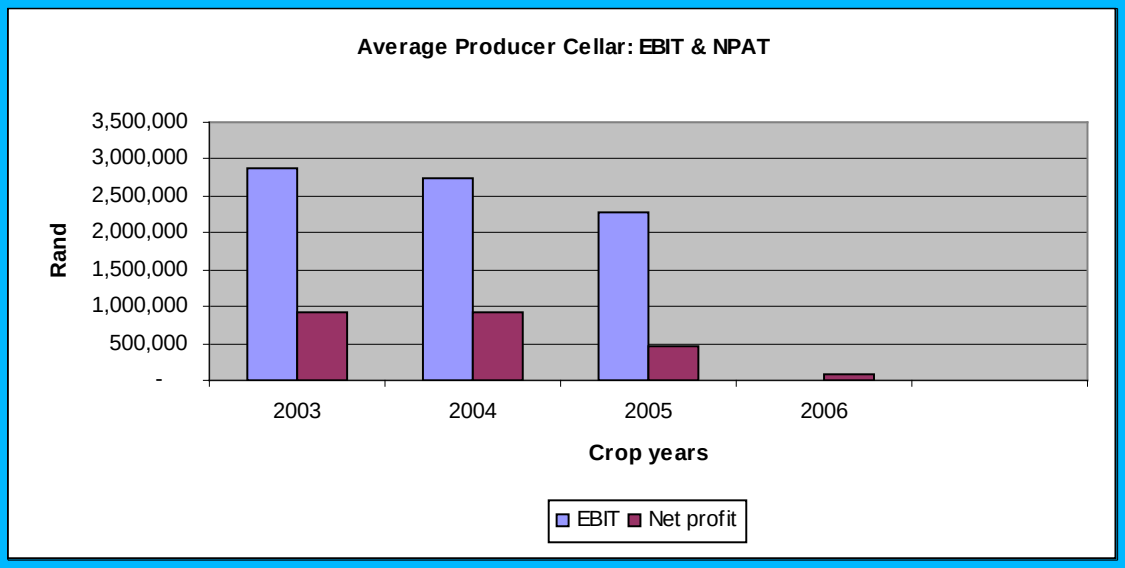

Figure 6: Average producer cellar earnings before interest and tax (EBIT) and net profit after tax (NPAT)

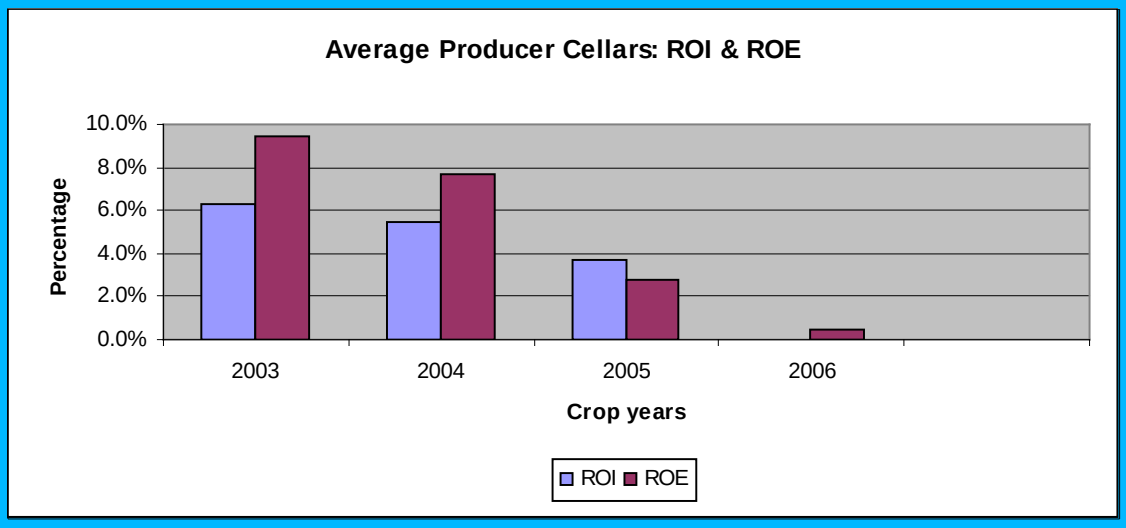

Figure 7: Average producer cellar return on investment (ROI) and return on equity (ROE)

3.1.3 South Africa / Australia benchmarking comparison:

Deloitte completed a financial benchmarking study for South African wineries during 2004 and 2005[12]. This appears to include producer and non producer wineries. The study was based on a similar initiative between Deloitte and the Winemakers' Federation of Australia that has been completed for the past 8 years[13]. The results are therefore directly comparable and can be used to provide an indication of

[12] See Deloitte: Winning strategies in the wine industry, 2004 and wine survey results 2005.
[13] See Deloitte: Annual financial benchmarking survey for the Australian wine industry

profitability between South African and Australian wineries. The results should nevertheless be used with the usual caution given the lack of information on the sample group, the effect of averages over a highly diverse industry and so forth. The South African sample was divided into two groupings namely wineries with a turnover less than R25 million and those greater than R25 million. This report only looks at the results for the wineries with turnovers of less than R25 million.

A summary of the most important ratios and graphs are set out below (see Table 4 and Figures 8 & 9). The ratios indicate that Australian wineries were subjected to major financial stress during the 2006 vintage. In general, the overall cost and profitability structure seems similar between the two countries, though it could be argued that South Africa's cost structures (cost of goods sold (COGS) and overheads) appear slightly higher. While the EBIT and NPAT margins change quite sharply from year to year there is no specific trend favouring either country. The same argument holds for the balance sheet structure and debt levels.

It would appear that there are ultimately few significant differences in the levels of profitability between the South African and Australian wine industries and the trends prevailing in each country.

Table 4: South African versus Australian wine

RATIO ANALYSIS AND COMPARISON						
	SOUTH AFRICA			**AUSTALIA**		
	< R25 million revenue			**< R25 million revenue**		
Year	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**
Revenue	100.0%	100.0%	Not available	100.0%	100.0%	100.0%
Cost of goods sold (COGS)	57.9%	64.0%		54.3%	50.3%	71.1%
Gross margin	**42.1%**	**36.0%**		**45.7%**	**49.7%**	**28.9%**
Overheads	38.8%	25.3%		36.3%	41.7%	34.1%
EBIT	**3.3%**	**10.7%**		**9.4%**	**8.0%**	**-5.2%**
Less interest + other income	6.9%	1.5%		1.4%	5.3%	-4.5%
EBT	**-3.6%**	**9.2%**		**8.0%**	**2.7%**	**-0.7%**
Tax	0.0%	2.7%		2.3%	0.8%	0.0%
NPAT	**-3.6%**	**6.5%**		**5.7%**	**1.9%**	**-0.7%**
Current ratio	244.0%	442.0%		320.0%	322.0%	331.0%
Debt to Equity ratio	96.0%	76.0%		62.0%	85.0%	145.0%
Debt to total tangible assets	43.0%	35.0%		39.0%	38.0%	43.0%
Total Debt to Equity ratio	124.9%	84.5%		115.1%	128.8%	253.4%
Debt ratio	55.6%	45.8%		53.5%	56.3%	71.7%
Own capital ratio	44.5%	54.2%		46.5%	43.7%	28.3%

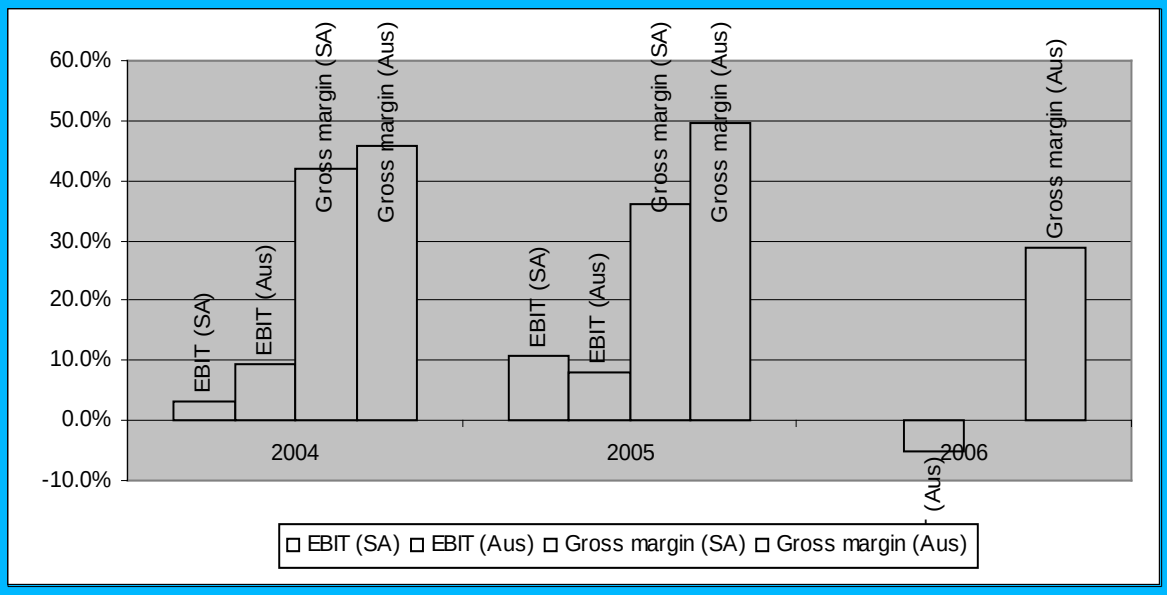

Figure 8: **Australia / South Africa income statement comparison**

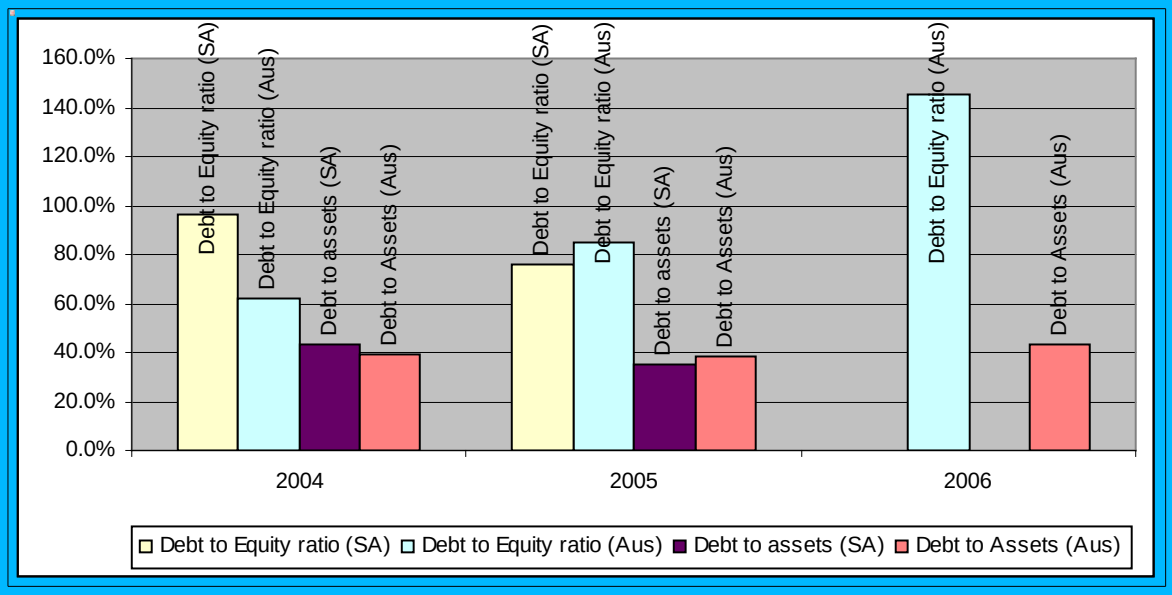

Figure 9 : Australia / South Africa comparison of profitability ratios

3.2 Investment growth and industry expansion

3.2.1 Investment:

South Africa keeps no official disaggregated data on foreign direct investment, and it is difficult to establish the extent of investment on a sub-sector level directly. So, for example, while it is possible to establish the extent of investment in a sector such as agriculture, it is almost impossible to do so for a sub-sector such as the wine industry. For this reason, indirect

indicators of levels of investment are required. The basic data for such an exercise in the wine industry are provided in Table 5. These are interpreted with the help of Figures 10,11 and 12. In this regard, Figure 9 shows the main trends in producer income over the past decade.

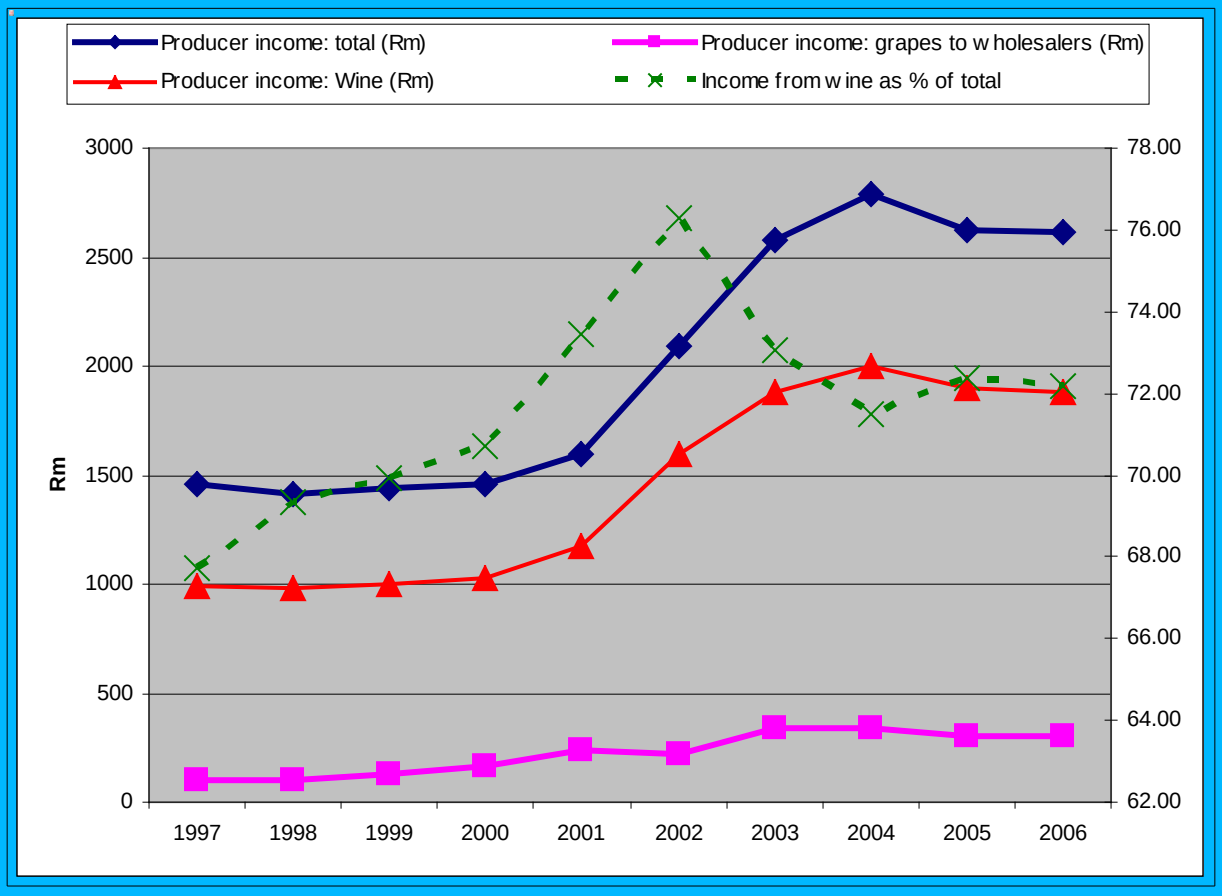

Figure 10: Trends in producer income, 1997-2006

These data show the influence of export expansion and, more importantly, the exchange rate, on producer income over the decade. Total nominal income almost doubled from R1 463 million in 1997 to R2 791 million in 2004 (left hand scale in Figure 10). Thereafter, producer income declined in both subsequent years. Figure 10 also shows that the share of this income from wine (as opposed to grapes, grape juice and wine for distilling purposes) reached its peak in 2002 (right hand scale) i.e. when the Rand was at its lowest.

The nature of the expansion in the wine industry can also be illustrated with regard to Figure 11, which shows the number of wineries in the industry by size. It is estimated that an additional 170 (mostly small cellars) were established since 2006. What is most evident is that the substantial increase in the number of wine cellars in the industry (an increase of 279 cellars over the 10 years, or more than 2 cellars per month - indications are that more than 200 new cellars have been opened since 2006) has been almost entirely in the categories of less than 100 tonne pressed (measured on the left hand axis). The data show that 203 of the 281 new wine cellars fell within this category. A further 61 new cellars fell within the 101-500 tonne (measured on the right hand axis) category.

