Australian companies using globalization to disrupt the ancient wine industry

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Abstract

Purpose – This paper aims to provide a strategic analysis of how globalization has enabled Australian companies to transform the wine industry.

Design/methodology/approach – The global wine industry is analyzed from two strategic management perspectives: Michael Porter's positioning concepts and the hypercompetitive framework of Richard D'Aveni with particular emphasis on the success of the Australian Yellow Tail brand.

Findings – The forces of globalization have caused significant changes in a historically stable industry. The success of the Yellow Tail brand demonstrates how a focused strategy with the right product, distribution and marketing can cause significant industry disruptions. Overall, the D'Aveni framework of hypercompetition seems to best describe the impact of Australian wine companies, although the generic strategies of Michael Porter may still be applicable when considering the French industry.

Research limitations/implications – The focus is on using two strategic frameworks; there are others which could have been included. The example of Australian wine companies has been used to illustrate the changes in the overall market, but studying other "new world" wine producers such as Chile or Argentina may also add insight.

Practical implications – The paper provides an example of how the academic frameworks of strategic management can be applied to different industries and shows that dynamic forces of globalization can emerge from any corner of the world and cause dramatic economic change.

Originality/value – This paper will be of interest to those studying the global dimensions of strategic management and its practical implications.

Keywords Wines, Australia, Globalization, Competitive strategy

Paper type Conceptual paper

The global wine industry can be analyzed from at least two strategic management perspectives: one, Michael Porter's positioning imperative of choosing a generic strategy from among cost leadership, differentiation, or focus, and two, the hypercompetitive framework of Richard D'Aveni which emphasizes the simultaneous importance of both price and quality for competitive survival. Despite the conceptual conflict with Porter emphasized by D'Aveni and Gunther (1995) in Hypercompetition, both perspectives help explain the wine industry. Porter's differentiation is consistent with the continued success of expensive wines, but in terms of the mid-price market, D'Aveni's emphasis on disruption explains well how Australian companies are using global economies of scale to transform this industry.

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Strategic management perspectives of Porter and D'Aveni

In "Competitive Advantage," Michael Porter (1998) recommends that a company conduct an industry structure analysis and then choose a specific firm positioning based on one of three generic strategies: cost leadership, differentiation or focus. Application of Porter's concepts to the wine industry is intriguing because, even though low-cost and high-end wines are readily identified as cost leadership or differentiation strategies, the plethora of consumer wine choices between $7 and 15 per bottle could be described as being in the difficult competitive arena of "stuck in the middle." In this broad middle price range, the extent to which companies can successfully pursue cost leadership, differentiation or focus strategies has created a major strategic dilemma. Porter (1998, p. 17) specifically warns that a company can become stuck in the middle when it "tries for competitive advantage through every means and achieves none." This happens because "each generic strategy is a fundamentally different approach to creating and sustaining a competitive advantage."

In contrast to Porter, D'Aveni and Gunther (1995) argue that in today's tumultuous world, the concept of a sustainable competitive advantage is dangerously inflexible and out of date. Unlike Porter's argument that several companies can prosper by pursuing different strategies, D'Aveni suggests that guerilla warfare is often the only way to survive, and that success is never long lasting. A hypercompetitive environment is one "of intense change, in which flexible, aggressive, innovative competitors move into markets easily and rapidly, eroding the advantages of the large and established players." The reality is that business now operates in a state of "constant disequilibrium and change." (D'Aveni and Gunther, 1995, p. xiii)

