

The Southern Hemisphere and Global Wine Markets to 2030: Case Study of Australia

Kym Anderson

Much like wine industries across the world, the Australian and Southern Hemisphere wine industry has been hit hard by the global recession and declining prices. Nonetheless, the Australian wine industry is well-positioned to recover from the current market situation.

Twenty five years ago, the Southern Hemisphere contributed 12% of the world's wine production and 1% of global exports. By 2009, however, it accounted for 18% of global production and a huge 27% of global wine exports. Australia's export-led growth is particularly striking, its shares rising from barely 1% to more than 4% of global production and from a mere 0.2% to 9% of global exports. Australia now exports two-thirds of its output (up from 2% in 1980–84), and is now the world's fourth largest wine exporter after France, Italy, and Spain. The huge vineyard expansion needed to deliver that dramatic transformation also has caused the stocks-to-sales ratio to spike.

In light of the current global oversupply situation, and drawing also on lessons from past booms, this paper focuses on how the Australian wine industry's international competitiveness and market shares might evolve over the next two decades. The longer term should see Australia trading its way out of the current surplus and back to expanding its global market share, especially in value terms as producers seek to differentiate their product more and focus on raising quality.

The Wine Industry in the New and Old World

The spurt of vineyard plantings from the mid-1990s, first in Australia and

then followed by other New World countries, has led to wine production growing far faster than wine consumption in the Southern Hemisphere. Initially, that output growth was driven by perceived export growth prospects as baby boomers reached middle age and supermarkets became a major outlet for retail wine sales.

However, the expansion in those export markets has been temporarily halted by the recessions on each side of the North Atlantic. The Southern Hemisphere has thus added to the chronic surpluses in Europe's wine-exporting countries (due to steeply declining wine consumption and slow adjustment by producers in those traditional markets). It has resulted in major declines recently in prices of grapes and wine, and in values of vineyard and winery assets in Australia, New Zealand, and elsewhere.

Booms and crises are not new to Southern Hemisphere wine producers, nor to wine markets in the rest of the world. Indeed they are normal for capital-intensive perennial crops, albeit with long cycles. That does not make the pain any easier for current producers though. Nor does it mean the pathway and speed of return to profitability are obvious, for the forces behind the latest cycle are different from those associated with previous cycles. In particular, the world's wine markets have become far more globalized over the past two decades, which has both broadened the market opportunities and increased the challenges from international competition.

Even as export volumes have grown, the share of global exports from the top five European suppliers has fallen from just over three-quarters to just under three-fifths. The Southern Hemisphere share of global wine production has increased by half since the

early 1980s (to 18%), and its share of global exports has risen from 1% to 27%. That export growth has been at the expense of not only Western European suppliers, but also the rest of the world whose share of global wine exports has dropped from 22% to 9%.

The decline in consumption in traditional wine-exporting countries (and in Argentina) has been matched by consumption growth in other New World countries, in wine-importing countries of Europe, and, most recently, in East Asia.

Winery Size and Concentration

Another important feature that distinguishes the Old and New World producers is the size and ownership of wineries. In the New World, it is not uncommon for the largest firm to account for one-quarter of sales. In the cases of Chile and South Africa, the biggest firm's share is close to one-third. The share of the two or three next-biggest firms also is huge except in South Africa, such that the many medium and small wineries account for only a minority of sales. The latter are mainly family companies, but the large firms are typically listed national companies or multinationals operating in several countries. By contrast, in the traditional producing countries of Europe, the shares of the four largest wineries are tiny, accounting for between 4% and 20% of total sales. (In China the top four account for 28%.)

This difference in firm concentration may well be important as both the Old and New World producers seek to obtain retail shelf space in a world in which large supermarkets are becoming ever-more dominant as outlets for wine sales. If negotiating strength is related to size, small and

medium-sized wineries may struggle in negotiating with such retailers.

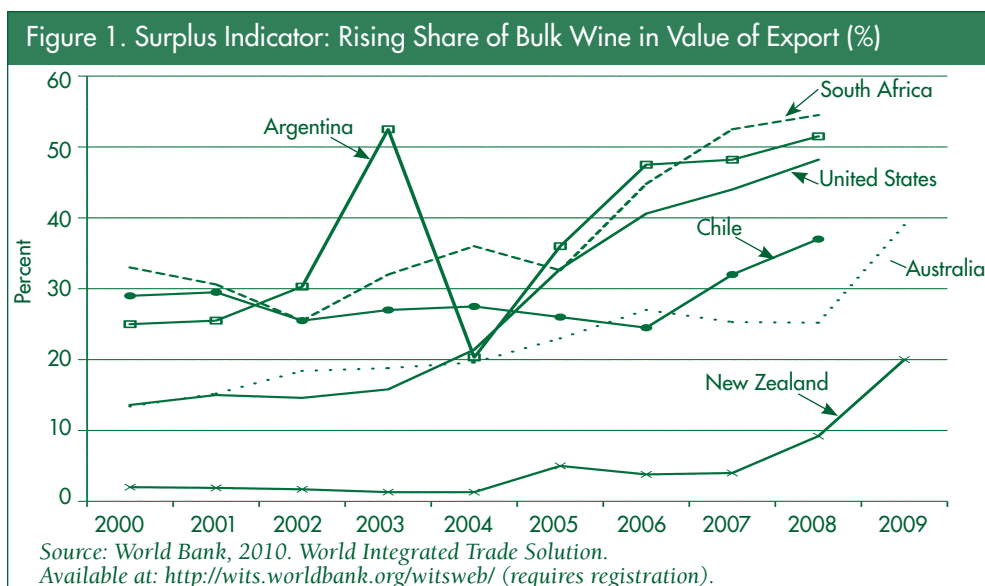
As well, in the United States the number of wholesale distributors in each state has fallen dramatically, so there too it may be the biggest wineries that capture the lion's share of the importers' attention. On the other hand, listed companies are always under pressure to deliver good news in their quarterly reports to shareholders, so some of the large wineries may look to shed assets or even vacate the industry if a long recovery period from the current over-supply situation appears likely.