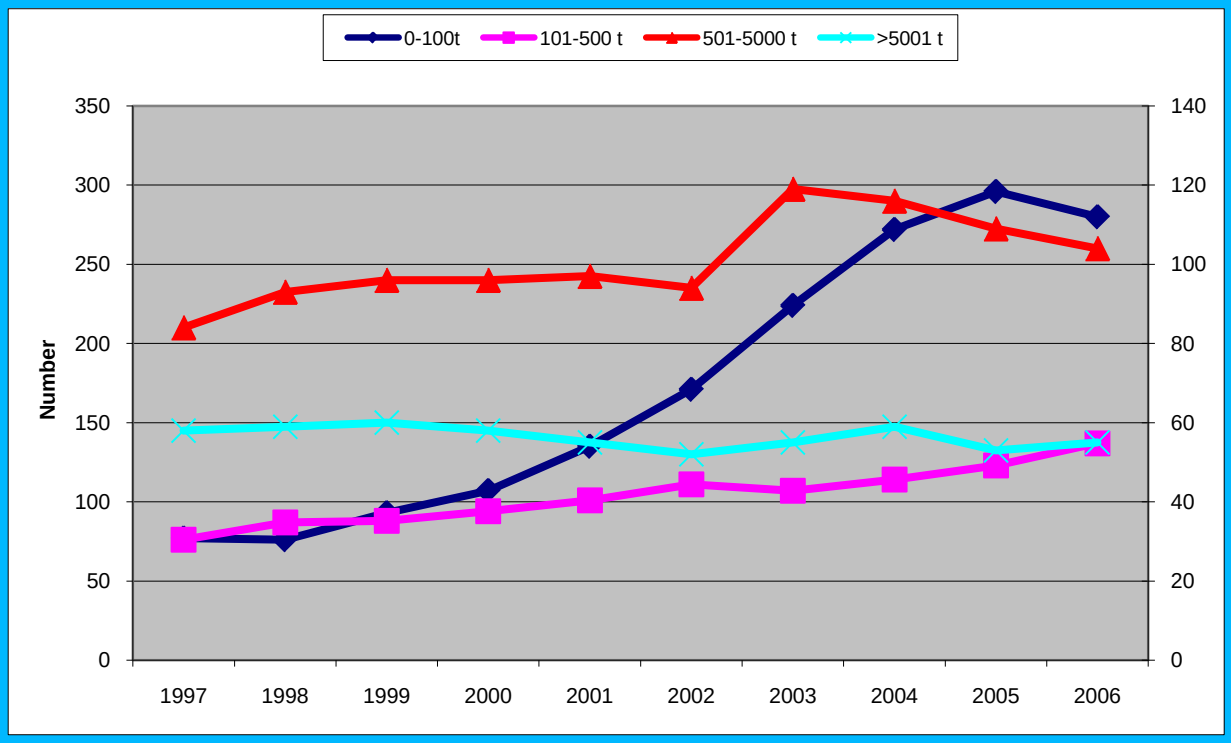

Figure 11: **New wine cellars in South Africa, 1997 - 2006**

Nonetheless, accepting that most new cellars are small, the scale of the addition to the processing capacity of the industry is impressive. Furthermore, the smaller size of the new cellars is because most have been built on wine farms, i.e. they fall into the category of private cellars rather than producer cellars (the former wine cooperatives) and also producing wholesalers.

Finally, Figure 12 shows the age composition of the vines. The figure indicates that the major investment flush in new grape-growing capacity peaked in 2000 - five years before the peak in the creation of new cellars; the lag conforms to expectations.

The data confirm the well-known fact that the wine industry reached a peak expressed variously: in terms of exports, production capacity (and hence investment), and growth, all at the time that the Rand fell to its lowest value against the US$. The fact that the decline that followed was not steeper can be ascribed to the slow recovery of the Rand against the Euro and Pound Sterling, especially as the UK and the rest of Europe constitute the largest export markets for South African wine.

An interesting observation on investment flows concerns internationally based investments in wine production, tourism and hospitality in the winelands. Groups such as Hess International, Lanoche, Constilation, Gallo, Cointreau, Vilafonte, to name a few are prominent in this context.

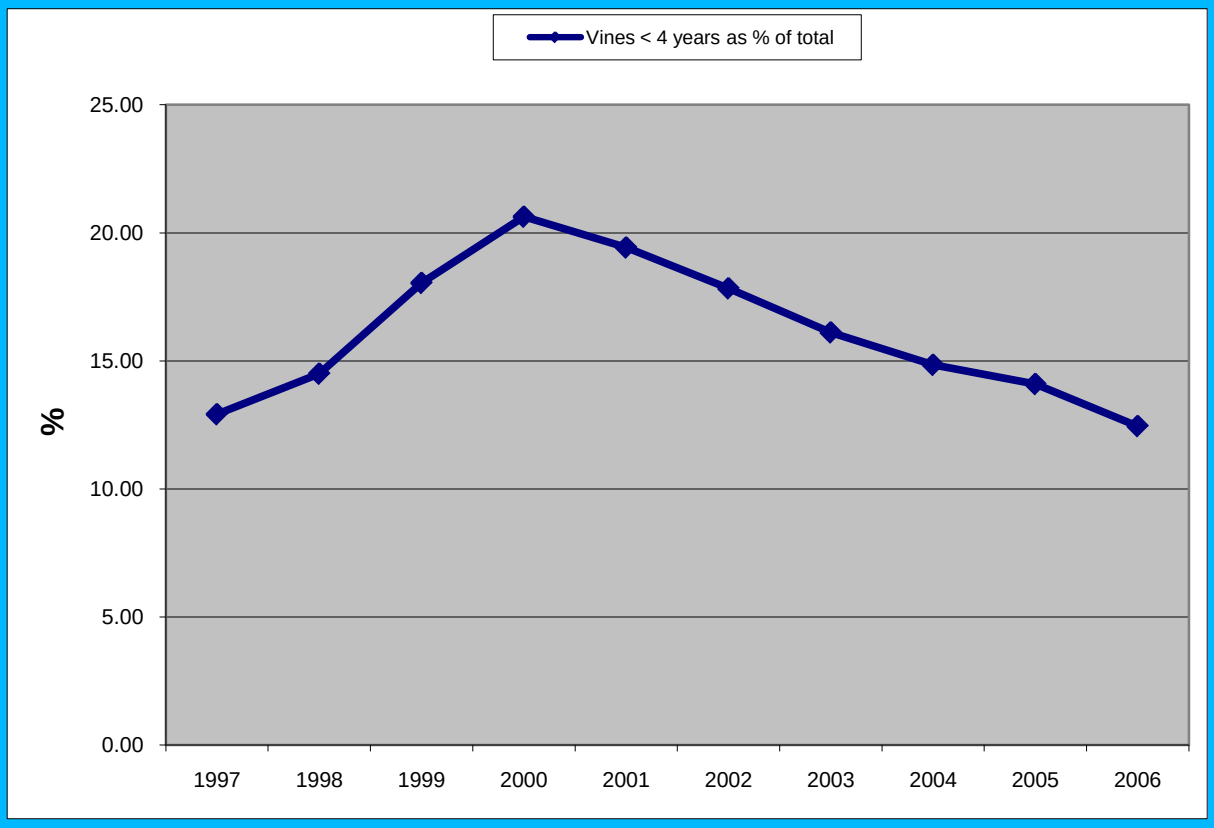

Figure 12: The age composition of vines in South Africa, 1997-2006

3.2.2 Value adding multipliers and linkages:

Error! Reference source not found.Table 5[14] contains the monetary values of each successive stage of the value adding process of wine making to selling for 2003. The data show that total turnover amounted to R10 675.27 million, based on a primary production base of R2 597.44 million, indicating an industry contribution that was some 4 times the initial value of the raw materials produced in the vineyards.

[14] Table 5 comes from Conningarth Economists, 2004. The macro-economic impact of the wine industry on the Western Cape. Paarl, SAWIS

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Table 5 : Basic trends in the South African wine industry, 1997 – 2006

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Producer cellars (number)	69	69	69	69	67	66	66	66	65	65
Private cellars (number)	218	237	260	277	310	349	423	477	516	494
Producing wholesalers (number)	8	9	8	9	11	13	16	18	21	17
Total wineries (number)	295	315	337	355	388	428	505	561	581	576
Total vine area (ha)	87301	89935	92601	93656	94412	96233	98605	100207	101607	102146
Vines 4 years and older (ha)	76025	76895	75892	74335	76071	79073	82719	85331	87284	89426
Vines younger than 4 years (ha)	11276	13040	16709	19321	18341	17160	15886	14876	14323	12720
Vines < 4 years as % of total	12.92	14.50	18.04	20.63	19.43	17.83	16.11	14.85	14.10	12.45
Total production (million litres)	881	816	914	837	747	834	956	1016	905	1013
Wine production (million litres)	547	544	596	540	530	567	713	697	629	710
Good wine as % of total wine	62.09	66.67	65.21	64.52	70.95	67.99	74.58	68.60	69.50	70.09
Domestic sales (million litres)	402	385	391	389	390	388	349	351	345	345
Proportion of total (%)	45.63	47.18	42.78	46.48	52.21	46.52	36.51	34.55	38.12	34.06
Exports (million litres)	111	118	129	141	177	218	239	268	282	272
Proportion of total (%)	12.60	14.46	14.11	16.85	23.69	26.14	25.00	26.38	31.16	26.85
Producer income: total (Rm)	1463	1413	1436	1458	1596	2089	2576	2791	2626	2611
Producer income: grapes to wholesalers (Rm)	98	103	124	165	236	219	341	344	306	299
Producer income: Wine (Rm)	991	980	1004	1031	1172	1594	1882	1996	1901	1884
Income from wine as % of total	67.74	69.36	69.92	70.71	73.43	76.30	73.06	71.52	72.39	72.16
Cellars that crush 1-100 t of grapes (number)	77	76	93	107	135	171	224	272	296	280
Cellars that crush 101-500 t of grapes (number)	76	87	88	94	101	111	107	114	123	137
Cellars that crush 500-1000 t of grapes (number)	32	42	42	37	44	38	50	56	50	41
Cellars that crush 1000-5000 t of grapes (number)	52	51	54	59	53	56	69	60	59	63
Cellars that crush 5000-10000 t of grapes (number)	19	26	20	24	26	24	19	21	20	20
Cellars that crush >10000 to of grapes (number)	39	33	40	34	29	28	36	38	33	35
% of cellars that crush <100 tonne pa	26	24	28	30	35	40	44	49	51	49

Source: Conningarth Economists, 2004. The macroeconomic impact of the wine industry on the Western Cape. Paarl, SAWIS

3.3 Market and export development

South African wines experienced a considerable growth in exports over the past decade: 110.04 million litres in 1997 – 271.62 million litres in 2006. Substantial value increases were also recorded (R2.5 billion in 1997 – R3.58 billion in 2006). The UK (30.4%), Germany (15.4%) and the Netherlands (13.7%) are the biggest exporting destinations.

Market development in the South African wine industry is the responsibility of Wines of South Africa (WOSA), a Section 21 Company affiliated to the South African Wine Industry Council. It counts some 300 wine exporters among its members. During a recent strategic review, agreement was reached on the following definition of success for WOSA:

"The South African wine industry will be a success when its reputation and trading skills result in it selling annual production at a profit to involved customers across a spread of markets, enabling the industry to renew infrastructure and deliver transformational benefits to all those involved in wine."[15]

The report goes on to state that:

"During consultations with industry participants, there appears to be a negative reaction to the idea that a proactive management of supply and demand should be conducted at a "national" level. There appears to be a preference for a more "Darwinian" approach; individual brand owners preferring to develop their brands alongside the overall Wine Brand South Africa work done by WOSA.

Furthermore, the researchers found that "South Africa has a natural brake on volume expansion by nature of its land… This allows the industry to concentrate on … the growth of profitable sales. South Africa trades across the whole range of vinous product, from distilling wine to ultra premium wine and will continue to do so. Profit optimisation will come from the holy mix of full overhead recovery and improved margins from increased selling prices. Typically this is achieved by product improvement, better selling efforts and the enhancement of reputation."

The researchers also investigated the perception that there is a debate within the industry about the role of WOSA in the overall effort of the country's export effort, but found that this was largely based on misconceptions about the role of WOSA and the public perception of its successes and failures. To this end it was the recommended that WOSA should not get involved in or associated with sales predictions or targets, which only set the industry up for unproductive criticism. The primary role for WOSA should rather be to build up a positive image for South African wine.

Furthermore, they recommended that WOSA move to a rolling three year planning system by export market, which would serve to clarify the debate over the relative importance of markets. They also found that South Africa as an industry, and WOSA as a body do not invest the correct level of funds required to do the job, and that the "Variety is in our nature" positioning is an ideal strategy for South

[15] Wineprophet, SARL, 2007. Strategic review for WOSA, Stellenbosch. Unpublished mimeo.

Africa, playing to the true strength of the industry: in one tiny area the country has as many site, soil and climate aspects as *half* the European wine countries put together.

As the report states:

“You lead the world in production integrity. Your wines have the great taste of vibrant individuality that comes from the nature of your producing areas. Although a niche player in volume terms you nonetheless can be the thinking person's favourite new world wine country by a clear margin. South African wine can be far more interesting and thus entertaining; not by virtue of manufactured advertising but by proudly *selling* your wine strengths to the world and telling the stories that go with the wines.

Some of the big brand owners *feel* that the positioning is hard to communicate in a simple form in the less expensive wine sector. We believe that "Variety is in our nature" message is sufficiently broad to work for both premium and mass brands, and can, for example, encompass describing SA wine as "Magic wines from a magic place" or similar. All industry participants seem keen to position SA wines as being from a special place.

It is worth remembering that for most people, the South African proposition is still simply inexpensive varietal wine in modern packaging, with no particular heritage. Most people choose wine from the shelf in front of them, and this is mostly what they see from South Africa.”

3.4 Wine Tourism

Wine tourism or the promotion of tourism by the wine industry has existed, at least on an informal basis, since the Stellenbosch Wine Route was founded in 1971. With this initiative wine producers in the Stellenbosch environment opened up their facilities to viewing, tasting and visiting. The right to sell wine was also obtained. Since then nineteen different wine regions have developed their own “routes,” the names and contact points of which are attached as Annexure 2.

It has to be mentioned that the whole wine producing area has contributed to destination marketing – lifestyle, facilities, knowledge and ambience - which was developed with little guidance from the wine authorities, and can compete favourably with any wine area in the world. Wine tourism as an activity within tourism generally, has been strong and well organised within the industry for the last 30 years, with many added facilities to compliment the tasting experience, e.g. accommodation, restaurants, art exhibits and outdoor activities.

It is generally accepted that the wine industry is not maximising its tourism opportunities, and indeed the tourism industry is not maximising what the wine industry has to offer.

The regional initiatives such as various wine shows, competitions and festivals add to the development of an attractive destination.

3.4.1 Industry structure:

In 2004 the then SA Wine & Brandy Company (today the SA Wine Council), established a Wine Tourism Steering Committee. The focus of this Committee was to link the various wine tourism initiatives and determine a strategic plan of action. The following stakeholders participated in this initiative:

- SA Tourism
- Cape Town Routes Unlimited (CTRU)
- SA Wine Council
- SAWIT
- WOSA
- Various municipalities
- Individual wine routes
- Product owners

A central Wine Tourism Forum was proposed to oversee the implementation of tourism development as suggested by Cape Town Routes Unlimited [CTRU]. But to date no such central body has been established. Following the establishment of the SA Wine Council in 2006 wine tourism was delegated to WOSA., under whose guidance the wine routes continue to meet and confer regularly.

WOSA has recently made moves to coordinate and consolidate all the different wine tourism initiatives in the Winelands. Up until this development the wine authorities, although officially recognising wine tourism had not developed an official strategy, apart from one that was compiled for the shared Wine Tourism Forum by the CTRU. The process never got started largely due to funding constraints.

It also has to be mentioned that the Cape Winelands District Municipality (CWDM) has developed certain initiatives in collaboration with the Great Wine Capitals of the World movement, putting Cape Town and the South African wine region on a pedestal with “wine cities” like Bordeaux, Florence, San Francisco and Melbourne. WOSA plays an active role in assisting the CWDM.

3.4.2 Current wine tourism activities by the industry:

The following indicates the extent and breadth of the activities currently being undertaken to promote wine based tourism:

- Regular speeches at conferences and expositions.
- Hosting lifestyle journalists.
- Interviews with researchers.
- WOSA’s cooperation with the South African Wine Routes.

- The website www.varietyisinournature.com was established with the focus on regional biodiversity experiences, eco tourism and for the individual wine regions to promote their unique natural diversity.
- Interviews with international travel channels.
- Assisting major wine tourism publications.
- Using Cape Wine, the industry's showcase, as a wine tourism marketing vehicle.
- Involvement in the Great Wine Capitals Global Network.
- Involvement in the Best of Wine Tourism competition.

3.4.3 Towards a wine tourism strategy:

From the 2005 Wine Tourism Strategic Plan complied by WOSA, the following important factors were listed as constraints:

- The lack of significant research into existing projects and the creation of new ideas;
- Lack of networking;
- A detailed study of who the wine tourist is and the demands that should be understood and shared with all stakeholders in order for the industry to deliver to the visitor's expectations;
- Very little cross-fertilisation of ideas or coordinated and concentrated marketing actions.
- A lack of a robust budget together with short-, medium- and long-term goals;
- Planning, resources and attendance of wine tourism at international and local shows;
- Issues like signages along the roads to improve tourist assistance are not negotiated in a coordinated fashion;
- A coordinating body with a proper budget.

The following actions are considered as important in the 2006 Wine Tourism Strategic Plan:

- To brand the Cape Winelands as a destination for visitors and wine lovers domestically and internationally. A strong brand is essential to communicate all that wine tourism in South Africa has to offer, and to combine the internationally recognisable symbols like the flag, Table Mountain and others to the image of the product of the vine.
- Actively supporting sustainable development initiatives for the broader community and the environment by actively promoting transformation within wine tourism.
- Maximising networking between the tourism industry and the wine industry.
- Setting training standards.
- Coordinate research and development concerning wine tourism.
- Launching and showcasing the wine tourism industry.
- Integration of the product e.g. centralised web portal/site with inclusive offering of experience and services.
- Developing a photo library and e-brochures.
- Develop year round activities to counter seasonality (streamline the calendar).
- To reach the domestic market beyond the borders of the winelands.
- Promote education and training programmes.
- Development of coordinated packages to be loaded on regional and CTRU Wine Tourism sites.