D'Aveni discusses four arenas of competition: cost-quality, timing and know-how, stronghold creation and invasion and finally, deep pockets. In each, it is not possible to protect competitive advantages, and the time in which an advantage can be enjoyed is limited. The cost-quality arena most closely relates to Porter's generic strategies. In this arena, companies compete based on different levels of price and quality, at least initially. Unlike Porter's construct, D'Aveni argues that the movements of competitors and the dynamic nature of the price-quality ratio need to be considered. Intense competition begins with price wars, and then firms move to position themselves by defining different dimensions of quality and service. Some firms will aim to be niche players (similar to a focus strategy); others will attempt to be full-line producers. Often, some competitors then move to the extremes of high quality, high price and low quality, low price. This tends to lead to other firms moving to a point of ultimate value, which is "the optimal ratio of cost and quality that can be delivered by firms seeking to offer high-quality/low-priced goods." When this occurs, a state of hypercompetition with intense price pressures and low profits emerges. The best example of this is the contemporary airline industry in which it is very difficult to get a price premium from a differentiation strategy. D'Aveni focuses on the movements within marketplaces rather than the structure of an industry; that is, he stresses the dynamic, not static nature of business. He also argues that "strategy is also the creative destruction of the opponents' advantage."

Strategic analysis of recent wine industry literature

In 1999, *The Economist* magazine ran a series of articles examining the global wine industry. While the data are now out of date, the trends identified have continued, and many of the insights are still highly relevant. In the article, "A Rum Business," (The Economist, 1999) Porter's five forces of industry structure analysis are used and it is suggested that the wine business has none of the favorable factors for it to be an attractive industry such as high-entry barriers, few obvious substitutes, a lack of reliance on suppliers, lucrative customers and not too much competition.

Rachman (1999) discussed the differences in the level of consolidation in the "Old World" wine industry of Europe compared with the "New World" companies of the Western Hemisphere, Australia, New Zealand and South Africa. The Bordeaux region of France had over 12,000 producers but in Australia, four companies dominated 80 percent of the wine market, and with their sophisticated marketing, have been "making good, consistent, keenly priced wine, carefully tailored to consumers' tastes." In the Old World, wine has been an agricultural product based on family traditions with variations depending on the specific farmland as well as annual variations in climate. This approach is centered on the French word for soil, "terroir," with the belief that characteristics of a wine are inextricably linked to the climate and the particular ground (sometimes down to the hillside) in which the grapes are grown. In the New World, the increased emphasis on technology together with a very consistent climate, has allowed producers to minimize fluctuations in quality.

Another major factor is whether rules such as the French appellation contrôlée (AOC) regulations protect consumers from mislabeled wines or whether they stifle innovation and restrict producers from responding to changes in consumer taste. For instance, the AOC rules dictate the percentage of alcohol, requiring producers to water down wine made from grapes grown in a particularly hot year. These rules also restrict the use of irrigation, oak chips, varietal labels and new grape varieties. The article (Rachman, 1999) concludes with the following statement from the chief wine maker at one of the premier cru Bordeaux chateaux:

> The Australians and Americans with only 30 years of serious wine making behind them, are still feeling their way, trying out which grapes work best in which regions, and what practices in the vineyard are most appropriate in a particular setting.

This suggests that the New World will develop its own processes and that France has little reason to reform its rules. As pointed out by Rachman, the market will determine whether or not that is true.

In "Wine's new world," Anderson (2003) discusses the industry in the context of globalization, describing the changes in consumption and the rise of New World Wines. He quotes the president of the French Beaujolais winemakers' union: "We were the center, the unavoidable reference point. Recently, the barbarians are at our gates: Australia, New Zealand, the USA, Chile, Argentina, South Africa." One of the interesting themes of this paper is whether the increasing globalization and consistency of wine will result in the homogenization of the product, the so-called "Myth of McWine." Anderson argues that this has not occurred, because consolidation happened from a low base, with the majority of New World wines currently being sold at the expense of fairly generic European vin de table. Many sophisticated and distinctive "super premium" New World wines are increasingly being produced. The article suggests that:

> ... the preference for differentiated products and the infinite scope for experimentation by vignerons, will ensure that there will always be small and medium sized wineries – like California's Ridge Wines and Australia's Petaluma – alongside the few large corporate labels such as E. &J. Gallo, Robert Mondavi, and Orlando Wyndham.