Such moves could provide opportunities for those smaller, often unlisted firms that are in the business for the long haul: they may be able to acquire selected assets at fire-sale prices, thereby underwriting their prosperity as the industry recovers from its current surpluses.

Booms and Busts

The share of bulk wine in a country's table wine exports is a good indicator of the current oversupply situation facing the world wine market. For Australia, since its latest boom began, bulk shipments were always below 15%, and for New Zealand below 5%. In recent years that share has been rising steadily, and by 2004 it was 20% for Australia, the U.S., and Argentina. By 2009 it was 20% for New Zealand, almost 40% for Australia, and even higher for other Southern Hemisphere exporters (Figure 1). Some of these bulk sales are to supermarkets developing their own labels. But much of that trade is a symptom of oversupply, and therefore can provide a rough indication over time of how far the industry is out of equilibrium.

Australia's wine exports have boomed several times in the past. In each case, those booms subsequently plateaued and the expanded acreage meant grape growers and winemakers went back to receiving low returns. Indeed, the



industry's prospects were sufficiently dire as recently as 1985 to induce the federal and South Australian governments to fund a vine-pull compensation program to encourage grape growers to move to alternative crops.

That long history of fluctuating fortunes gave reason to expect Australia's latest wine boom would be followed by yet another crash, such as a crash in wine export prices (and thus winegrape prices), if not in wine production and export volumes as has indeed begun to happen (Figure 2).

The latest boom differs from the earlier booms in several respects. One difference is that the latest boom is overwhelmingly export-oriented. Another major difference between the recent

and earlier booms is that the quality of wine output has improved dramatically during the past two decades, relative to the cost of production.

For the first time, the industry has been in a position to build brand, regional, and varietal images abroad to capitalize on those improvements in the quality of its grapes and wines. That image building has been partly generic, but mostly from the promotional activities of individual corporations and their local representatives abroad. Australian wines have also over-delivered in terms of value for money in Northern Hemisphere markets.

Australia's average export price rose three times greater than the global average over the 1990s. However, Australia

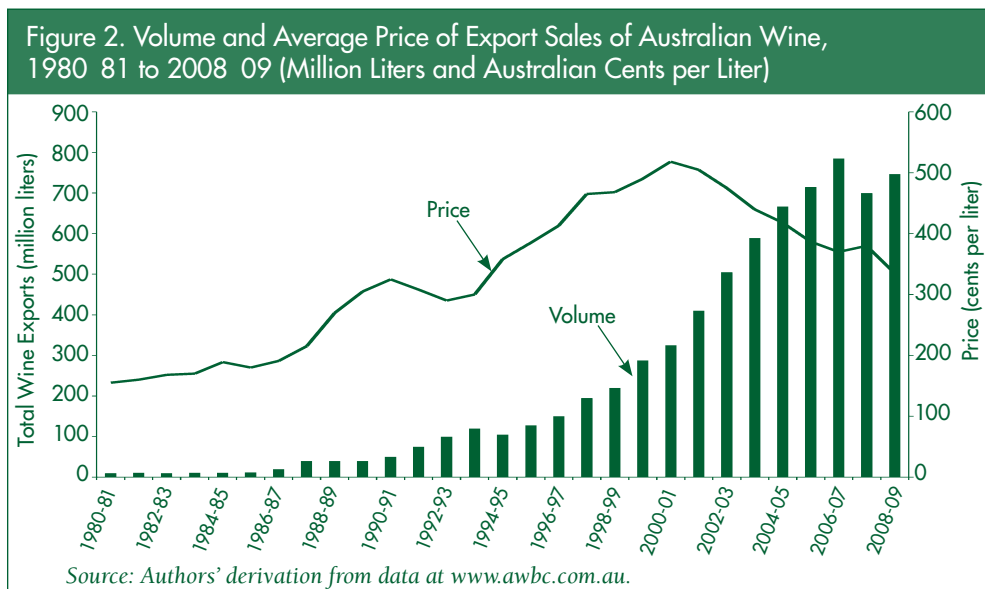
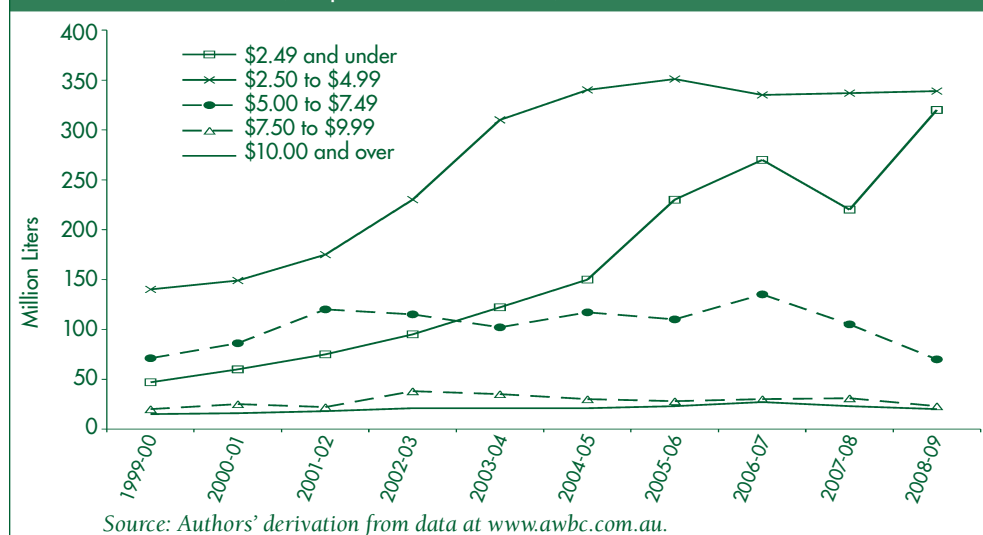