- To further develop the "Best of Tourism" competition of the Cape Winelands District Municipality and WOSA.
- To align a strategy with all the stakeholders.
- To develop Gateways to the Winelands at strategic points, administered by one central office incorporating knowledgeable staff, all the technological facilities, training and educational facilities and a central booking office.

3.4.4 The Winelands and the 2010 FIFA World Cup:

The Western Cape Province and the City of Cape Town have taken the lead in developing a structure in preparation for the onslaught expected during the month of June 2010. The Cape Winelands District Municipality, Stellenbosch, Paarl, Worcester and other towns have all made certain developmental moves and are still aiming to act as a base camp for a team during the tournament. However, little if anything has been done to market the wine region as a destination for soccer lovers. The emotional impact of the occasion is not yet understood and appreciated, and a concerted effort should be made to make full use of the event.

The wine industry should be fully and permanently represented on the decision-making bodies of the event. Soccer lovers like to party and historical/culture tourism will be of lesser interest to this particular audience. Wine regions need to establish who will officially gear up during that month for the influx. Stellenbosch has already moved the date of their wine festival. Other possibilities are to stage various events and to get involved with the fan parks that are planned to be developed over the region. The marketing benefits accruing to the industry from such participation are likely to be of substantial value to the industry.

3.5 Constraints facing the industry

3.5.1 Infrastructure, supply chain and logistics:

The industry recently participated in comprehensive "supply chain and logistics" analysis through the CSIR and the Agro Logistics project of the National Department of Agriculture. The major challenges were listed as: currency fluctuations; back logs with certification and inconsistencies in the wine supply channel (which influences quality negatively); and effective traceability systems, which although progressing, need upgrading to confirm to the latest EU standards (refer to Figure 13).

Some of the major bottlenecks identified were in laboratory testing and certification capacities. These impact negatively on quality and consistency and the timeous issue of certificates. The contracting out of such services from the government laboratory to accredited private facilities is in a pilot phase.

The relative higher cost of packaging materials (glass bottles in particular) and the inability of the local industry to produce new bottles/packaging designs quickly and economically is of further concern. Global volume-driven economics are expected to have an influence on the matter, which could encourage the future bulk exportation of wine.

Port/harbour inefficiencies are also being experienced. Operational matters, such as congestion, transportation coordination, delays caused by SARS inspectors and a lack of information sharing with, for example the export fruit industry, were identified as constraints. Limited shipping options also contribute to "inflated rates" and rail costs and services are generally viewed to be poor and not effective.

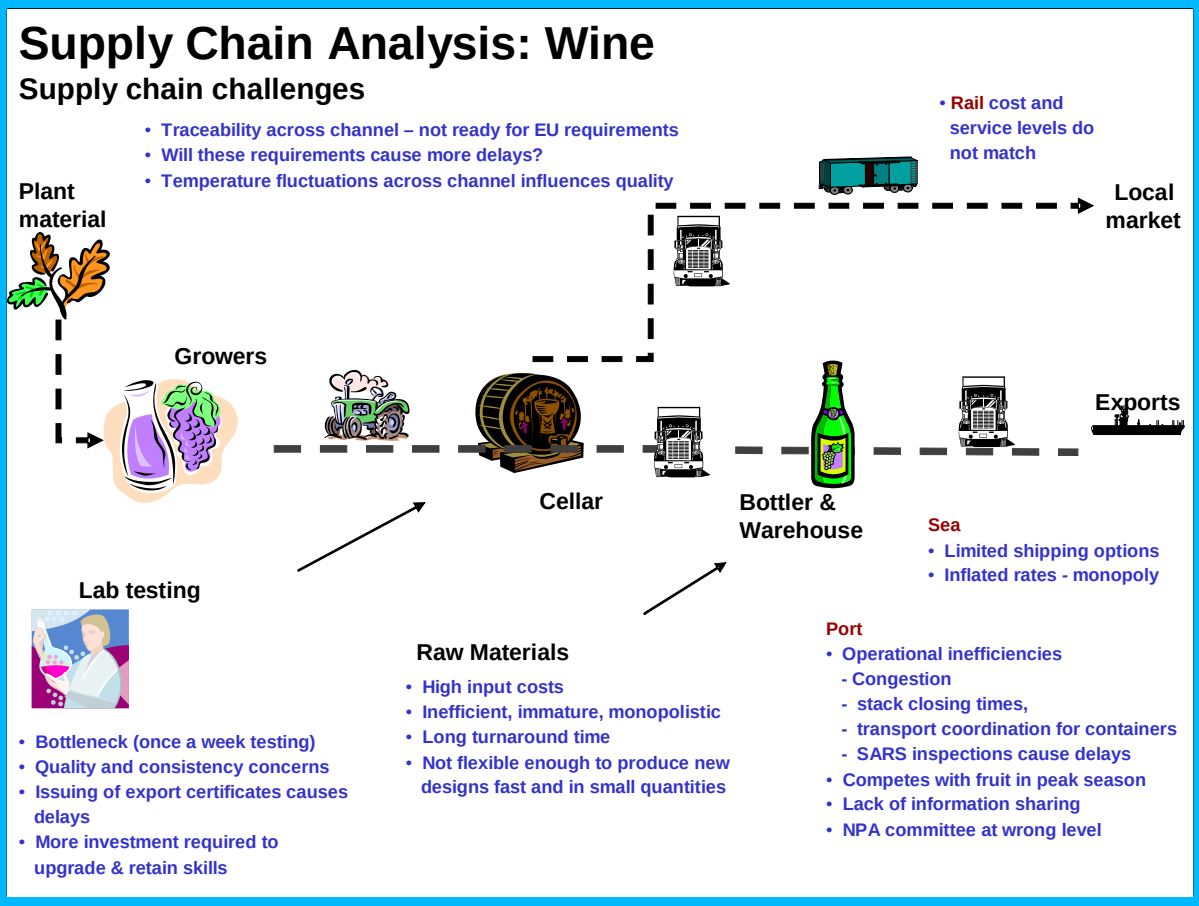

Figure 13: **Infrastructure and supply chain logistics**

4 COMPETITIVENESS OF THE SOUTH AFRICAN WINE INDUSTRY

4.1 Measuring performance

Competitiveness performance is a dynamic and involved process rather than an absolute state of affairs and can therefore only be assessed in a relative sense and over time. The growth produced by competitive activities should thus be sustained rather than short-lived. Short-term efforts such as opportunistic "price wars and cost cutting" seldom sustain a competitive position. Long-term or sustained performances are therefore relevant in defining and analysing competitiveness as quoted below:

"(Wine) industries and firms are competitive when they are able to deliver products at qualities and prices that are as good or better than their competitors; and they are able to attract sufficient sources of capital, land, labour, technology and management from other competing economic activities". In short, "to be competitive in today's world is to continue to trade your wine products successfully" (Esterhuizen & Van Rooyen, 2007)."

The long-term competitiveness index and the trends in competitiveness for the wine industry in South Africa as measured by the Relative Revealed Trade Advantage (RTA)[16] index is shown in Table 6. In Figure 14 the trend is illustrated. From Table 6 and Figure 14 it is clear that South Africa's wines are increasingly internationally competitive with a sustainable and positive trend over recent years. The wine industry in South Africa shows positive trends in competitiveness in the long run and it should not lose its competitiveness status in the near future if its dynamic ability to continue to trade is sustained.

Table 6: The competitiveness index of the wine industry in South Africa: trends from 1961 to 2003 based on the Relative Revealed Trade Advantage (RTA) index

Product	RTA 2003	RTA 2002	RTA 2001	RTA 2000	Trends 1961-03	Trends 1980-03	Trends 1993-03	Trends 1998-03
Wine	4.93	4.28	3.76	4.02	+	+	+	+

Source: Own calculation based on data from FAOSTAT 2005

Notes: Competitive (RTA > 1), marginal competitive (1 > RTA > -1), not competitive (RTA < -1); '+' Positive trend; '-' negative trend.

It is interesting to note that the economic deregulation of the South African wine industry which coincided with the introduction of South Africa's first democratic government in mid nineties (1994-1997) provided the basis for an increase in its competitiveness status. This was preceded by the

[16] Both import and export duties are considered.

period of economic sanctions – seventies, eighties and nineties – resulting in low competitiveness performance. Some analysts refer to this as the "Madiba Magic" period with international markets opening up for the wines of the "rainbow" country. The situation, however, is clearly more complex. Factors such as improved market knowledge, replanting of improved (mainly red) grape varieties and virus free plant materials, technological innovation such as changes in wine styles to accommodate changing consumer preferences, were all required to sustain performance. The impact of exchange rate changes is also clearly illustrated in Figure 14 – from 1993 onwards.

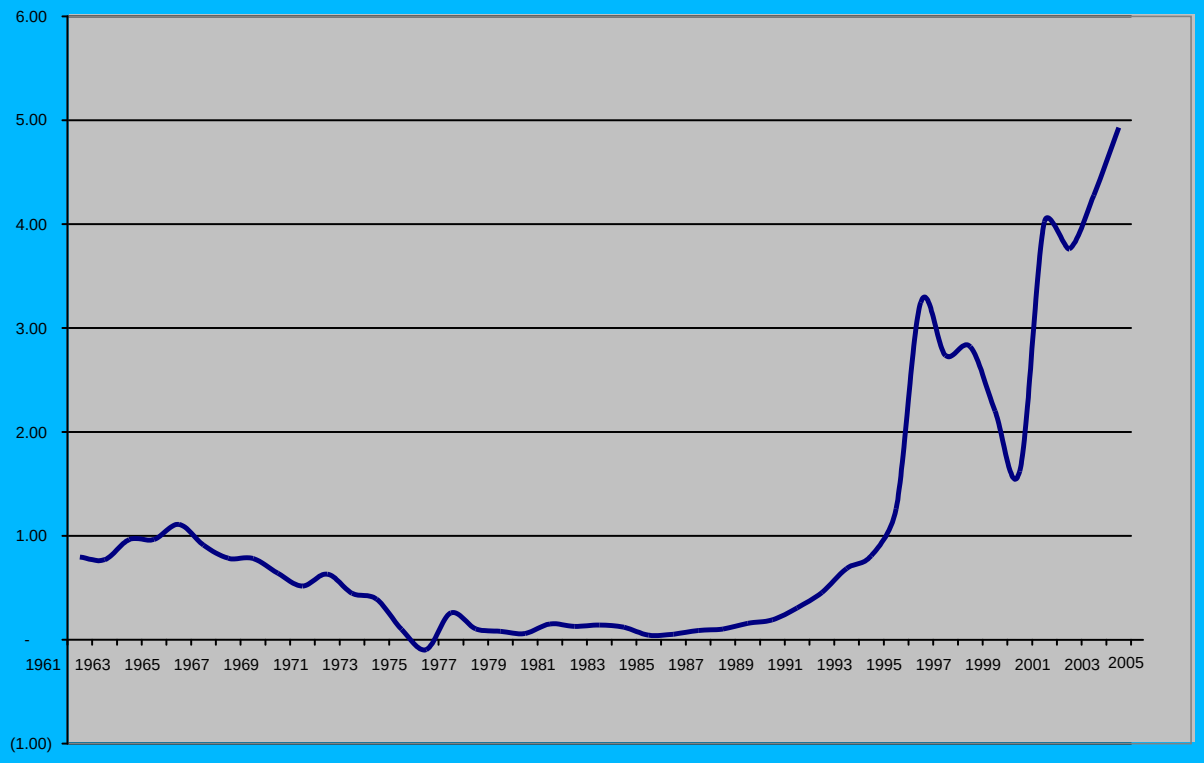

Figure 14: The Wine Competitiveness Ratio - trends in the competitiveness of the wine industry in South Africa (1961 – 2003)

4.2 Global comparisons

Wine trading (both at import and export levels) is one of the most dynamic and competitive activities in the agro-food environment. Since the late 1980s, the share of wine production that is traded internationally has nearly doubled and wine trade has brought major gains to participants in expanding countries, but pain to many traditional producers. A view of South African competitive performance in comparison with some other major wine trading economics will therefore be instructive. In Figure 15 the relative "middle" position of South African is shown.

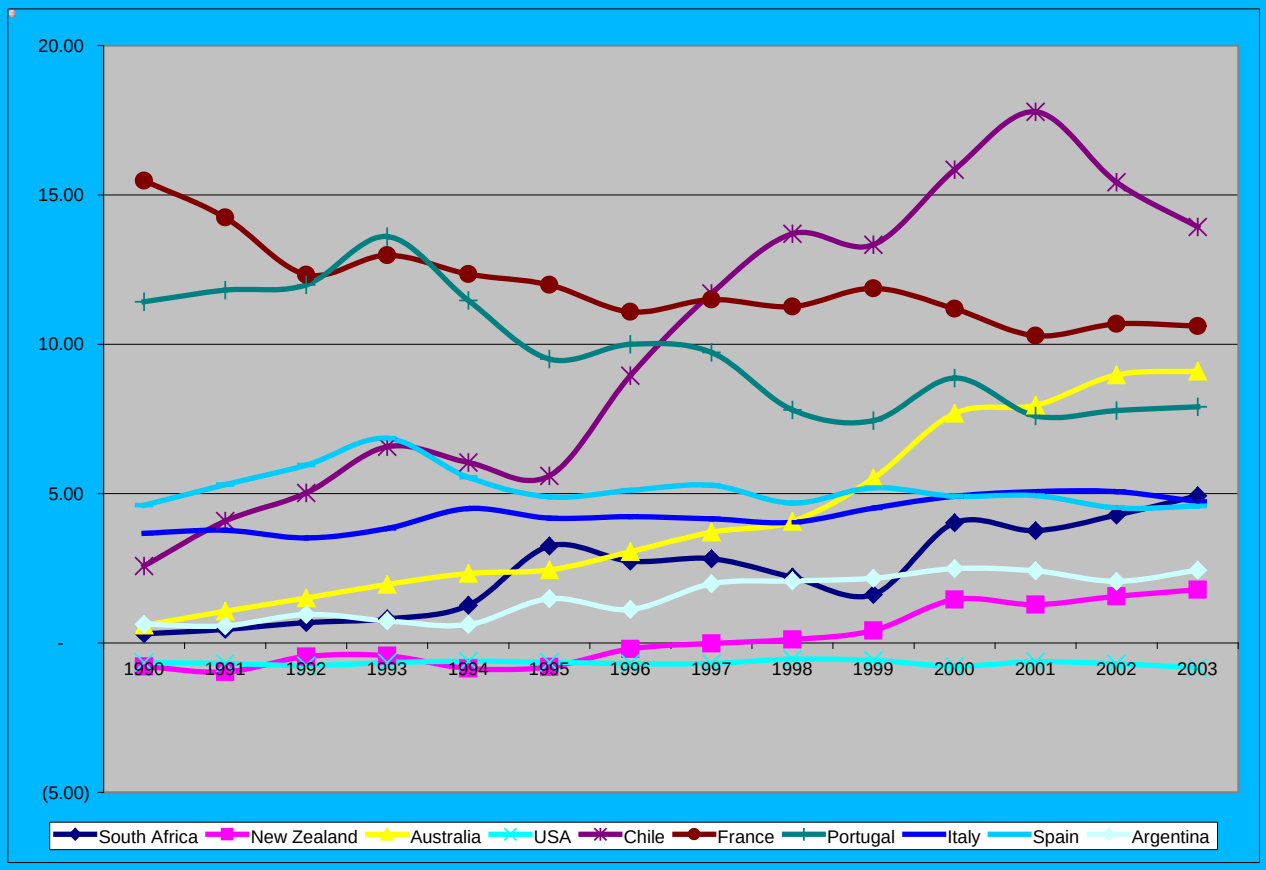

Figure 15: Trends in the competitiveness of selected wine producing countries (1990-2003)

4.3 The determinants of competitiveness

According to Porter (1990) four broad competitiveness attributes that each nation establishes and operates for its industries must be considered. These attributes are:

- Factor conditions: The nation's position in terms of factors of production, natural resources, level of production costs such as the price of labour, capital, land, water, fuel, pesticides, machinery, the supply chain, knowledge and infrastructure and all transaction costs, necessary to compete in a given industry;
- Market conditions: The nature of demand for the industry's product and service and the ability to capture this demand through marketing and sales, for example, demand composition, demand size and information on trends in demand;
- Related and supporting industries: The presence or absence of supplier industries and related industries that are internationally competitive;
- Firm strategy, structure, and rivalry: The conditions and environment governing how firms are created, organised and managed, and the nature of domestic rivalry;

Government clearly plays a vital role in orchestrating these determinants - influencing each either positively or negatively, through its policy-making and operational inputs. Indeed, government as a

determinant of an environment which is intended to enhance competitiveness must be viewed apart from the previous four determinants.

Finally there is the role of chance. Chance/uncertain events are occurrences largely beyond the power of firms (and often the national government) to influence. Events such as wars, diseases, political decisions by foreign governments, large increases in demand, shifts in world financial markets and exchange rates, discontinuity of technology can be described as chance events and would be exploited in a competitive manner by highly competitive industries.

In Table 7 these determinants of the competitiveness in the wine industry in South Africa are indicated. These items were rated through the WES to have an enhancing (3), constraining (1) or a moderate (2) impact on competitiveness.