In another article, Anderson (2001) argues that collaboration among firms at an industry-wide level is essential for the Australian wine industry to succeed, stemming from the need to generate and productively use information, especially when selling a differentiated product like wine. The benefits of centralized R&D through the Australian Grape and Wine Research and Development Council (GWRDC) are highlighted by the claim that around 1996, Australia supplied up to 20 percent of the global flow of papers on viticulture and oenology, although it had just 2 percent of the world's wine production. Another key success factor is the generic promotion of Australian wine abroad through the Australian Wine Export Council. The active encouragement by the Australian Government of innovation in its wine industry supports Porter's (1990) national industry related clusters.

Global wine-market trends

Globally, overall wine consumption since 1996 has been static at 22-23 billion liters per year. Traditionally, wine has been a continental European product both in terms of consumption and production. As can be seen in Figure 1, by total volume, France and Italy are the largest consumers of wine, but the USA is catching up rapidly, and the UK market has had strong recent growth. In per capita terms, this trend is significant, with consumption dropping in the traditional wine drinking markets of France and Italy while rising in the UK.

Production of wine has seen more dramatic changes than consumption as shown in Figure 2. Another significant trend in the wine industry is the increase in global trade as measured by the ratio of export volume as compared to global production. This percentage has risen from 15 percent in 1988-1990 to 26 percent by 2001. As the majority of lower priced wines are sold domestically, the proportion of traded wine in higher value production is even greater and is estimated at 37 percent (Anderson, 2004). Overall, French, Spanish and Italian producers have had to rely more on

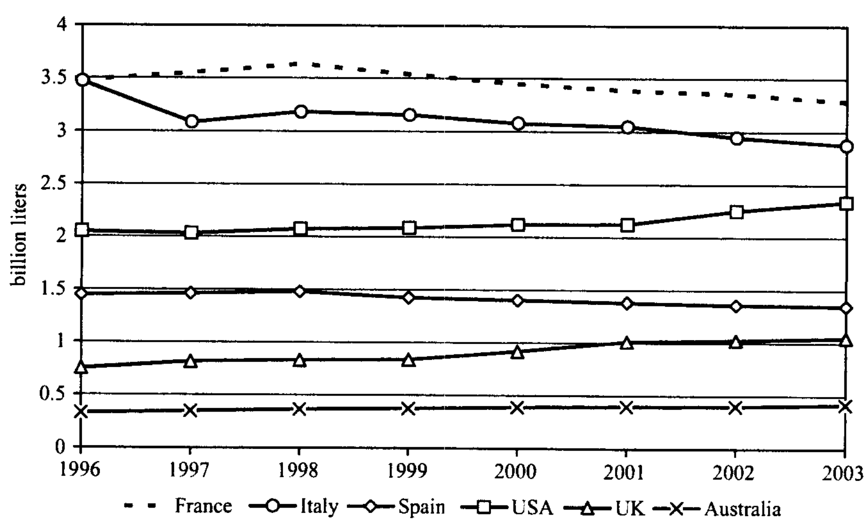
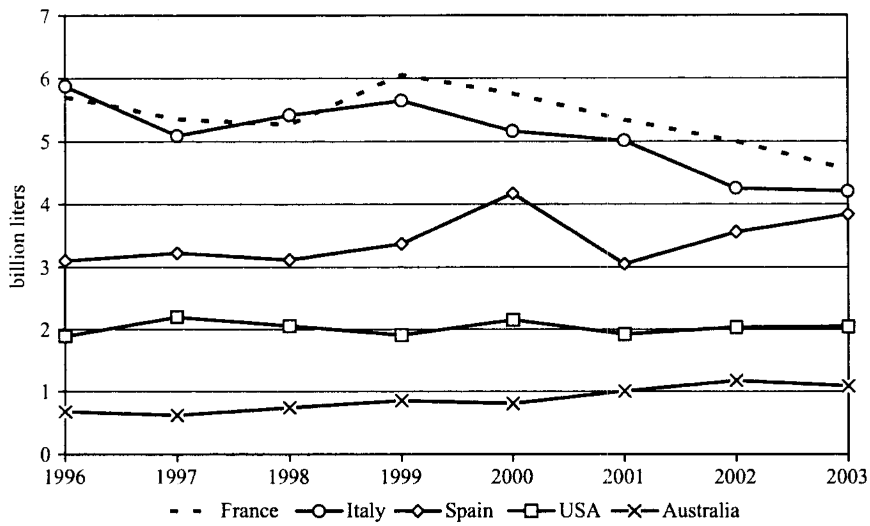


