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RESEARCH IN ECONOMICS AND RURAL SOCIOLOGY

Globalization of the world wine market and restructuring of the supply-side

The wine market has experienced major transformations in the past thirty years, with a consumption collapse per capita in the historical Southern European producing countries and the emergence of new actors in America and Oceania. The result of this was a structural gap between supply and demand, generating wine-growing prices and income instability, mainly in the European Union and, more recently, in Australia. This alteration goes with a restructuring of the supply, with the emergence of an oligopoly with fringes¹ already observed in other agrifood sectors. A dominant group of powerful multinational firms has settled in, based on a high-scale strategy, strong marketing of products and the capture of distribution networks. This strategy finds its financial resources in the growing **financialisation** of corporate governance. It appeals to public authorities, especially European ones, for a reform of the institutional sector-based framework.

In the wine sector, the globalization phenomenon has been perceptible for ten years. We have seen a change from a market structure where supply and demand were concentrated in traditional producing countries (mainly France, Spain, Italy) to an increasing dissociation of production and consumption areas, with, at the same time, an emergence of new suppliers (mainly in the South) and new demanders (mainly in the North). The results are deep alterations of the actors' behaviour which is reflected by more or less important crises in the chains.

The study presented here is based on research work carried out at Unit Moisa (INRA, Montpellier, France). The main theoretical and methodological tools are industrial economics to explain the structure and running of an international wine market over a long period (oligopolization tendency); management sciences which help characterize the dynamics of firms (strategic positioning) and mobilized resources (production system, distribution channels and marketing). Appropriate databases were created to provide the necessary materials for research.

A complex market of unstable balance and strong institutional components

Because of the nature of the given good and the multiplicity of its attributes, in particular the cultural and affective dimension of both producer and consumer, and the vast number of actors concerned, wine has generated a market of much greater complexity than that observed with other agrifood products. This is what explains the delay observed in the globalization of the wine market compared to other sectors (dairies, for instance).

Over a long period (1965-2005), **world demand** has gone through 4 decennial stages. A significant rise until 1975 (+20%), particularly due to the creation of the Common Market, a stagnation between 1975 and 1985 at around 290 million hl, then a fall until 1995 (-20%), mainly due to the consumption drop per capita in European producing countries and lastly, a slow revival at around 240 million hl in 2005 (+10%). This recovery is at the same time due to an intra-European stabilization (by compensation between countries of strong growth like the United Kingdom and declining ones like France) and to the expansion of new consumer countries (North America, Asia). These trends can be explained by the different status of wine depending on the countries: a traditional beverage in Latin countries with an attachment to the indication of origin, a beverage of social differentiation in "new" countries. Generational effects are also important. The results are even noteworthy differences in prices, but with a tendency to convergence due to market globalization. However, we must emphasise that 90% of world wine consumption accounts for 25% of the population and that only fifteen countries provide more than 80% of the market, which could be considered as growth potential.

Like any agricultural product, **wine supply** will depend on a combination between cultivated areas and yields, with specificities resulting from the vine's perennial nature, the multiplicity of vines, technologies, regulations (in particular, as far as the origin of products is concerned, for instance AOC classification in the European Union) and, of course, from the firms' and investors' behaviour.

The world's vineyards have lost 25% of their surface area over 30 years and have stabilized at around 7.5 million ha

¹ Market structure, characterized by a small number of huge leading companies (dominant oligopoly) and a vast number of very small firms (fringes).

since the beginning of the millennium. This drop is mainly due to the European Union (-34%) which, with the Dublin agreements of 1984, implemented subsidised measures of vineyard uprooting to cope with the collapse of table wine prices. In the 1990s on the other hand, new producing countries (NPC: Australia, New Zealand, Argentina, Chile, United States, South Africa) conceived strategic development programs of production towards international markets, going through mass planting, what explains the stability observed for a few years at the international level.

Yields are subject to natural resources (soil, climate uncertainties and grape varieties), techniques, types of wines produced, laws. This combination of multiple factors leads to a great diversity. However, a diachronic analysis reveals different strategies and performances depending on countries. Thus, in Spain, the average yield per hectare has increased by more than 50% over the last ten years. Italy, Eastern and Central European countries have also seen a significant rise. France and Germany have stagnated. Henceforth, productivity gaps are considerable: The UE-25 is around 7 t/ha, while the “rest of the world” is almost at 10 t/ha.