Table 7 : **Determinants of competitiveness for the South African wine industry**

Factor conditions	Rate	Firm strategy, structure and rivalry	Rate
Labour	(2)	Industry structure	(2)
Cost of low-level skilled labour	2	Regulatory structure and standards in industry	2 – 3
Quality of low-level skilled labour	2	Flow of information from customer to company	
Availability of low-level skilled labour	3	Local	(2)
Cost of skilled labour	2	International	2
Quality of skilled labour	1 - 2	Supply chain collaboration in product and process	2 - 3
Availability of skilled labour	2	development	
		Information flow from primary suppliers	2
Cost of doing business in SA	1 - 2	Bargaining power of customers	2
Availability of water	2		2 – 3
Capital	(1 – 2)	Rivalry	(2 – 3)
Cost	1 - 2	Intense competition in the local market	3
- Availability	2	Source of competition in the local market	3
Climatic conditions the past three years	2	Entry of new competitors	3
Location in terms of international trade	2 – 3	Substitutes of products and services	2 – 3
		Difficulty to start a new business	1
Technology	(2)	Firm strategy	(2 – 3)
Cost	2	- Unique products, services and processes	2 – 3
Quality	2 – 3	Production of affordable high quality products	3
Availability	2 – 3	Production of environmental friendly products	2 – 3
		Strategy to employ quality technology	2 – 3
Infrastructure	(2)	Investment in human resources	2 – 3
- Cost	2	Continuous innovation	2 - 3
- Quality and availability	2	R&D spending	2
Average score for factor conditions	***(2)***	***Average score for firm strategy, structure and rivalry***	***(2 – 3)***
Market conditions	**Rate**	**Supporting industries**	**Rate**
Information on local markets consumer orientations:		Local suppliers of materials, components, equipment and	
Knowledgeable and demanding and buy innovative	(2)	services	(2 - 3)
products		Availability	2 – 3
Actively seek out the latest products, technologies	2 – 3	Quality	2
and processes		- Sustainability	2 – 3
In pace with rest of the world	2	International suppliers of materials, components,	
Concern over ethics and production methods	2	equipment and services	(2 - 3)
Importance of environmental friendly products		Availability	2 – 3
	2 – 3	Quality	2 - 3
		- Sustainability	2 – 3
	2		
Information on export markets consumer		Financial support	1 – 2
orientations:	(2 – 3)	Scientific research institutions	(2)
Knowledgeable and demanding and buy innovative		Availability	2 - 3
products	2 – 3	- Collaboration	2
Actively seek out the latest products, technologies		Electricity supplies	2
and processes	2 – 3	Telecommunication firms	2
Concern over ethics and production methods		Internet service providers	2
- Importance of environmental friendly	2 – 3	Specialised information technology services	2
Products		Technical information flow	2 – 3
	3	Glassware suppliers	2
Local market size	1 – 2	Packaging material suppliers	2
Export market size	3	Road transport companies	2 – 3
Local market growth	1 – 2	Air transport companies	2

Export market growth	2	Training and skills development facilities	1 – 2
Average score for market conditions	***(2)***	***Average score for supporting industries***	***(2)***
Administrative regulations	1 – 2	**Cost of crime**	1
Competence of the bureaucracy in the public sector	1	**Health**	2
		Developments in Africa	2
The tax system's impact on investment and risk-taking	1 – 2	**Biotechnology**	2 – 3
		Strong rand	1
Impact of legal changes the past five years	1 - 2	**Fluctuations in the exchange rate**	1 – 2
Environmental and biodiversity regulations	2 – 3		
Trade policy	2		
Clarity on land reform policy	1 – 2		
Labour policy	1 – 2		
Macro-economic policy	2		
Clarity on bee policy and codes	1 – 2		
Trust in the political support system	1		
The current political climate in South Africa	2		
Average score for government	***(1 – 2)***	***Average score for chance***	***(1 - 2)***
1 = constraint 2 = moderate 3 = enhancement ( ) = average			

Source: Own calculations from the 2005 Wine Executive Survey

4.4 Analysis: constraints and opportunities

4.4.1 Factor conditions:

The average score achieved for all factor conditions is 2, which means that on average the factor conditions in South Africa have a moderate effect on the wine industry's competitiveness. The factor conditions that are constraining competitiveness most are the quality of skilled labour, the high cost of capital and the high cost of doing business in South Africa. The factors that have an enhancing impact on the competitiveness of wine industry in South Africa are the availability and cost of unskilled labour, the cost, quality and availability of technology in South Africa and the location of the wine industry in South Africa in terms of the international market.

4.4.2 Market conditions:

The executive survey (WES) also indicated that the local market size and growth in the local market are constraining the competitiveness of the wine industry in South Africa. From a positive viewpoint, buyers of South African wine are knowledgeable, demand and buy innovative products and buyers are concerned over ethics and production methods. No clear indication on the quality of market information however was given although the information on consumer orientations was rated positive.

4.4.3 Related and supporting industries:

Most of the supporting industries are rated by the wine industry in South Africa to have contributed positively and have a positive impact on the industry's competitiveness. It is especially the availability, quality and sustainability of local and international suppliers of the wine industry's components, materials and equipment, the availability of scientific

research institutions[17], technical information flow and road transport companies that contribute positively to the competitiveness success of the wine industry in South Africa.

Access to training and skills development facilities and financial support are constraining the competitive success of the wine industry in South Africa. This latter observation on financial support systems must largely be related to the long-term nature of capital requirements of the industry and constraints and costs in mobilising funds and high real interest rates i.e. cost of finances.

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4.4.5 Firm strategy, structure and rivalry:

The fourth broad determinant of competitive advantage in an industry is the context in which firms are created, organized and managed as well as the nature of rivalry. With an average score of 2 to 3, firm strategy, structure and rivalry as a whole, have a positive impact on competitiveness of agribusinesses in South Africa. Some of the major enhancing factors include the regulatory structures and standards in the industry, integrity systems, intense internal competition, entry of new competitors on a regular basis, the production of affordable high quality products, firm level investment in human resources, employment of quality technology, the production of unique products, services and processes, the production of environmental friendly products, and continuous technical innovation.

4.4.6 Government support and policies:

The wine industry in South Africa is highly regulated and to a large degree dependent on sound partnership arrangements with government. Government policy and support on matters related to export and trading, science and innovation, empowerment and transformation, tax and excise duties, natural resources such as land and water, labour relations, financial arrangements to name some, impacts directly on this sensitive and highly market orientated industry.

[17] Although there is concern about the expected decrease in funding.
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With an average score of between 1–2, government services, policies and support systems are viewed to act in a constraining manner to the competitive success of the wine industry in South Africa. The major constraining factors are: burdensome administrative regulations, the impact of legal change, the competence of personnel in the public sector, South Africa's tax system's impact on investment and risk-taking, South Africa's resources policy (labour and land) and clarity on BEE transformation policy and the scorecard system.

It is interesting to note that the South Africa's environmental regulations are rated by the wine industry in South Africa to have a positive impact on their competitiveness, while macro-economic policy, the current political climate and trade policy are providing moderate enhancements.

4.4.7 Chance factors:

Chance events are occurrences that have little to do with circumstances in an industry and are often largely outside the power of the firms or a country to influence. Chance events however are important because they create opportunities and discontinuities that could allow shifts in competitive performance. Chance events can nullify the advantage of previously established competitors and create the potential that a new firm can supplant them to achieve competitive advantage in response to new and different conditions (Porter, 1998).

The cost of crime, the strong Rand and fluctuations in the exchange rate are important chance factors which have a constraining impact on competitiveness of the wine industry in South Africa. Aids does not yet feature as a major factor for the wine industry, while global technology developments are anticipated to provide competitive opportunities.

On average, the wine industry is not well positioned yet to exploit change occurrences in a positive manner. This may require more structured interaction in a global context to fully exploit aspects related to technological innovation, Africa's opportunities and fluctuation in exchange rates.

4.5 *Conclusions: Major drivers in the wine industry*

From the industry analysis, a number of future drivers are listed:

(i) **Product quality improvement and product integrity:** The plantings since 1997/98, the quality upgrading of South African wines and the introduction of measures to effectively combat illegal flavouring practices contributed substantially to the current position of strength. Initiatives and measures to enhance such industry level applications will be a future "building block" of success.

(ii) **"Brand SA" roll-out:** The ability to establish a unique "Brand SA" proposition for South African wines will assist in creating a differentiated "playing field" for South African wines. WOSA's efforts to craft a unique and vibrant marketing message based on the diversity of the South African winelands (including social and biodiversity is in progress and provide exciting opportunities). Furthermore, the inclusion of biodiversity codes at farm and cellar levels in the "Integrated Wine Production" system gives substantiation to this particular drive; social and transformation codes will follow soon, with the gazetting of the Wine Transformation Charter.

(iii) **A sharper market segment focus:** The exposure of wine producers and marketers to evolving preferences and the focus on "doing-the-right-things right" is driving the export initiative of South African wines. It is however clear that the increased understanding of the evolving market will be required to survive in a highly competitive global environment. The selection of appropriate countries, market segments in particular and price points and a clear comprehension of the required business systems to operate successfully in the selected segment will be necessary to give operational effect to a "Brand SA" strategy. Market segmentation will be a key in this focus area with ethical and environmental positioning as an important competitive advantage for South African wines.

(iv) **Cost effectiveness technology and business systems:** South Africa's wine production cannot position itself as a "high volume-low unit cost" producer. South African wines should thus rather focus on higher quality, higher value points in particular market segments. However, the South African wine industry will still be highly constrained by relative high input cost systems. Technical efforts to increase yield per hectare (without compromising on wine quality) and to reduce supply chain costs and time (delay) costs will require innovative R&D solutions and information systems.

(v) **Business focused economic transformation:** Successful BEE strategy could enhance political and social stability and productive resource mobilisation significantly. The establishment of entrepreneur oriented "black business class" and top level black business leaders must be considered as a significant driver of the South African wine economy of the future. This will also impact positively on the necessary domestic market expansion of the consumption of wines as a lifestyle activity amongst black professionals.

(vi) **Driving focus in the global arena:** The South African wine industry is strongly linked to global trends that need to be integrated into a South African strategy. The following should be noted:

- China is emerging as a possible new competitor – already 450 000 hectares in 2004 (number 5 in the world). Intelligence is required on possible China wine marketing strategies.

- Shifting demand (Consumers want more clarity on the nature and ethics of a product; and companies need customer loyalty); increasing retail power (supermarkets); increasing competition and creating brand value; reliable supply chain systems.

- The world is looking for quality red wine. Premium red wine products that uplift the image of a country's wine industry in total are thus required.

- Global business consolidation processes are underway - mergers and acquisitions and joint ventures of wine companies to form bigger brands and to achieve greater market access.

- The settings of multi-national wine companies are expected and links with global supply chains are expected sooner than later in South Africa.

(vii) **International trade agreements:** The global trends and the use of concepts such as "Geographical Indicators" and "Traditional Expressions", to direct international trade regimes could be significant for global wine trade and South Africa is in a good position to exploit new opportunities but should also guard against the establishment of new "trade constraining" barriers.

(viii) **Successful and proactive government and industry interaction to establish an enhancing business and social environment:** The wine industry, at a recent workshop on competitiveness, rated an open "red telephone line" to government as vital for a successful and performing wine economy. This partnership will be required to focus on a number of activities. These include market development, regulation and export promotion; the active positioning of "Brand SA" by government agencies (NDA, dti, SAA, Tourism, etc), infrastructure expansion, research funding and technological innovation; economic empowerment and transformation support; trade agreements and policy development; combating crime and the simplification of regulations and a reduction in bureaucratic "red tape" to name a few areas of concern. The WIP, the Wine Industry Transformation Charter and the wine industry representative structures are expected to focus on government/ industry interaction on priority areas and actions.

5 EMPLOYMENT PRACTICES

The wine industry succeeded in sustaining employment over the past decade. As was referred to earlier, in 2003, 256 908 persons were employed (215 820 in 1996), with a total household income of R14 715 million (R5 940 million in 1996).

5.1 Status quo in respect of compliance

Although there is some measure of compliance with Sectoral Determination 13 (SD13) which governs employment practices in the agricultural sector, recent studies indicate a perception that many employers in the wine industry do not fully comply with these regulations (Dopstop study for Department of Economic Development and Tourism; Presidential Group Study on employment equity compliance).

The Wine Industry Transformation Charter describes the employment relationship in the industry as problematic, and documents areas of concern such as:[19]

1. widely held perception of employers' reluctance to comply with labour laws and

2. the replacement of permanent employees with seasonal or part-time workers (Wine Industry Transformation Charter 2007 p.15). A large part of these casual workers are women, who are generally paid less than their male counterparts, thereby reinforcing gender (financial) inequality.

5.2 Casualisation of farm labour; its implications for farm workers/dwellers

The increasing overall trend in the employment practice of outsourcing labour is taking root in the wine industry and is expected to grow significantly. Recent studies (see Dopstop Project and Women on Farms Project websites) indicate that a large group of wine farmers use contract labour/outsourcing. This scenario presents both government and industry with something of a dilemma, because on the one hand it serves as a BEE opportunity for black entrepreneurs, and cuts costs for the farmers, but on the other hand exposes an already vulnerable group (farm workers and other unemployed poor people) to often unscrupulous labour broker practices which display scant respect for basic conditions of employment and worker's rights to employment benefits. Labour outsourcing is perceived by many workers and various NGO groupings as farmers trying to avoid the Extension of Security of Tenure Act (ESTA).

There has been an intensified protest of late against farm evictions occurring in the agricultural industry. Different groups (Women on Farms Project; BAWSI) have linked it directly to the ESTA, to the point of fighting for a moratorium on all evictions, legal or otherwise. It has to be considered that the ESTA is intended to provide security of tenure for workers living on the farms. Despite this act, many evictions still

[19] Also see Annexures 3 and 4, 2004 and 2005 wine industry baseline surveys respectively, conducted for the Wine Charter Steering Committee.

take place without any legal backing or prescribed procedures being followed. The call by farm workers is that any eviction, even the lawful ones, causes immense social turbulence and family destruction in tight-knit rural communities. It is especially the farm worker children's education that suffers from such social disruption.

5.3 Towards a 'best practice' scenario

With the dawn of democracy farm employee legal rights improved significantly. Among these count the right to unionization, right to strike and other benefits as laid down in Sectoral Determination 13 (SD13, e.g., minimum wages, access to mediation, CCMA; Extension of Security of Tenure Act). The wine industry charter acknowledges the above and sets out an implementation strategy for its members to address problems such as the skewed nature of its labour relations.

5.4 Community social responsibility

What does community social responsibility entail in wine farm community context? The current state of the social situation of farm workers in wine regions is varied but generally paints a bleak picture. The wine charter highlights several of these conditions, including poor housing (buildings), lack of indoor running water and flush toilets. It further indicates poor health conditions, citing high incidences of infectious diseases such as TB and alcohol-related diseases such as Foetal Alcohol Spectrum Disorder (FAS) which take a high toll among wine farm workers. Violence against and abuse of women and children constitute serious social ills on some wine farms.

Low wage levels are another area underscored by the wine charter. Although the 2001 Census put the average remuneration of full time farm labourers at R1189 per month, the Dopstop study cited elsewhere found an average of less than R800 per month on more than 40 wine farms in the Olifants River Valley as recently as 2004. This state of affairs lends currency to the perception that farmers and labour brokers alike do not take wage legislation seriously and show little respect for the dignity of their employees.

On the more positive side, efforts are also underway to improve these conditions. Agri Western Cape, Labour and Government established an aid accord to deal with such matters. Concrete evidence of abuses remains elusive. There also seems to be evidence that the business sector will play an increasing part in social upliftment. Judging from the number of conferences and discussions around the BBBEE Codes of Good Practice, the advantages of a sustainable Corporate Social Investment (CSI) strategy seem to be gaining currency among certain corporate entities. These businesses realise that besides the need for compliance to the codes, they also stand to gain via good reputations, positive branding, Fair-Trade certification, etc, and the benefits associated with these.

The quality of life of large sections of the wine farms communities is severely impacted by the abuse of low quality alcohol. The Dopstop study confirms that the constant availability of and access to alcohol, combined with a lack of sport and recreational facilities, contributes to a poor quality of life. Teenage pregnancies and the abuse of women and children are also contributing factors. Although not too much

information is available at present, it might be time to start looking what role/effect HIV/AIDS is having on the quality of life of farm workers.

Corporate Social Investment/Community Social Responsibility (CSI) needs a higher profile than it currently enjoys. The labour-intensive nature of the wine industry makes this more urgent. The Wine Charter made a start in this direction by renaming the CSI element of the Codes of Good Practice as Rural Development and Poverty Alleviation, thus putting more emphasis on the plight of farm workers.

A view on CSI worth considering was articulated at a recent conference with the theme: *Making CSI Matter.* (Trialogue Conference, as quoted in Mail and Guardian, Nov 30th, Dec 6th, 2007: BEE, p.4): CSI does not only make good business sense, but businesses can play a role in consolidating South Africa's developing democracy if they can understand what really constitutes social exclusion. CSI does not stop with the economic engagement of people, but must move from "chequebook donations to developmental investment."

On some farms this movement toward social inclusion is already occurring, with individual employers taking a pro-active stance toward the development of their workers and children. Creating inclusive environments is just as important as supporting people with resources to reach the maximum potential. South Africa is quoted as being ranked 6th out of 61 world class economies on Corporate Social Investment (*2006 World Competitiveness Yearbook*). The wine industry would do well to make sure it is a proud part of this development and help to maintain or improve that position.