Figure 3. Volumes of Wine Exports by Price Segment, Australia, 1999–00 to 2008–09 (A\$ per Liter, FOB Prices)



was not alone (that rise was exceeded by other New World wine exporters, albeit from different bases). Since 2001, its average export price even in nominal terms has fallen (see Figure 2)—a consequence in part of the Yellowtail phenomenon. Moreover, since 2006 the volume of exports has grown only for wines priced below A\$2.50 per liter (Figure 3). This is the result of a surge in the share of bulk wine in Australian exports documented earlier.

Australian Efforts to Strengthen its Competitive Edge

Looking beyond the immediate difficulties, there are reasons to be cautiously optimistic about the future for wine industries in some regions. Major adjustments will be required for many participants. However, if there is a willingness to continue to invest for the long term (rather than just focusing on quarterly returns to shareholders), and if the earlier spirit of collaboration within the industry can be re-invigorated, a return to at least normal levels of profitability should be possible.

For Australia, another needed change that is beginning to show up in the statistics involves diversifying exports beyond the four English-speaking countries that have

been the dominant destinations for Australian exports in the past.

The Asian region in particular shows great promise for Australian wineries: it is relatively close, Australia already has a strong trade and investment presence there in other product areas, it is booming economically, and the number of alumni returning there from Australian educational institutions is growing rapidly. The region accounted for barely 5% of Australia's wine exports until a few years ago, but since then sales have grown rapidly. With per capita consumption still very low in Asia, there is considerable potential for steady long-term growth in demand and in returns from marketing investments. Several of these characteristics apply to other New World wine exporters, including Chile and California.

During the past two decades, the Australian wine industry improved its competitiveness in no small measure by large investments not only in vineyards, wineries and wine marketing, but also in the creation and dissemination of production and market knowledge.

Investments in R&D has been especially important for competitiveness. The return to R&D in the next two decades may be even higher than in the past, bearing in mind marketplace changes and long-term uncertainties

such as climate change, water and other environmental policy reforms, and prospective alcohol tax changes. Transgenic biotechnology offers much promise for accelerating the research discovery process, but consumer resistance to genetic engineering is limiting the exploitation of that opportunity.

A return to prosperity for the Southern Hemisphere wine industry is certainly possible, but it is not likely to be fast or easy. Like several competitors, the Australian wine industry is well-positioned to sell in the bulk wine market. The country is land- and capital-abundant, so it can supply large volumes of consistent, low-priced, branded premium wine.

Australian wine producers also have some advantages in marketing to the expanding Asian market—proximity and existing market shares in these countries. Australian wine quality and marketing expertise has also increased considerably in recent years, as it has in Chile and a few other places. Yet a return to prosperity will also require a willingness to continue investing for the long term, especially in R&D and marketing.

Kym Anderson is the George Gollin Professor of Economics at the University of Adelaide and affiliated with the Wine Economics Research Centre at the University of Adelaide. He can be contacted by e-mail at kym.anderson@adelaide.edu.au.

For further information, the author recommends the following:

Anderson, K. 2010. "Contributions of the Innovation System to Australia's Wine Industry Growth," Ch. 4 in *Innovation and Technological Catch-Up: The Changing Geography of Wine Production*, edited by E. Giuliani, A. Morrison and R. Rabellotti, London: Edward Elgar (forthcoming).

Intangible Business. 2010. "The Power 100: The World's Most Powerful Spirits and Wine Brands, 2010." London: Intangible Business. www.drinkspowerbrands.com.