In 2005, world wine production was around 277 million hl (-7% compared with 2004), close to the (average) level of 1999 and 2000 crops. Vineyard size showed a certain inertia, but yields fluctuated a lot. The result is a great stability of supply, which is an essential factor for the understanding of market mechanisms. The 1990 drop in European production (uprooting) marked the fall of world supply. New Producing Countries (NPC) took over (planting) and consequently, production recently experienced an upturn. As a result, the world supply structure was profoundly modified.

The gap between supply and demand (wines and industrial uses, distillations) alternatively presents periods of surplus and (briefer) shortages. The opening of the European market to world trading made 1999 Wine-CMO (Common market organisation) interventions ineffective and progressively turned **current economic surpluses into structural surpluses**.

The Malthusian practice of supply-management in Europe helped New World producers take over the main part of growing markets (UK, USA). Coupled with European specialization of productions (range, colour), this phenomenon mechanically entailed an **expansion of the international market** (export volume rose up to 35% between 1980 and 2001) which represents one of the main factors of sector globalization. All the countries profited from this rise in trades, but NPC saw their wine exports increased by 41% within last 20 years, with better and better valued wines: in ten years, the unit price rose by 28% in these countries against 3% in traditional ones.

The institutional framework of the wine market is generally more important than it is for other agrifood products. In fact, because of its classification as an alcoholic beverage, wine is given particular attention by the Health authorities who try to limit consumption thanks to sales control regulations and tax (excise duties). Supply is regulated through planting rights (or uprooting), market withdrawal (distillation, storage), but also measures for

product identification and standardisation and control of oenological processes. The wine market is managed at different levels according to countries: strictly in the European Union, with the CMO and a quite complex system of appellations, more gently in NPC, generating major competitive distortions at the international level. The heterogeneity of the institutional matrix and particularly the managerial cultures will explain corporate behaviour and the supply structure prevailing in each country or area.²

The emergence of an oligopoly with fringes in the world wine industry

There are no global statistics available on the supply structure at a microeconomic level. However, on the basis of national observations, we may assert that the wine sector remains quite fragmented with several hundred thousand individual producers and thousands of firms, often cooperatives, all over the world. For instance, in France the number of wine-growing cooperatives (still and sparkling wines) may be estimated at about 870, trading supplies of more than 100,000 individual producers. This cooperative production represents about 45% of overall French production, that is to say 57 million hl in 2000.

The second difficulty in the analysis of the market structure is that there are no data on the turnover achieved by the world-wide scale industry. For 2004, by calculation, our assumption based on FAO statistics shows turnover of US\$ 60 billion. That same year, the top 40 firms achieved accrued turnover of about US\$ 21 billion, that is to say 36% of the total industry turnover. In the past years, there have been several major takeover operations, leading to this rather high concentration rate compared with the total amount of firms in the sector, but low compared with other beverage sectors. At present, in these sectors the share of the top three firms would be as follows: wine 11%, spirits 25%, beers 28%, and soft-drinks 80%. It may be deduced from this that the wine industry is witnessing the emergence of a structure of “oligopoly with fringes”. The world specificity of the oligopoly is attested to by the international distribution of big company activities.

The essential factor forming the oligopoly is **external growth** which may be analysed from the modifications of corporate capital. Next, it is necessary to identify the levers and strategic consequences of such a movement. From our world wine database we registered 1265 restructuring operations in the wine sector between 1980 and 2005. These operations mainly concerned the European Union (48%), Oceania (21%) and North America (15%). They took on a regional character rather than a transcontinental one. In this way, the acquisitions made at the initiative of French, Australian, North American and Spanish companies (which are the most active ones, with nearly 60% of the total amount observed) were made on national soil. However, the most important takeovers are trans-national: Fosters/Beringer, (Australia/United States, 2000, 1.4 billion, for instance). The internationalization tendency via direct foreign investments should intensify.

Three stages may be distinguished over the last 25 years: a strong acceleration from 1986 to 1990, then moderate growth and, finally, a downturn from 2003 on. The accumulated figures of the 1265 listed operations is close to US\$ 70 billion, that is to say an average of \$ 2.8 billion per year,

representing a modest fraction of the sector's turnover (less than 5%). Two thirds of the identified transactions correspond to the complete takeover of "preys", an index of an intense competitive climate, while *joint ventures* stay very much limited in number (66 over 1986-2005). The operation pioneers mainly belong to the alcoholic beverage sector (53%). Second, there are investment companies (23%) like Crédit Agricole S.A. or Rabobank, and specialized funds like the International Wine Investment Fund in Australia. Thus, we may talk of a **financialisation** of the wine sector in the sense where corporate governance depends more and more on shareholders from the sphere of finance, to the detriment of historical shareholders who came from the wine-growing chain. Financialisation at the same time implies that institutional investors have a relational capital and master complex stock-exchange techniques.