5.5 Workforce and skills development

***Status quo* with special reference to literacy levels, need for core skills, etc:** The literacy levels in the agricultural sector in general and wine industry in particular is of some concern. The Wine Charter refers o a 1996 study which put the median level of schooling among farm workers at less than 6 years, with literacy estimated to be 20% among adult farm workers. A later study among adults on two wine farms in the Boland (Boskovic et al, 2003) indicated that 25% had no formal education, while a further 21% had completed only grade Grade 5 (Standard 3). Later studies have confirmed that the situation has not improved, and that educational and literacy levels remain generally low. A concern expressed in the 2003 study is that alcohol abuse increases as the educational levels drops. There is thus a need to seriously consider intervention in this area, because it could lower alcohol abuse and probably improve quality of life of affected people, in addition to the higher level of productivity that a literate and educated workforce can bring about.

5.5.1 The role of SETAs to enhance the process:

Given the poor level of educational of farm workers, the SETAs could play a major role in improving the situation. The implementation of SETA's mission, which is to have workplace skills development plans for every employee and a National Skills Development Matrix for the entire workforce of the country, would enhance the social conditions of the average farm worker. The need to develop higher and core skills among wine farm workers should be made a priority. Efforts in this regard are underway, especially in

wine management and wine making. Often one hears anecdotes of skills plans which have been developed for workers, but are gathering dust. Well-intentioned legislation such as the Skills Development Act seriously is seriously lacking in implementation if the above statistics are anything to go by.

6 AN OVERVIEW OF TRANSFORMATION AND BLACK ECONOMIC EMPOWERMENT

The major strategy directing BEE in the wine industry is the Wine Industry Transformation Charter with its seven performance categories of ownership and control, employment equity, skills development, enterprise development, preferential procurement and rural development. Twenty percent of the wine industry statutory levy is also spent on transformation.

6.1 The Wine Industry Transformation Charter

South Africa's past, present and future find expression in the wine industry, reflecting greatness and a creditable performance alongside the painful reality of our country's history, reflecting also the remarkable political and economic transition of our times together with the promise of shared growth and development for all South Africans in the years ahead.

The Wine Industry Transformation Charter recognises that broad-based change and development are essential to move forward to a deracialised industry – a non-racial society – in the 21st century. The Charter's purpose is to give impetus to change and development within the industry, and to provide the strategic framework and associated Scorecard necessary to advance black economic empowerment (BEE). Growth, renewal and engagement are the watchwords.

After more than four years of intense consultation and serious deliberation among representatives of all major industry stakeholders – black and white, workers and owners, civil society, NGOs and trade unions, farmers, wine-makers and traders – the wine industry adopted and submitted the Wine Industry Transformation Charter to the government for its consideration (see www.winecouncil.co.za).

This is a milestone in the history of the South African wine industry and is the first discrete agricultural sector initiative to establish a transformation charter. The Charter provides a clear statement of intent and commits all the role-players to the transformation and renewal of the industry.

The Charter was approved by the Board of the SA Wine Council on 30 July 2007 and as mentioned earlier, was submitted to the Minister of Agriculture and Land Affairs and the Minister of Trade and Industry for registration as a Section 12 Charter. Progress is awaited.

(i) **Vision and challenges:**

The vision for transformation is for "sustainable economic and social black empowerment through growth to achieve a representative, united and prosperous wine industry."

The main challenges to be addressed by the Charter are:

- A highly skewed ownership regime
- Improving labour relations and fostering human dignity
- Advancing women in the industry
- Security of tenure and security of employment
- Economically viable transformation
- An integrated and representative value chain
- Mobilising knowledge, business acumen, capital and "social capital"
- Rural development and poverty alleviation

(ii) **Dimensions of empowerment:** There is a broad agreement in the wine industry, as reflected in the wide-ranging consultation process leading up to the drafting of the Charter, that there must be accelerated change and development in the wine industry. This requires a partnership that embraces the skilled wine grape producers and winemakers, top class researchers and competent business enterprises whose efforts have helped to fuel economic growth over the past decade, the workers who work in the vineyards and cellars, and a responsive government - all to create an enabling, appropriately regulated environment. Combined efforts are necessary to compete at a higher level in world markets and to grow exports; to open paths of opportunity for those previously excluded under apartheid; and to provide a decent way of life and human dignity to those who work on the wine farms.

Success in transforming the industry is premised above all on growth and the creation of new opportunities, rather than the redistribution of existing opportunities alone. The dimensions of empowerment described in the Charter are:

- Ownership
- Management
- Employment equity
- Skills development
- Preferential procurement
- Business development
- Rural development and poverty alleviation

The scorecard - implementation and scoring:

The Wine Charter is not aligned with a tick-box approach to "scoring" black empowerment performance. Rather it attempts to change mind-sets and to develop a cooperative spirit to drive and manage implementation in the industry. The current status of the Wine Charter is that of a Section 12 Sectoral Charter. For purposes of business with government (including obtaining licenses in the industry) the provision of the generic Scorecard will apply.

While large parts of the wine industry (enterprises with a turnover of below R5 million per annum) could be excluded from the formal scorecard, the Wine Charter as a "statement of intent" applies to the entire industry and everyone has a responsibility to commit themselves to the improvement of housing, health conditions, and the provision of sanitation, clean water, training and the observance of appropriate terms and conditions of employment. Skills development as well as economic and social development in the wine industry, land reform and upliftment of farm worker environment are also positioned as priorities.

Particular incentives are provided in the charter to contribute to transformation as described by it and even where enterprises are technically excluded (below R5 million), they would still have to demonstrate their adherence to improving conditions in the industry and show active involvement in empowerment if they were, for instance, to tender for government contracts.

All enterprises, including exempted enterprises, will have to provide proof of their turnover in order to comply with the Charter. Sufficient evidence of qualification as an exempted enterprise includes an auditors' or similar certificate. Exemption implies exemption from the scorecard, but not from the underlying principles of the Charter itself. Thus, when enterprises submit proof of their exempted enterprise status, they shall also have to sign a commitment of compliance with the Wine Industry Transformation Charter.

(iv) **Who is covered by the Wine Industry Transformation Charter:** The Charter covers the entire wine industry. The Scorecard is aimed at enterprises that have earned more than half of their turnover on average over the free financial years prior to being scored from business activities in the production of wine grapes and of wine, brandy and grape juice concentrate, and who are not subject to the Liquor Industry Charter .

The Wine Transformation Charter is aligned with the Government's Codes of Good Practice and Scorecard on Black Economic Empowerment. These identify three categories for scoring: large enterprises with an annual turnover above R35 million per annum are judged on four of the seven elements, while micro enterprises with a turnover below R5 million are excluded.

Through the statutory levies, all industry players, producers and trade also contribute to transformation as at least 20% of the levy (±9 million) is directed towards transformation initiatives within the framework of the Wine Transformation Charter.

6.2 BEE models in the wine industry

6.2.1 Overview:

For an understanding of relevant BEE models it is necessary to confirm some of the driving principles of empowerment, outlining the kind of dynamics which are needed to lead to

successful empowerment and sustainable economic gain. The relevance of these principles is highlighted through observations made on several BEE and land reform initiatives recently investigated in the Western Cape.

The first of these is that empowering people is a more a complex undertaking than often perceived. Empowerment and enablement are synonymous concepts; an empowered individual must not only own his or her own economic destiny but also have the tools and support necessary to enable him/her to direct this destiny. Although appearing trite, this statement is relevant because it illustrates the multi-dimensional nature of empowerment. Empowerment is often regarded simplistically – as a single dimension (usually ownership) without recognising that it actually involves a number of factors, like the availability of skills, access to and quality of resources, support, infrastructure and markets. Recent research experience on the implementation of Land Reform in the Western Cape[20], has revealed that in many cases legal ownership of the land, assumed to be sufficiently empowering on its own, did little to improve the quality of life of the beneficiaries; beneficiaries were often abandoned without the capacity to use the land to their own advantage.

A corollary emanating from the complexity principle is the concept of 'balance'. Balance, in this instance, describes, for any empowerment initiative, the state of interactivity generated by the applied mix of influencing factors (such as skills, leadership, resources and motivation) which affect the performance of BEE projects and determine their outcomes. A useful conceptual analogy of the balance idea lies in the mechanics of chemical equilibria. When chemical ingredients of specific concentrations and volumes are combined under a set of extraneous physical conditions (e.g. temperature, time, pressure, light) the combination reacts and then settles into an equilibrium. If one or more of the ingredients/conditions are altered, a new equilibrium is created, usually in the case of chemistry predictable through scientific understanding.

Similarly, empowerment equilibria, much more subtle and difficult to predict, are created from the reaction of influencing factors introduced into an empowerment or land reform initiative. Here, the human and economic resources are the 'chemical ingredients', whilst the extraneous influences (or operating environment) are the 'physical conditions'. It is obviously important that these influencing factors are applied in the correct 'balance' if sustainable empowerment, the desired outcome, is to follow. Until recently, the concept of 'balance' has been neglected in designing BEE initiatives; like for example too little capital on too much land or too little expertise on skills intensive enterprises. Clearly, an appreciation of the concept of 'balance' is important in evaluating BEE models, a factor recognised in certain conclusions regarding land reform criteria which were reached by the VinPro land reform investigating team of 2005[21].

Summarised, these conclusions require the project design to be in balance by ensuring that:

[20] See Annexure 5 and 6. These were included as they provide details of land reform projects and a number of them produce wine grapes in the Western Cape and a proposed rating system for land reform projects.

[21] Vink, N. et al (2005): Land Reform in the Wine Industry – Wine Producer Programme. This team was assigned to research empowerment in the wine industry as a precursor to the development of a Wine Transformation Charter.

- Adequate capital is available to farm the land, notwithstanding the high cost of wine land in certain areas;
- The demand for high level skills in a skills-intensive industry is met by including appropriate expertise into the initiative;
- An appropriate exit strategy is in place in the event that exit should become necessary;
- Expectations (appropriately managed) that tangible benefits will be met.

The term 'economic' in the BEE acronym has added significance in the agricultural context. The term would normally imply meaningful participation in directing the economy, either in general or for a specific industry. In Agri-BEE, however, the term 'economic' has a direct link to the concept of 'sustainability'. This is because much of Agri-BEE is allied to the politically relevant issue of land redistribution with its objectives of sustaining rural livelihoods and exercising environmental care. An added problem is that in agriculture it is often not easy to make a reasonable profit and there is considerable risk involved. Findings in respect of land reform in the Western Cape from the studies indicated above indicate that intended black empowerment through land reform is often not sustainable (for a number of reasons) and little or no economic security accrues to the intended beneficiaries.

Sustainable enterprise implies generating adequate returns on the work and capital invested. The recorded experience of the VinPro investigative team is again relevant and is repeated here verbatim.

"The research conducted by the team (of researchers) showed clearly that successful land reform models should aim to ensure that:

- The farming operations were profitable, i.e. that all participants should be able to anticipate a return to the capital and effort that they invested in the enterprise;
- The farming enterprise was sustainable in the longer run, i.e. it had to lead to a commercially and environmentally viable commercial enterprise;
- The farming enterprise had to lead to real and tangible empowerment within acceptable time limits.
- The VinPro initiative as a whole had to support real transformation of the South African wine industry.
- To this end, each land reform project had to contribute in a meaningful manner to transformation, and thus ultimately to the process of Black Economic Empowerment."

A final general thought on BEE models is that each empowerment initiative differs from the next - requires a different design, involves different players, and calls for a different balance of influencing factors. It is important to evaluate AgriBEE initiatives with a 'horses for courses' approach rather than a 'seek and apply best practice for all' approach; there is no best general BEE model, rather several, each depending on its own circumstances. The only factor common to all BEE initiatives is that the required outcome must be both empowering and sustainable in the long term.

An interesting interpretive model emerged from the earlier mentioned study of Land Reform in the Western Cape (2006) which bears mention here. It is a progression model illustrating the way in which land reform projects evolve over time and is represented in Figure 16 as two paths (trajectories) leading, through recognisable phases, to either success or failure. Each project begins its successful or unsuccessful journey soon after it is launched. If a project finds itself on the road to failure it can only rectify its position after returning to the beginning to start again. Correction therefore requires substantial and costly intervention. Of nearly 120 projects visited during the study (including those in the wine industry) all could be categorised by experienced judgement into those on the road to success or those on the road to failure. (Interestingly, 43% were found to be on the success trajectory though mostly at an early stage.) This interpretive model, taken together with the various observations on complexity and balance underlines once more the importance of correct planning at project inception.

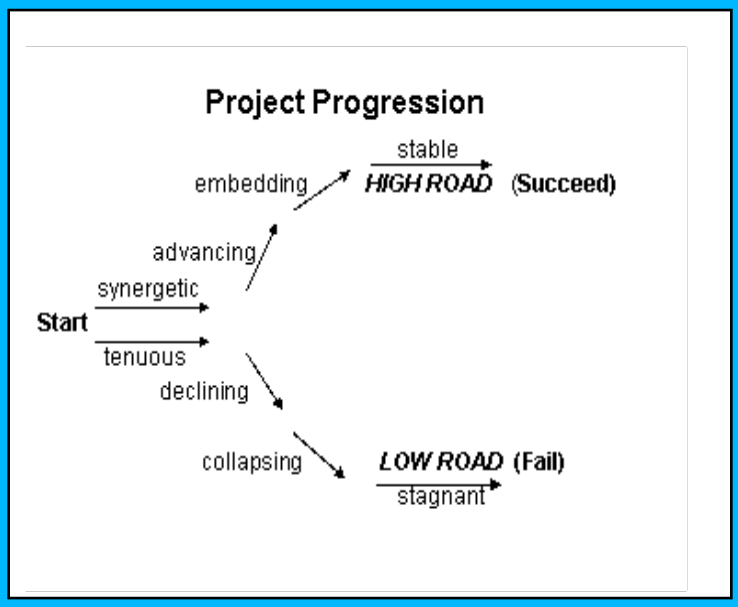

Figure 16: The evolution of land reform projects

6.3 Empowerment models reviewed:

The above conceptual background, by bringing into focus the sensitive and complex reality of empowerment, points towards the things to look for in the various Wine-BEE models. BEE will only achieve its goals of enablement and sustainability where the influencing factors are positively working towards a successful outcome; a meaningful analysis of models must holistically consider these factors. One way of analysing BEE models is by considering their ownership structures, operational activities and financial profiles.

The list below covers the various models accepted under the Wine Transformation Charter and are also currently in existence in the Western Cape plus some which are proposed or in the planning stages. Each model has its own strengths and weaknesses and can be adapted where necessary for the specific situation under consideration. The list is not definitive; there may be other creative possibilities as yet unaired. Moreover, It is possible to fuse some of the models into a kind of hybrid - like combining profit share with housing schemes, etc.

The models can be grouped into two groups – land linked BEE (with a major element of land reform) and BEE that is not land linked.

Land-linked BEE models.

- Individual entrepreneur
- Crop share
- Profit share
- Accrual of crop or profit share (time assisted acquisition)
- Contract farming and satellite schemes
- Employee equity schemes
- Co-operatives
- Community based ventures
- Collective farms
- Housing

BEE models - not land linked

- Marketing and brands
- Value add SMEs
- Service SMEs

6.3.1 Individual entrepreneurs:

This model is easily described. It is where one or a small number of black entrepreneurs take ownership of an integral portion of a link in the value chain such as a wine farm, cellar or say a wine brand.

Ownership structure: The commercial entity is owned by a single or very small group of BEE entrepreneurs either as a proprietorship, close corporation or company. The particular entity is of little significance as far as the model is concerned. Obviously the owners have total control over the activities of the unit and are free to appoint management of their own selection as well as take advantage of their BEE status in terms of operating within the industry and the support which such status attract.

Operational issues: In this case all staff is appointed by the entrepreneur(s) and is subject to their direction. Development of the resources under their control (including debt funding) will be carried out without external help unless such help, like employing a mentor, be felt by the entrepreneurs to be needed.

Financial profile: Where land is involved LRAD funds are available to black entrepreneurs. Such funds are provided by government as a grant which can be leveraged up by increasing the beneficiaries own inputs including assets and so-called sweat capital (see comments later). An important condition attached to the grant is an inability to dispose of the property, at least within a five year time period. Funding is also available to black entrepreneurs from CASP (Comprehensive Agricultural Support Programme) which seeks to finance specific machinery, equipment and other input costs. As entrepreneurs, the owners are free to borrow from commercial banks and the Land Bank which offers softer conditions and a lower interest rate to empowerment projects. The balance of the funding will off course be the entrepreneur's equity.

General comments: Because of the limits of government funding for individuals (twenty thousand rand is granted) entrepreneurs require considerable capital of their own in order to pursue a full ownership option in any integral commercial unit within the wine industry. In some cases farms are being purchased by wealthy black businessmen who have the resources to develop the farms according to their own specific needs. These entrepreneurs have the capacity to employ the necessary expertise – an essential component of successful operation within any of the value chain links. In some instances black entrepreneurs have been able to extend the capital grant base through including extended family members as beneficiaries. Strictly speaking these are in the category of community based schemes. A small family group does, however, allow operations to continue without the need to consult an often disinterested community group which is the normal procedure with community schemes. A very small ownership group is able to act decisively in pursuing their business objectives. Group size is a factor which significantly affects the efficiency of an empowerment project as will be seen.[22]

6.3.2 Crop share:

A crop share scheme, which applies to producing farms only, is the result of a contract between the commercial farmer and one or more 'contractors'. The contract, written or verbal, describes an area of land which the contractor can farm on his own account and then pay the farmer/owner of this land a share of the crop. The land does not form part of the BEE balance sheet; nor is the funding for land required. A possible empowering extension is to build into the contract an accrual of a portion of the value of the crop over time in a way that enables the farm to be acquired in the long term. All sorts of variations on this scheme are possible including where BEE participants are given a share of the crop in exchange for their work plus an amount set aside to enable participants to build up capital to start their own enterprise. The latter possibility has ramifications in terms of the Conditions of Employment act; such conditions may seem to be unfair as far as the beneficiaries are concerned.

Ownership structure: In essence, nothing is owned by the beneficiaries except for their share of the crop; in whatever manner this is calculated. In empowerment terms the value of such an arrangement would depend upon the value and term of the contract. Accepting that security is an important part of BEE (a recommended criterion for land reform evaluation), such a model could only be accepted as BEE-acceptable if the contract allowed for an additional portion of the shared

[22] The 2002 Census of Agriculture shows that half of the commercial farms in South Africa have a turnover of less than R300 000.

crop to accrue in order to purchase a meaningful share of the business (portion of the land perhaps), if not the business as a whole.

Operational activities: Where crop sharing is practised, the application of management and source of expertise should be clearly specified. The operations will need guidance which could be through the farmer or through sources identified by the BEE party. The very interesting variation is that the land could pass into temporary government ownership where the government, as trustee, could fulfil the function of farmer in the above model. The problem of appropriate control over use of the land would have to be dealt with.

Financial Profile: A standard crop sharing model is similar to a leased asset where the lessee has to provide all input costs for his own account. The crop share sacrifice will be solely on the value of the grapes (as far as this report is concerned) produced in the specifically identified land. This means that the costs will have to be financed, possibly as a lien against the crop. Even in cases where labour alone is provided the BEE partner will have expenses which need to be financed. The accrual effect over time could also be used to generate capital as it takes effect.

Comments: Share cropping provides a way of empowering PDIs with minimal capital. However, unless some form of accrual system is built in there is nothing to work for, the outcome is insecure, it is based on a seasonal time frame, and not particularly enriching for the participants. The land and vineyards do not belong to the empowerees, the principle of 'enablement to shape ones own destiny' does not apply. However, where there is a linkage to the acquisition of land, crop sharing makes extremely good sense as the transition to ownership is gradual along with the transfer of responsibility and skills and will lead to the ultimate empowering event – ownership and control of the land.

6.3.3 Profit share:

A profit share model is similar to crop sharing except that what is shared is the revenue and expenses applying to the field or farm. Profit share is common business practice since it encourages employees to be conscious of the monetary value of inputs and outputs and become aligned to the making of profit. The profit share model is not accompanied by an injection of capital (this would be a share equity scheme, described below) therefore no capital grant is required for beneficiaries. There is no ownership of the assets employed, resulting in an imbalanced dynamic at least with respect to economic empowerment. The situation becomes more acceptable, however, if profit share is linked to the acquisition of assets over time.

Ownership structures: Typically such a system would operate between a farmer and his employees where the farmer retains ownership in directing the operational activities. From an operational point of view, a profit share may well result in worker efficiencies which are beneficial to both the project owner and the workers. Workers are also exposed to their share of risk should no profit be generated.

Financial profile: Because there is no capital injection required from the BEE party, the financial profile is essentially the farmers' own. Any costs attached to this profile should not be part of the share arrangement.

Comments: Unless profit sharing is accompanied by a plan to own the entity, it has little value as a BEE project. Where applied, it is important that only those costs influenced by the employees be included in the calculation (like say pruning costs); costs which are controlled by the owner (such as the selection of spray material) would need to be excluded in the calculation of 'profit'. Furthermore, a profit share scheme exposes beneficiaries to climatic and market risk in which risks they are expected to share. The result is that outcomes on the downside can create disappointment. Indeed, many of the problems arising from profit share schemes have to do with a poor understanding by employees as to how their particular scheme works and their position in it in relation to expectation.

6.3.4 Accrual of crop or profit share (time-assisted acquisition):

This model takes a part or the entire crop or profit share earned by the BEE party and accumulates this into an equity account. It is therefore possible to purchase all or a share of a business entity given enough of an income share and enough time.

Ownership structure: This scheme is principally dependant on farmer and employee relationships. There are various ways in which the ownership of such a scheme could be structured. Shares in the governing company, for instance, could be warehoused after issue and then distributed over time to scheme beneficiaries on the basis of previously negotiated values. The number of shares allocated each year would of course depend upon the performance of the company, in turn depending to some extent upon the performance of the BEE participants. This is similar to an option scheme whereby shares are acquired upon which an option has been granted at a certain (usually discounted) price. An option scheme is not necessarily automatic since it requires a 'call up' process. The distribution of shares to employees over time can be made to the group (a trust) or to individual employees based even on the equivalent of an employee scorecard.

Operating activities: The management of an accrual type scheme is usually in the hands of the farm owner until such time as a meaningful stake in the farming business has been acquired. Such a stake could be a part of the farm or possibly even an entire farm.

Financial profile: The accrual scheme does not require upfront funding. The purchase of shares is paid for out of income or crop accrued over several years. At present LRAD type funding is not available for steady asset accrual over time. This is a pity as acquisition in this way could be advantageous.

Comments: Schemes like these are potentially effective where they can be acceptably engineered. Payment over a period of time to some extent alleviates the high capital requirement of an upfront farm purchase. It also implies effective skills transfer and should result in a motivated workforce eventually taking up the mantle of ownership and responsibility over time. The difficulty obviously is in finding farmers who are prepared to lock up a portion of their farm or a meaningful stake in their

company for future disposal on the basis of a fixed price and without immediate guarantees or cash. Is this not a case for intervening by buying out the farmer and allowing the process to continue in an 'employee trust' mode. Such intervention could be undertaken by state bodies such as the Land Bank.

6.3.5 Contract farming and satellite schemes:

This scheme involves the contractual business relationship between a number of emergent farmers and a central processing facility, which facility is sometimes also surrounded by producing land. Contracts are awarded to farmers to supply the processing unit at fixed prices and for a fixed term. Such schemes are common in developing countries particularly where a large capital outlay is required in crop processing, such as a tea factory or sugar mill, where economies of scale are critical to the efficiency of the processing unit. Most of the sugar industries in South Africa operate on this basis. Contract farmers are often known as out-growers. The central processing units can be owned partially or fully by BEE participants.

Ownership structure: There is a two fold ownership structure here. As mentioned, the processing unit or supporting agri-business will have its own ownership structure which may or may not include shareholdings held by the outg-rowing farmers. The out-grower farmers on the other hand, will probably have sole proprietorship on their own portions of land. Where this is not the case, it is quite possible that leasehold arrangements with an accrual dispensation could be entered into. Indeed an accrual of part of the rent could be combined with debt to enable the land to be fully purchased from the lessee (for instance Land Bank, government). The above is effectively a hybrid model whereby the out-grower through revenue accrual and a fixed supply contract to the processor can eventually acquire land.

Operational activities: Most often it is in the interest of the contracting agri-business to transfer skills and expertise to emerging farmers. Such agri-businesses are also able to offer working capital against delivery of the crop. A sound symbiotic relationship is therefore possible. The satellite units predominantly found within the contract mandate are able to manage their own land with confidence.

Financial profile: If properly planned, and with the support of a reliable agri-business, much of the working capital requirements can be met through the value of the contract. Additional funds would be required to purchase the farm – such funds coming from a combination of grant, debt and equity. In the case of time-based accrual, equity would be built up and assets acquired over time.

Comments: The sugar industry in South Africa has indicated the usefulness of contract outgrowing schemes[23]. There is little reason why some of the larger wineries cannot assist the empowerment process in a similar way. Unfortunately, the present time is not economically conducive to the establishment of new vineyards for out-growers. It does however open the door for the purchase of larger farms which could be subdivided for out-growers. This may turn out to be an important BEE

[23] Discussions with management of TSB at Mpumalanga

option, once the wine cycle changes for the better and could be carried out in collaboration with government.

6.3.6 Employee equity schemes:

Employee equity schemes are historically among the most popular models in BEE and land reform in the Western Cape. These schemes are to do with the arrangement whereby farmers sell portions of their farm shareholding to their workers. In the process the workers acquire voting rights and, in some cases, veto rights on undesirable (to them) structural changes which the farmer might be considering. In isolated cases the employees have a half share in the business. In the process employees become involved in the management of the farm as board members and receive dividends *where these are declared*. One objective of such a scheme is that workers are motivated to improve productivity for the benefit of 'all the shareholders'. Another, and this is why the scheme is attractive to employers, is to assist in strengthening the farming balance sheet. Some of these schemes are successful; others not, mainly due to the confused roles of the project players and often intrinsic flaws in the operation itself.

Ownership structure: The ownership structure is an important consideration in such a scheme because through it the responsibilities and controls between the employer and employees are allocated. Employees are usually represented *en bloc* through the formation of a workers trust or similar entity. Because most share equity schemes are in the form of a company, the shareholding apportionment to the employee group is important for empowerment.[24] Less than 25 % gives the workers a minority interest with little power over the business, unless these can be achieved on the side via contractual arrangements. Such minorities have limited rights and are often little more than a nuisance-lobby to the employer. For this reasons, small minority share equity schemes are insecure. Where shareholding is greater than 25 %, the employees have substantial veto rights and the power to become part of the consulting framework where major changes to the farming business are planned. A shareholding that is 50 % and more, offering equal or a full control, is fully empowering and desirable from that perspective. *Again, there is no reason why the shares cannot be increased to the 50% level through profit retention or accrual.*

Operational activities: In nearly all cases of employee equity schemes ultimate control is vested with the employer/farmer. However, in practice, this control is muted by the 'unaccustomed' role of employees as partial business partners. Employer/farmers have found it difficult to direct their workers where those workers perceive themselves also as joint owners. A more workable arrangement is where the farmer and his employees invest jointly in an outside farm or brand, say, as 'equal' shareholders, in which case the conflicting roles of owner and employee are set aside. Importantly, from an operational point of view is that an employee equity model must be founded upon understanding and trust for the farmer to farm effectively with his employees.

[24] Often neglected when empowerment is evaluated is the way in which the *en bloc* PDI entity is structured and managed. This determines the degree of empowerment of the *individuals* within the group.

Financial profile: As mentioned, much of the popularity of employee equity schemes comes from the need for farmers to strengthen their balance sheets or fund the development of their farms. Elsewhere in the chain, equity schemes are a useful way to enhance BEE credentials. Land reform money entering the system is usually but not always used productively. Sometimes the funds are used to pay pressing debts.

Comments: The employee equity scheme model is extremely useful in respect of both land reform and BEE. It is a mechanism of sharing, sharing in several aspects of the business and in a way *which can be contractually linked in a time-based manner to the ongoing transfer of ownership*, control and even management – in large steps or by degrees. If this model is correctly balanced, it has: the advantage of a built in and motivated mentor (the farmer or business owner); the business is usually a going concern so the outcome is more secure; flexibility and, where required, rigidity can be contained in the articles of association; time frames linked to options can be accommodated; shares can be warehoused in trust pending later transfer; shares can be bought or sold under predetermined conditions giving the committed BEE partners the opportunity to accumulate shares and the less committed the opportunity to dispose. The failures from share equity schemes lie in: lack of balance in the project design; entering the arrangement for the wrong reason, i.e. to stay solvent; where expectations are not aligned to outcome; where risks have not been properly communicated.

6.3.7 Joint venture schemes:

Joint venture schemes may be defined as those schemes where a farmer or other commercial entity in the value chain forms a separate business unit with emerging producers or other interested PDI groups. The two parties could, for instance be a commercial farmer with his employees each investing in a separate joint venture such as a fish farm on the farm, or another separate farming entity or indeed a cellar or brand development business.

Ownership profile: The joint venture would be owned by the commercial farmer on the one hand and a group of empowered individuals on the other. The proportions of ownership could be in any ratio depending upon the objectives of the alliance, i.e. who would have effective control, what assets could be brought into the venture and from whence the financing would be sourced? Again several possibilities could be built in during the negotiating stage: how shares could be acquired over time, performance related options and the like; bearing in mind that phased in ownership would probably be the most sustainable in the longer term.

Operating profile: Management of such a scheme would be vested with the commercial farmer or business manager. The labour could be provided by the empowered individuals in lieu of investment capital. As with all BEE models, it is necessary to build in to the management profile the necessary processes for skills transfer, without which empowerment is not real.

Financial profile: Initial funding would be in the form of farmer investment capital (possibly physical resources) along with an LRAD grant should land acquisition be part of the project and also CASP. Debt could be included and could be provided by the farmer as loan capital or a commercial source guaranteed by the farmer. In the latter case such debt could be converted into

share capital by transferring it into the hands of the empowered group as their share of profit pays it off.

General comments: Separate joint venture models where resources, management, and a skills transfer mechanism are built in and where there is no confusion of employer/employee roles, are the most balanced and in the consultants view the most likely to work in the longer turn. Indeed, it is possible that such schemes may become the most popular over time, provided that sufficient incentive is offered to the commercial farmers either through: overall asset enhancement; participation in beneficial marketing arrangements such as fair trade; or even through the more general advantages of BEE score card enhancement. Where such incentives to the commercial partner in such a scheme are applied they need to be balanced by ultimate benefit to the empowered group. Such outcomes are in the greatest national interest.

6.3.8 Co-operatives:

As the name implies co-operative schemes provide an operating entity from which members through collective strength, can carry out their operations more efficiently. To operate, co-operatives require a common goal, a membership group and a controlling body elected by the members. Shareholdings are equally distributed between members, though the profits may be distributed according to each member's contribution to the overall turnover or activities of the co-operatives. Each member operates independently in what he is doing but is subject to the rules of the co-operative. Co-operatives are of many kinds such as product marketing, production, processing, input supply, and the supply of services.

Ownership: Ownership and control of the co-operatives is in the hands of its members. A member's investment share is usually very small (therefore with little incentive for the member to protect it). The bulk of the financial structure is usually financed with debt offered by a national implementing agency such as the Land Bank.

Operational structures: As mentioned, a governing body or Board of Directors is elected by the co-operative members and, is free to employ the necessary technical and management expertise.

Financial profile: Traditionally, co-operatives are funded with little equity capital being mainly loan capital either guaranteed or levied by the members and/or provided through parastatal finance. Co-operatives are intended to provide support where the fee levied for that support is usually based upon cost with little margin for profit. The advantage of the co-operative is its collective usefulness in support rather than its ability to generate a dividend. Profits should be generated by the members own business activity.

Comments: As could be expected, the co-operative structure has implications on business vision, motivation and efficiency. What enabled co-operatives in the past to grow rapidly were tax concessions on profit margins, the cash from which was directed into expansion and sometimes with the passing of time into inefficiencies as without tax, it was easier to compete in the market. With some of the incentives removed, entrepreneurial and corporate organisations in competition with co-operatives became more successful, leading to the general decline of co-operatives as they

were then known. The co-operative has its value, however, in providing a collective and structural framework and a mouthpiece for community based organisations, such as community farms and marketing organisations. The original advantage of scale bargaining and efficiency is again stimulating interest.

6.3.9 Community-based ventures:

The LRAD and SLAG policies of land reform lend themselves to community based ventures. These are activities which are owned by a group or community – often residents in the same area – formed to purchase a farming enterprise. Such ventures are fully owned by the community and controlled by a handful of trustees. Large or small communities are involved.

Ownership structure: The owner of the assets is usually a Trust with community members as equal beneficiaries. Trustees manage the business or property on behalf of the beneficiaries.

Operational structures: Where expertise is not available within the community, it is sometimes is brought in, in the form of a mentor. External management and mentoring can have a critical effect since empowered individuals positioned in a skills vacuum have to rely heavily on such expertise. It is also nearly always the case that only a few members of the community investing in such schemes actually enjoy active participation – even as workers. A corollary is that non-active members through weight of numbers have the power to orchestrate the sale of a business or property preferring to have the cash than be sidelined.

Financial profile: Normally the financial profile of the community based ventures is heavily geared with debt. Most such ventures are financed from LRAD grant capital assisted by CASP funding, which is often insufficient to make a project fully operational. There is considerable danger that such schemes result in under capitalizing and, finally, failure. The Land Bank has funded a number of the earlier land reform schemes in the Western Cape but nearly all of these have been unable to succeed. The amount available for a family under government grant schemes is insufficient to purchase land and simultaneously have enough working capital.

General comments: As mentioned there are many community based ventures in South Africa and a few in the wine industry. Generally these are severely imbalanced schemes – large numbers of non-participating beneficiaries, insufficient capital, excessively authoritarian leadership by trustees and a general lack of skills without the means to acquire these. Should schemes be devised which could lessen the capital burden of land purchase and concentrate the funds into working capital and acquiring skills, a community scheme could work. It is still necessary however to minimize the number of beneficiaries involved, as large numbers of people are often accompanied by significant disillusionment.

6.3.10 Collective farms:

By collective farms is meant usually the aggregation of land out of smallholdings to be farmed using farming protocols guided by a central authority. The authority, which may delegate its powers to an elected group, will allocate facilities, machines and marketing services and requisites to the participants. The authority is appointed by government which acquires the aggregated land on

behalf of the collective community. Conceptually, this process could be temporary to get the farm up and running after which the land could be owned collectively in an entity (like a Communal Property Association (CPA) that governs its use. Participation obviously requires the acceptance of certain rules and regulations applying to the collective.

Ownership: The collective farm could be owned by the government or a parastatal. The possibility exists that the community may take transfer over time. The shared resources and production are owned equally by the community. This is close to the co-operative model.