Many observed takeovers are driven by **four main purposes**: the search for a crucial size, brand policy, purchase of grapes and access to distribution networks.

The first objective is called "**large-scale effect**", because, the turnover will help lower production costs thanks to economies of scale, take on the big distribution groups under better conditions by increasing the volume of sales, and lastly, raise financial resources to make bigger and bigger investments, particularly in the intangible (chiefly R&D and communication). The crucial size for joining the oligopoly remains modest (around US\$ 300 million, to be compared with about 3 billion for the whole agrifood industry). About ten firms achieve this in the United States and France. However, there are large gaps between American leaders (more than two billion) and other leaders. The large-scale effect will depend on the corporate market, that is to say on the availability of big enough firms in a given country. And yet, there are few medium-size businesses on sale, especially in Europe, which should result in an acceleration of the concentration of small and medium-sized businesses.

The second purpose is the **strengthening of notoriety** among consumers by owning powerful and well-known brands. The brand capital is one of the elements which explains the success of *wineries* in new producing countries (for instance, Jacob's Creek from Pernod Ricard in Australia). Two medium-sized firms are behind real success stories in the United States: the Australian Casella Wine with "Yellow Tail" and the American Bronco Wine with "Two buck-chuck". The combination of huge promotional advertising budgets (which remain "under-marketed" for the wine sector) by world leaders (US\$ 37 million for Gallo in 2002), with coordinated institutional support (Australia) explains the progression of NPC market shares. More generally, brand policy is part of a marketing control (in particular, product segmentation x markets) that firms from traditional countries often fail to have. In this respect, faced with mass-marketing, it is important to have competitive and well-marketed *premium* and *super premium* products (between US\$ 3 and 7 per bottle) to claim a place in the dominant oligopoly.

The third element is to **ensure grape supply**. It is essential for a wine producer to have enough raw materials available, according to precise qualitative specifications

and at previously negotiated prices. These factors may lead to a statutory or contractual vertical integration of firms, as may be observed in Australia, the United States or in the case of European Cooperatives.

The fourth objective is **the control of distribution networks** which helps either meet the mass distribution requirements or get closer to the consumer in the case of specialized stores. Furthermore, the increasing logistics costs lead wine businesses to control the downstream sector. Trans-national marketing networks are thus forming, federating several firms (for example, Maxxium Worldwide, Pacific Wine Partners in the United States and in Australia). The part played by the supermarkets (Wal Mart, Carrefour, Tesco, etc.) is obviously essential in the management of the value chain and drives the middle-of-the-range wine segment.

Conclusion

The slowdown of stock-exchange issues and world wine restructuring operations observed over the last two years must not lead to an "end of the story" assumption. In fact, the globalization and financialisation of the sector are far from over if we refer to other agrifood sectors. These capitalistic dynamics pose two types of questions: i) where will the future decision-making centres of the world wine industry major companies be (Europe, United States, Australia)?, ii) is the emergent agro-industrial model compatible with sustainable development requirements? The political framework of macro-economic governance (the Common Market Organization (CMO)) at a multilateral level, and future European Union Wine-CMO will be decisive in answering these questions.

As far as the CMO is more broadly concerned, recent research work from Unit Moisa puts forward a rather radical revision integrating the new globalization order. As to market management, it is to be hoped that old undifferentiated and inefficient mass tools will be replaced by economically (sorts of vine, yields, types of product, technology) and socially (giving-up or creation of business according to regional specialization) adapted and targeted systems. Ultimately, a public policy of re-labelling (particularly the reform of the appellation system) and of supply stimulation becomes indispensable. That policy will come through an incentive to economic and commercial organization of the chain. In other words, a focus on firms, coordinated with the sector-based system, appears to be indispensable to take up the challenge of international competitiveness which cannot but intensify in the years to come with a probable reinforcement and enlargement of the NPC categories (China, India). For the European Union, one of the potential tools to mark out the supply may be the indication system of place of origin, subject to being recognized within the framework of international governance (CMO).

Finally, the future of the wine-growing chain in Europe seems very much restrained by the actors' capacity of organization and coordination which will require the reconciliation of two strategic lines which are apparently contradictory. On one side, the consolidation of the model based on natural and cultural resources (roughly, the system of controlled designation of place of origin, creating captive niche markets thanks to the fame effect), orientated towards *ultra-premium* products and icons. On the other side, a configuration of the

supply to be built up in order to be able to compete with NPC actors and which is founded on competitive, easily

identifiable products, implying mono-firm large-scale effects or resulting from strategies of inter-firm alliances.

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