Operational structures: Each farmer produces the agreed product(s) within general guidelines which meet with the marketing and input programmes. The central administration of the shared resources is traditionally (to collectives) appointed by the government; appointees are reputed to be drawn from the more politically orientated members of the collective.

Financial profile: Collective farming does not easily operate smoothly because often with a group of farmers with similar goals in a sharing environment, conflicts emerge. This applies to shared resources (the capital for which is supplied through government grants) where timing and maintenance issues affect some members of the collective than others.

Comments: The collective farming model has a bad history in Africa and elsewhere. Theoretically it could be seen to be promising where emerging farmers possess the necessary competency, and the prescribed production guidelines are correct. It would also require that the way in which crop is shared should reflect each individual effort and performance. Ultimately, it is the way such a scheme is structured and governed that will determine its success. If the governance is electively formed and individuals farm the land for their own account one must recognise that the model is more like that of a co-operative.

6.3.11 Housing:

The housing empowerment projects are in many ways a component of the commercial farming activities. Simply, such schemes are the provision by the farmer of land to a group of employees to empower them with possession of the land, build a house upon it thereby acquiring an asset for their future. Such schemes and the administration of the housing are usually governed by CPA's (Communal Property Associations) entities owned by the community members and which determine the rules around which the Associations and their members function.

Ownership structures: Ownership and title of the land and buildings is vested entirely with the CPA (or sometimes a Trust). There is complete freedom to develop the property for mutual benefit, with special arrangements built in to the CPA articles to describe the conditions under which houses are transferred from one family to another.

Operating structure: The CPA is governed by elected directors/trustees who ensure that administration and regulation of the CPA is according to the articles and the reasonable and

realistic needs of the owners. It is relevant that the housing model does not generate income – it merely creates an asset.[25]

Financial profile: Housing schemes are no longer being promoted but were originally financed after 1994 by SLAG grants from government at R16 000 per family (compare LRAD which is R20 000 per individual). Land and term finance are often also supplied by the farmer.

General comments: The system is empowering in the sense that it creates an asset in the hands of empowered individual; but it does not assist in the empoweree's general economic improvement and his capacity to direct his own destiny, which is what empowerment policies are intended to promote. Furthermore, housing requires servicing and standards that are often unable to be supported by the CPA itself, nor indeed the farmer, and often require a reluctant municipal intervention.

6.3.12 Off farm business opportunities.

Marketing and brand development: (also see 6.2.14 [i]). The development of brands in wine is a growing trend along with the increase in farm and boutique wine cellars and so-called virtual (blender's) wines. Brand development and marketing presents an opportunity for BEE in association with wine cellars. It can even be done in the virtual context without the full connivance of wine cellars using only their bottling facilities. In this case, wine is spot purchased from various cellars or farmers and then blended and bottled. The BEE association is by shareholdings where shares are taken up by PDIs at a discount and is a way of gaining BEE scorecard value as well as offering access to "fair trade" markets. Also, brand development can be carried out as part of an employee equity scheme.

Ownership structure: Brand ownership is usually jointly owned with the cellar concerned, though there are some operations, e.g. Bouwland, where the (virtual) brand is exclusively owned and marketed on a commission basis through either a cellar or marketing agent.

Operational structure: Normally the BEE participants are relatively passive though brand development offers employment to some of the appropriately skilled members. Marketing management is usually in commercial hands (by agreement) with BEE representation being involved, with the plan that the BEE group fully assumes control within an agreed time frame.

Financial profile: Where there is a linkage to land, brand development costs can be assisted through LRAD funding. It can also be assisted by loans through IDC and Land Bank. In general, there is no substantial requirement for promotional capital as the brands are distributed initially on a small scale through agents or distributors charging a commission or cellars with retail capacity – for example Bouwland wines are sold from Beyerskloof Wine Estate, the estate which helped sponsor the BEE outcome.

[25] Unless it is situated in a town or village and viewed as an eventual retirement home which could accrue a rental income in the interim.

General comments: The marketing and brand opportunities have proven to be successful particularly in the fair trade and 'ethical' consumption. Brands are also being linked (like Sonop Winery) to organic production giving a unique lever into the market place, particularly overseas. Ultimately, brands of consistent quality appropriately marketed can develop a substantial value of their own which in the longer term will be of significant benefit to the BEE owners/partners.

The fact is that virtual black wine business developments are gaining momentum in the BEE arena; the latest developments warrant an extended discussion. Since 2001 a number of BEE business entered the downstream-end of the value chain as trading or marketing companies. The idea is to reduce infrastructural costs, given the capital intensive nature of the industry. Table 8 provides a list of the known black wine businesses in question. As they are not primarily wine grape producing entities but rather businesses focusing on marketing and trading, they are often referred to as "virtual" wine companies.

Table 8: A list of "virtual" black wine businesses since 2001

Emerging wine companies (2001-2007)	
Buthelezi Wines	Women-in-Wine
Yammé	Lathita Wines
The House of Lindiwe	Kuyisa Wines
Malibongwe	Kholisa Wines
Mia Cara Wines	Vunani Wines
African Roots	Loopspruit
Ses'Fikile	Kumala
Phumlani Wines	Bouwland Wines
Blouvlei Wines	Thabani
Imvula Wines (previously Sibeko Wines)	Thandi
M'Hudi Wines	Re'Mogo Holdings Ltd
Black Grape	Eden's Vineyards
Crossroads Wines	Tukulu
Sagila Wines	Indaba
Thokozani	Karuwa, etc

Source: Sefoko and Ndanga (2007).

A number of these companies organized themselves into a trade organisation called the South African Black Vintners Alliance (SABVA) which focus on promoting the interests of their members in the wine value chain.

A SWOT Analysis by SABVA (Sefoko & Ndanga, 2007) revealed the existence of these "virtual" BEE companies (Table 9).

SABVA believes there is potential for wine sales by their companies in all markets, particularly in the township areas. Some segments of this new wine consumer profile prefer to drink established brands. Blind wine tasting including new brands should be an integral part of the SABVA wine marketing strategy.

Some members believe that SABVA needs to be given more financial support to be effective. However, current internal feuds are seen by other members as an indication that "collective politically-inclined" business models are seldom viable as they deal with prejudicial issues borne out of the concept of entitlement. This may hinder the business process.

Table 9: **A SWOT analysis of "virtual" black wine businesses**

Strengths	Weaknesses
Build strong brands through ethical labels.	Lack of professionalism by members: do not attend meetings and conferences or follow-up on support initiatives. This attitude borne out of a sense of entitlement.
Opportunities in branding for exports with outsourcing of winemaking.	Initial focus on the demanding export market without sufficient skills and delivery capacity or systems.
Virtual company model cut costs by avoiding of primary production.	Lack knowledge of the origin, history and technical aspects of the wine being promoted (e.g. soil, climate, conditions, winemaking styles, etc).
Entrepreneurial spirit will be activated, if properly channelled.	Differentiation on ethics not sustainable.
	Cash-flow problems: focus only on increasing wine sales and less on reducing costs.
	In retail outlets, new entrants have a tendency to equate securing shelf space for wine to success *per sé*.
	Lack of time commitment: some new entrants still retain their full-time jobs and perceive wine business as a spare time cash-generating activity rather than a long-term business investment.
Sectoral and industry organisations offering knowledge, financial and organisational support (e.g. WOSA, SAWIT's SPV initiative, ECI, SEDA, etc).	Government departments use strict business criteria and many emerging black businesses find it problematic to qualify.
The emerging and growing South African black wine markets (townships) and US African-American market (east coast).	The Virtual company model serves to establish a label but may not be sustainable as an organisational and integrated business model.
Exclusive wine tasting sessions at specific outlets.	Not in full control of the supply chain and winemaking process create marketing challenges.
Guarantee consistency of supply and quality.	Export market is flooded with wine.
Support through partnerships/agribusiness linkages with established business and more viable than government support, especially at the beginning; independence only later on.	Competing for the same resources and market. Black business perceives to receive prejudice from established businesses; the latter tend to internalise black businesses as part of their BEE obligations.

	"Red tape" with export market.
	No financial support focused on new entrants.
	Cannot compete with huge marketing budgets of established operatives.
	The fluctuating exchange rate in export markets.

Source: Sefoko and Ndanga (2007).

Most members agree that it is financially more advantageous to be involved further along the value chain rather than at wine grape production level. Production history or heritage and place of origin may however play an important role in some market segments. For example, Thandi's "fair trade" tag provides the main component of its traceability system ("back to the production place/farm of origin").

6.3.13 Service SMEs:

This is a particularly interesting general set of service opportunities which are able to grow out of the wine industry. It could be anything from contract harvesting and fertilising to transport of grapes and marketing, even staff recruitment and the like. Some of the bigger corporate businesses in the wine industry are in a position to provide significant support into such BEE initiatives.

Ownership profile: The ownership profile in such endeavours would depend upon the nature of the business concerned but is mainly entrepreneur owned. Some businesses, such as for instance contract harvesting provide relatively low barriers to entry and can offer significant possibilities in entrepreneurial development and empowerment generally. Others can seek assistance for finance through the DTI schemes and even the commercial banks. The IDC has facilities for worthy SMEs.

Operational structures: Businesses of this nature are usually managed by the entrepreneur, usually guided by their wine industry customers.

Financial profile: Typically such businesses are funded on low capital by the entrepreneurs themselves. More successful entrepreneurs will have access to government, quasi-government as well as commercial bank funding for SME development.

General comments: BEE involvement in the service industries and also value adding has significant advantages and should be energetically encouraged. The wine industry is large in the Western Cape with several opportunities along the value chain. Many of these do not have particularly high barriers to entry, but by entering, the process of accruing skills and entrepreneurial experience opens the way for further empowerment possibilities. The scorecard mechanism intended for Wine BEE will further accelerate the development and exploitation of such opportunities. Along with available BEE funding in general and Land Reform funding in particular there is good reason to believe that Agri BEE in the wine industry will make a useful contribution to BEE in South African in general.

6.4 Tools and levers

This section will consider some of the approaches towards facilitating BEE whilst at the same time minimising the failures. In respect of Land Reform, a great deal is known. The most important are insufficient capital, lack of skills, unhealthy group dynamics (especially where there are larger groups), inappropriate planning, disappointment amongst beneficiaries and disregard from commercial partners in the equity schemes. All these are examples of the 'lack of balance' problem discussed earlier. The tools or mechanisms which can mitigate some of the imbalances are mentioned below.

6.4.1 Mentors:[26]

To mitigate against the lack of skill and experience at management level of BEE participants most land based projects in the Western Cape have mentors allocated to them. In most cases this skills ameliorative mechanism is working successfully – though in others the mentors have proved to be either lacking in appropriate skills (including relationship skills) or commitment, and the assistance offered is infrequent and insufficient[27]. Without doubt, the best mentors are those which have an equity stake in the empowerment project, where there is a meaningful stake in the outcome, and requires a partner's input rather than the paternalistic approach which regrettably is intrinsic in the meaning of 'mentoring'.

6.4.2 Sweat Equity:

The concept of providing a capital input through a promise to work (thereby maximising the LRAD grant) has proved to be impossible to enforce. Many beneficiaries claiming the benefit have not worked on the project. This has lead to the virtual abandonment of sweat capital. But the principle has merit. Where sweat has been applied the feeling of ownership and empowerment follows. Consideration should be given to BEE models where certain shares or a proportion of the ownership could be held in trust and issued against the value of the work input to those individuals who work on the project.

6.4.3 Warehousing of shares:

This concept has many applications and is being very usefully employed as a means of transferring ownership as the project profits are able to cover the investment costs. The IDC is an institution which utilises this system. In the warehousing scenario funds are invested as equity and held in trust for release at a later stage against repayment of the original input finance plus a previously agreed accumulated interest. Such repayment comes from the BEE share of the profit. The interest rate charged for BEE projects is usually well below the market. An option system could be similarly applied where BEE entities purchase cheap options realisable out of future income, the value of shares being determined through an upfront negotiated arrangement. Variations on this theme, as mentioned, would be to lease (or sharecrop) with an option to purchase. The purchase of a shareholding (from LRAD funding for example) plus options upfront would be an attractive way to increase shareholdings over time of the PDI component.

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[26] The South African Wine Industry Council is currently involved in industry wide mentorship programmes, supported by the National Department of Agriculture. A number of skills including farming, winemaking, finances, business management, etc are provided.

[27] Personal experience while researching land reform projects.

6.4.4 Regional differences:

The issue of land values is an important one and a serious obstacle to Land Reform and BEE. Investigations[28] carried out on BEE for the wine industry which preceded the development of a Wine Charter highlighted the differences between the different areas – particularly in respect of capital returns. This study, which surveyed the different wine producing areas from an economic perspective, considered the concept of a 'funding gap'. The funding gap is simply the difference between the productive value of the land (value derived from acceptable returns within the investment milieu for similar risk) and the market value which is based upon the willing buyer, willing seller price of land. It would make sense therefore that for land-based empowerment to succeed the government and wine industry authorities should plan for substantial additional funding. Failing which potentially empowered participants will find it impossible to become entrenched as meaningful players in the wine economy. To assist in bridging the funding gap, creative consideration could also be given to time assisted land acquisition through warehousing, granting share options, assisting the 'lease with option to buy' alternative.

6.4.5 Conclusion:

There are several BEE model options available in wine BEE. Some are working successfully. Some have not worked because of imbalances and detrimental organisational dynamics. Others have not been tried but are in the 'design' pipeline whilst still others are proposed but need the stamp of government approval to implement. The evidence is that most models could be regarded as workable given the right conditions – thereby underlining the huge importance of examining each potential BEE project on its merits and designing well in advance a balanced programme for its implementation.

6.5 Perceptions of BEE

What are the current perceptions of BEE by the intended beneficiaries in the wine industry? Anecdotal information is varied. A study by Sefoko *et al* (2006)[29] is one of the few that has examined this issue in the agricultural environment by way of a scientifically conducted study focussed on the wine industry. It is only necessary here to summarise the relevant findings

Three questions were examined through focus group discussions conducted in a broad-based survey. These are:

(i) What do the beneficiaries of BEE perceive to be important?

Six dimensions were identified as important, viz:

[28] See footnote 21.

[29] Sefoko, N., Janssens, W., Van Rooyen, CJ. & Bostyn, F. (2006). Measuring perceived black economic empowerment: the case of the South African wine industry. Agrekon 45 (4) 381-405. The study is continued as research towards a PhD N. Sefoko.

- *Business ownership and control:* To have something that belongs to you or your group with regard to the business. Control means to have the power or authority to direct, order, manage or make business decisions.
- *Access to finances: T*o have access and control over your finances.
- *Employmen: F*eeling secure in your job and work environment.
- *Human resources management:* Feeling satisfied and respected in your job.
- *Social capital environment:,* Access to social structures and networks and to use the knowledge gained and the contacts made to create new possibilities for your own economic initiatives.
- *Collective action:* To organize, defend and promote your interests at business and industry level.

In all these, there were no age, gender or work level differences observed, but geographical differences were found. This suggests that variation does occur at the firm level and at regional level. High scores were observed on employment security and the feeling of respect in the work place. Respondents also identify strongly with issues that are related to their social environment.

(ii) What are the responses to the newly adopted Wine Industry Transformation Charter?

Respondents, when asked about their perception of the importance of the Charter as well as each component of the recently adopted Wine Transformation Scorecard, indicated that skills development, rural development and employment are the three most important. Beneficiaries also perceived their own progress in this regard as positive.

(iii) What are the respondent expectations about their BEE status in the future and the gap between perceptions and expectations?

The preferred objective is to ensure that respondents improve their level of empowerment with focus on the following: access to finance; improved individual capabilities and skills; job security; and being respected in their workplace. Interestingly, and perhaps contrary to conventional wisdom, business ownership and control is currently perceived to be of lesser importance. However, this dimension was considered necessary to sustain progress over the long run.

The gap between perceptions and expectations is indicative of the tension between the prioritization and implementation of BEE strategies (through the specifications of the charter) *viz-a-viz* the empowerment preferred by beneficiaries and the actual pace of transformation.

As would be expected, the beneficiaries felt strongly that successful BEE transformation strategies must be participative in nature and should allow flexible approaches to accommodate their changing needs and expectations. The management of perceptions versus expectations is also important to sustain progress.

7 A MULTI-PRONGED APPROACH TO SUSTAINABLE GROWTH AND DEVELOPMENT

The Wine Benchmarking report provides a broad-based "benchmark" of the wine industry as it is today: competitive and conscientiously grappling with major challenges to sustain its levels of performance. From this viewpoint, the South African wine industry will have to focus on five areas for sustained growth and expansion, which are:

(i) the crafting of an identifiable "Brand South Africa" proposition to portray the uniqueness of South Africa as a wine-producing region of excellence, adhering to sound social, environmental and business ethics;

(ii) the introduction of measures to counteract the negative impact of a fluctuating Rand such as cost effective production processes, effective supply chains, increased productivity and unique marketing strategies;

(iii) the implementation of transformation through social capital development[30] and successful BEE activities;

(iv) the establishment of a sound industry/government partnership to create a competitive framework in order to stimulate investment and development in the sector; and

(v) increase funding for industry level initiatives, especially in market development and technological innovation.

7.1 The role of the wine firms

The macro environment provides the framework within which firms operate and compete. In the final analysis, the behaviour of private sector wine firms will establish the competitiveness of the industry. This will require the ability (and strategic support) to build on enhancements and to reduce the impact of constraints. It is also clear that certain constraints cannot be dealt with directly at firm level, for example the fluctuation of the Rand. These are exogenous factors. Firm level strategies can however reduce the negative impacts of such factors. From this report, a number of key firm level focus areas have emerged. They are:

(i) **Create a culture of innovation:** Innovation at firm level is the introduction of new goods, systems and services. The wine industry in South Africa rated innovation as a major enhancement to their current ability to compete. Firms must proactively identify and adapt quicker to changes in consumer demand, market trends, technology and to new sources of competition.

Wine firms in South Africa should actively challenge competitive pressures, not avoid them. Part of this strategy could be to take advantage of market changes to create the impetus for innovation. In doing that, companies will be able to sell to the most sophisticated and demanding buyers and channels; seek out those buyers with the most difficult needs; establish norms that exceed the

[30] Refer to Annexure 7 for a recent workshop report "Making wine work for all," – dealing with social responsibility in the wine industry, currently under consideration by the SA Wine Council. The report proposes industry level action on a number of aspects including the following: target groups, responsible alcohol use, rural development and poverty alleviation, security of tenure and farm evictions, sectoral determination and employment conditions and land issues.

toughest regulatory hurdles or product standards; source from the most advanced suppliers; upgrading of skills and productivity.

(ii) **Conduct consumer analysis and market research:** Knowledge of consumer preferences and the dynamics and employing innovative means to capture such preferences in product choices are vital for success. Markets are evolving rapidly which new segments to focus on. Investment in market intelligence is a necessary requirement for competitiveness. Wine firms should clarify their strategic approaches in local and global markets.

(iii) **Differentiate the product:** Differentiate wine products into recognisable brands and establish their South African identity and develop a link with "Brand South Africa".

(iv) **Increase productivity:** To sustain competitive advantages, the wine industry in South Africa must achieve more sophisticated competitive positions over time, through firms providing higher-quality products and services or producing more efficiently. This translates directly into productivity growth. Productivity, rightly understood, encompasses both the value that products command in the marketplace and the efficiency with which they are produced. Improving cost efficiency alone - or producing more units per unit of labour or capital - does not necessarily elevate wages and profits unless the prices of the products or services remain consummate.

As global competition places greater pressure on the prices of standard goods, efficiency alone is no longer sufficient. Advanced industries improve their competitiveness more by differentiating their products and by driving up the value of their products and services (because of better technology, marketing and associated services, for example) and by moving into new fields through innovation, than by producing standardised products at lower cost. South African wine firms should actively trade-up in addition to achieving economies of scale to reduce production costs.

(v) **Accept domestic rivalry:** Intense competition in the local market is rated by the wine industry in South Africa as one of the most enhancing factors to competitiveness. Vigorous domestic rivalry creates sustainable competitive advantage at national level. It is however also important to grow internationally, seeking international partners or acquisitions.

(vi) **Focus on integrity and ethics:** This aspect needs broadening. Integrity can be defined in two ways. First, consider its literal meaning, "the state of being whole or entire". This definition is appropriate when set in context with the concept of "food chain". No longer can the food chain simplistically be seen as a linear flow of food products (including beverages) from primary agriculture to the consumer. Today, each and every part of this flow must be considered an integral link; the integrity of each link affects the integrity for the entire chain or network.

Second, integrity is defined as "uncompromising adherence to moral and ethical principles". No longer is it sufficient to ensure the food chain is safe and efficient. Today, the consumer is increasingly aware and concerned about the total integrity of their food (and beverage) system and they generally respond negatively if this trust is broken. The consumer is better educated and informed than previously and with more complex concerns.

Many of these concerns are sensitised by social interest groups raising awareness on issues such as the environment, human welfare, sustainability and ethical practices in the workplace. The introduction by the industry of biodiversity codes into the "Integrated Production of Wine" scheme to protect the unique Cape fynbos is one such positive step in this context. The Wine Industry Transformation Charter and Scorecard is another. Wine firms should insist that industry structures continually strive for improved systems governing ethical management, while the industry at large should establish effective control systems. Auditing of labour and social practices by organisations such as the Wine Industry Ethical Trade Association (WIETA) and the Biodiversity & Wine Initiative (BWI) should be embraced at firm level.

(vii) **Drive for quality:** The wine industry in South Africa identified quality as one of the most important strengths and enhancements to their competitive success. This strategy should continue. Customers demand high quality and value. Providing world-class quality requires a thorough understanding of what quality really is. Quality must be measured in terms of performance, additional features, reliability, integrity and conformance to standards, durability, serviceability and aesthetics.

Only by moving beyond broad, generic concepts and identifying the more specific elements of quality as perceived by the target market, can firms identify target needs and set performance standards more precisely - and deliver world-class value. Efforts to discourage/prevent "wine flavouring" and continuous efforts to achieve virus free vineyards are necessary requirements for all round quality, as also is consistency of product.

(viii) **Implement social responsibility, transformation and BEE:** Social development and economic upliftment must be accepted as the most important firm level transformation strategies that could influence economic sustainability in the wine industry in South Africa.

Changing the South African historical dualism with its legacy of social and economic exclusion and discrimination along racial and gender lines and redressing a wine industry characterised by highly skewed levels of ownership, managerial and technical skills combined with a lack of access to economic opportunities are all major challenges. Firms need to contribute in this context.

The core focus, alongside economic growth, is social capital development to support BEE and to enable previously disadvantaged individuals in the wine industry to upgrade skills, create economic ownership, to gain access to assets and to participate in business opportunities along the full wine value chain. Successful firm level social and economic empowerment requires policy adjustments and operational initiatives in the spheres of cultural change, economic and social responsibility programmes and skills development, to empower the staffing structures on which the firms depend to perform competitively. This should also include efforts to improve the living conditions of workers; to enhance life skills in the broader worker community; to ensure a balanced relationship between worker representatives and employers in the workplace; and to establish an expanded and demographically more balanced ownership status.

In making these changes, the integration process can and should be orchestrated in such a way that it contributes constructively to the competitive success of the wine industry and to the country at large. The components of the Wine Transformation Charter and Industry Scorecard provide a clear framework for firms to integrate empowerment into their performance management systems.

The role of wine cellars (co-operatives) should be viewed as central to a Wine-BEE strategy as this activity links wine grape production to the value chain.

7.2 What the wine industry believes government should do to support the wine industry

Government does have a central role to play in promoting competitiveness performance in the South African wine industry through a particular set of rules, regulations, policies and interactions – all establishing the macro-environment for the industry. The study makes it clear that government is viewed an important player in a successful South African wine industry.

The study has revealed several functions and roles in a successful wine industry. Firstly, government should take responsibility in encouraging transformation and change in an orderly manner and through appropriate incentives; secondly, government should reduce the "cost of doing business" and promote domestic rivalry and market access; thirdly, government should stimulate innovation in the industry; fourthly, the wine industry believes that government should support the wine industry in competing in a distorted and risk prone global economy. Government receives more than R3 billion annually from the wine industry in excise duties. The industry is currently mobilising R50 million for support systems from its own ranks and believes the government does have a responsibility augment this fund.

Specific approaches for the South African government to sustain and enhance the competitiveness of the wine industry include the following:

(i) **Confirm the Wine Industry Transformation Charter:** Any uncertainty in regards to the required performance by industry support to transformation in order to ensure access to government incentives and support mechanisms such as licensing etc will impact negatively on the growth path of the industry. This will also constrain its ability to introduce and sustain transformation initiatives and BEE schemes. The finalization of the Wine-BEE Charter must therefore be viewed as an important priority.

The Charter, it should be added, provides a well-considered basis for required government support systems, interventions and incentive structures.

(ii) **Create a stable macro-environment but avoid intervening directly in the economy, particularly in factor and currency markets:** The government does have a direct role in creating a stable macro-economic environment and "clear-rules-of-the game". The fluctuating Rand has been perceived by the wine industry as a constraint on the competitive edge of the wine industry.

However, the wine industry feels strongly that government should not intervene in factor and currency markets.

The transformation agenda may however require certain direct actions by government in respect of land acquisition, BEE and labour legislation. Policies developed to intervene in such factor markets could carefully be considered. A fine balance between direct intervention and the transformation agenda will have to be established.

(iii) **Assist the industry in enforcing strict product safety and environmental standards:** Strict regulatory standards and the production of environmental friendly products are currently enhancing the competitive success of the wine industry in South Africa. Government through agencies such as the South African Wine and Spirits Board and the wine industry through its appropriate bodies should continue with this policy. Stringent standards for product performance, product safety and environmental impact put pressure on companies to improve quality, upgrade technology and provide features that respond to consumer and social demands. The provision of sufficient and capable laboratories to support testing and certification was identified as an important constraint in the South African wine industry.

(iv) **Promote sustained investment:** Government has a vital role in shaping the environment which directly influences the goals of investors. The manner in which capital markets are regulated, for example, shapes the incentives of investors and, in turn, the behaviour of firms.

Government should aim to encourage sustained investment in social capital and human skills, in technical innovation, R&D and infrastructure such as port facilities. A powerful tool for raising the rate of sustained investment in industry should be considered; this is a (tax) incentive for long-term (five years or more) capital gains restricted to new investment in corporate equity. The incentive could focus on transportation and port upgrading. Government should also support through inter-governmental dialogue and other means the marketing of “Brand SA”, focusing on countries such as USA, EU etc.

(v) **Fight crime:** Crime is identified by the wine industry in South Africa as one of the most constraining factors to their competitiveness success. Government and businesses alike have a responsibility to fight crime in South Africa. Crime has a negative influence on investment and the confidence of people and businesses in the future of the country, possibly nullifying the competitive advantage the wine industry has established.

(vi) **Support wine trade in the unequal global environment:** The international trade environment is by no means fair and equal. South Africa is a small player in this global environment. Some of the big industrial countries’ trade blocs are not only competitive and aggressive, but also subsidized. Industry together with government needs to deliberate and strategise in this regard. Both export policies and anti-dumping measures should receive ongoing scrutiny in an attempt to level the playing field..

A strong thrust which jointly involves both industry and government towards developing "new wine markets" is required. A South African "Identity" depicting South African firms as reliable, worthwhile and high quality business partners and the "proudly South African" and "Brand SA" initiatives should support such a "globalisation impact" strategy.

(vii) **Support technological innovation:** As mentioned previously, government is earning more than R3 billion directly from the wine industry. Substantial increases through the THRIP programme, support through the ARC and the Department of Science and Technology would greatly assist the Wine Industry's performance in a competitive global market.

(viii) **Focus on specialised education and knowledge development systems -** Apart from general public sector support with basic national infrastructure and research in areas of broad national concern such as health care, government has critical responsibilities for fundamental national issues such as primary and secondary education. The lack of quality of skilled labour is currently constraining the competitiveness of the wine industry in South Africa. Human resource capacity is required to manage the need to continuously improve productivity. Improved labour conditions together with more flexible labour regulations and training across a broad front must be highlighted.

Broadly applied, non-focused efforts rarely produce competitive advantage. Programmes such as specialised learnerships and apprenticeships, together with research efforts at relevant institutions connected to an industry innovation system (which in this case includes specialised research chairs at universities and THRIP programmes) and focussed private investments of companies, ultimately create the factors that yield competitive advantage. Current initiatives by the Wine Council and the University of Stellenbosch to establish a "Centre for Wine Product Development and marketing" are a good point in case.

(ix) **Government administration – reducing unnecessary "red-tape" and ineffective bureaucracy:** These factors considerably increase the "cost-of-doing-business" and are prioritised by the industry as major constraining factors. Human capacity development will contribute to effective government administration.

7.3 Industry level focus

The complexity of creating a competitive and equitable South African wine industry is far reaching and challenging. Collective and coordinated actions at industry level are called for. This study indicates that there are several activities at this level should be enhanced:

(i) **A strong "wine industry voice":** This is important as strong, coordinated representative industry views are required to engage government agencies (on items such as levies, trade and resources policies, a range of acts and legal regulations) and international bodies. The SA Wine Industry Council, and its four business units, is currently playing this role.

(ii) **A strategic partnership between government and industry:** Wine Vision 2020, the Wine Industry Strategy Plan (WIP), the Wine Industry Transformation Charter and the IPW provides approved frameworks for such interaction which now need to agree upon directed outcomes and funding support to enhance the performance of the industry.

(iii) **Develop and establish "Brand SA":** Imperative of establishing a generally recognised "Brand South Africa" has been highlighted. The objective here is to position South African wines as unique and vibrant, wines produced by responsible and innovative persons and by way of environmental and socially sustainable systems and ethics. Government support should be engaged to assist in this effort.

(iv) **Coordinate and conduct industry business:** The initiation, alignment and coordination of the selected industry activities funded with levies need structure and format for which purpose industry action is considered necessary if the required value is to be added. Activities to be considered for industry level action must have a strong inclination towards the "public good" and could include:

- generic (domestic and export) market development and promotion of the wine industry, including tourism;
- the mobilisation of appropriate training and education strategies and systems;
- the reduction of the cost of doing business;
- development and dissemination of industry level knowledge and information provision;
- support to develop industry level BEE and other transformation strategies and models;
- investigation of cost factors constraining business development;
- focused investigation and analysis of constraints to competitiveness and
- the development and direction of industry level strategies and investments in research and innovation.

(v) **Establish industry level accountability:** Industry level operations are guided by a mix of voluntary and obligatory arrangements. Whereas membership of industry bodies could be voluntary, contributions by participants to statutory levies are obligatory. The governance systems guiding and focusing industry level activity, should clarify accountabilities and activate appropriate management and organisational arrangements. This will assist in changing certain perceptions of the industry as "fragmented" and "unfocused.

7.4 Recommendations and lessons for other agri-processing industries

A number of wine industry experiences could provide pointers to other agro-processing industries. These would include:

(i) **Create a "Brand SA" proposition:** South Africa provides unique opportunities for agricultural industries to differentiate its products and to be established as a visible and attractive niche market. The wine industry embraces this proposition. The industry through the institution of the Wine Industry Transformation Charter and Scorecard sets a clear code for social ethics and economic

upliftment, while the IPW highlights the high level of environmental ethics in the industry. These codes influence production and processing systems directly and provide a uniquely South African identity (Brand SA) regarding matters that are of increasing importance in international markets such as the EU, Japan and the USA.

(ii) **Industry directives for transformation management:** The wine industry took a pro-active step in developing a transformation charter to suit its own peculiar circumstances, while seeking alignment with related processes such as AgriBEE, the Liquor Industry Charter and the Codes of Good Practice of Governance. The more than three-year consultative process required for this process afforded wine industry leaders and role-players from other constituencies the opportunity to meet each other "eye-to-eye" on difficult but important issues. The resulting consensus with the Wine Industry Transformation Charter and Scorecard and its consequent approval is a clear manifestation that the wine industry has "crossed its Rubicon"; it has changed from "we must" to "we want " to transform – and in a structured, well managed and broad-based manner.

(iii) **Strategic industry management:** Following from the previous point on transformation, the wine industry proved that a broadly based representative structure, accommodating all stakeholders, can act as a unified industry voice. The SA Wine Council is now viewed by all as the legitimate "industry voice", with responsibility for strategic direction and accountability over statutory wine industry levies. The focused and ring-fenced nature of statutory levies is viewed as highly relevant here. The Wine Industry Strategy Plan (WIP), together with the Wine Charter, the IPW and Vision 2020 provide clear directives and benchmarks for the strategic management of the industry. These frameworks also provide a constructive basis on which to build the required government: industry partnership.

(iv) **Requisite government: industry partnerships:** In context of the above strategic frameworks and agreements it can be noted that the wine industry did manage to mobilise support from government for initiatives related to R&D (through the THRIP), training, mentorships and export development. Requests for greater government support in matters related to further development of the industry through technical innovation and transfer, training and skills development, export market development, the expansion of certification processes, and of infrastructure (roads, ports, etc) are nevertheless still being strongly articulated by industry, *inter alia* in view of the highly competitive but unique global trade environment for wine.

Other industries require similar "partnership solutions", in particular those with a challenge to establish unique "Brand SA" propositions. These would for example include Rooibos tea, Honeybush tea, essential oils and medicinal plants (e.g. buchu), thatching reeds, to name a few industries. The opportunities for BEE initiatives in such enterprises should not be underestimated.

(v) **Value adding initiatives:** Players in the wine industry often find that production income from wine alone provide for marginal returns to the resources invested. By adding value through processing, brand development and recently through "experience/life style" initiatives such as wine tourism, hospitality, outdoors experiences to name a few, financial returns could improve substantially. The "Green Wine Route" in the Elgin area to illustrate the Biodiversity & Wine Initiative is one example,

combining unique landscape, with wine production, fynbos, hospitality and a range of tourist activities. Similar initiatives, where possible, in combination with other agro industries, could be considered.

(vi) **Industry intelligence:** The wine industry took a lead with the introduction of industry level "intelligence systems" such as "Wine Foresight", the Wine Business Confidence Index", the "Wine Competitive Executive Survey" and the use of the BFAP and Provide economic models. The successful application of these decision support systems underscores the necessity of a sound and extended information base (provided by SAWIS, WOSA, Winetech and WIDA) and also the need for involvement of industry experts to ensure the necessary reality checks.

(vii) **Responding to a dynamic global environment:** The opening-up of the international market in the early 1990s, stimulated some remarkable performances by the South African wine industry. Political changes of the time provided opportunities which were seized by wine industry players. His momentum was sustained by continuous innovation, swift business responses to dynamic market conditions, changes in product style and quality requirements and aggressive competitive strategies. Exposure to the global market initiated an "outward thinking" culture, demanding greater effectiveness of the various support structures of the wine industry; the availability of funds through focused statutory levies then stimulated and enabled innovative responses by the firms and companies.

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