Figure 1.
Consumption, total volume selected countries

Sources: www.onivins.fr, Office National Interprofessionnel des Vins (Onivins)



Source: www.onivins.fr

Figure 2.
Wine production, selected countries

exporting their wines as production has continued to exceed consumption. At the same time, New World producers have improved their ability to compete in these export markets, especially in the UK, the USA, and Germany. These trends show how globalization is transforming the wine industry with support for the disruption hypothesis of D'Aveni's framework of hypercompetition.

The disruptive impact of Australian wines in the US and UK markets

The critical market battlegrounds for the disruptive forces of Australian globalization are in the major import markets of the USA and the UK. In these markets, Australian wineries have dramatically expanded their exports as shown in Figure 3.

In the UK market, changes in the licensing laws during the 1970s allowed supermarkets to sell wine. By the mid-1980s, supermarkets accounted for more than half the retail wine sales in the UK, and much of this were for store brand wines sourced from large distributors or wine companies (Anderson, 2004). Australian wines have also benefited from lower transportation costs resulting from technological advances in container shipping. In terms of global comparisons, Australian companies can deliver wine to the UK market for approximately the same cost as trucks from vineyards in the South of France (Bartlett *et al.*, 2004, p. 133).

Australian companies, emphasizing the historical ties between the UK and its former colony, quadrupled imports into the UK market in the last ten years as shown in Figure 4. Interestingly, only American wines had comparable success; sales for European wines as a whole were flat.

The market for wine in the USA over the last decade has some similarities to that in the UK with increasing per capita consumption and sales. But unlike the UK, regulation of wine distribution and retailing is highly localized, with the rules governing where and how wine can be sold, largely decided at the state level. This means that there is not the same need to offer a large volume of wine in order to get a

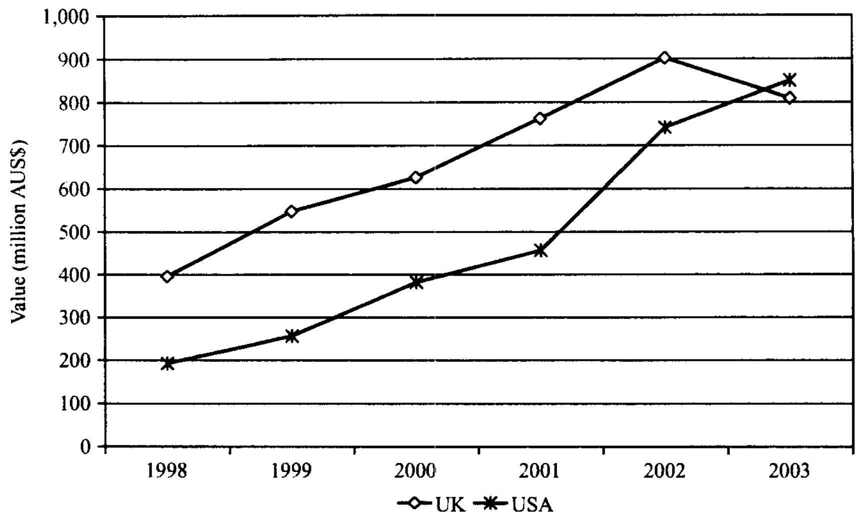


Figure 3.
Australian exports to US and UK (value)

Source: Australian Wine and Brandy Council available at: www.awbc.com.au

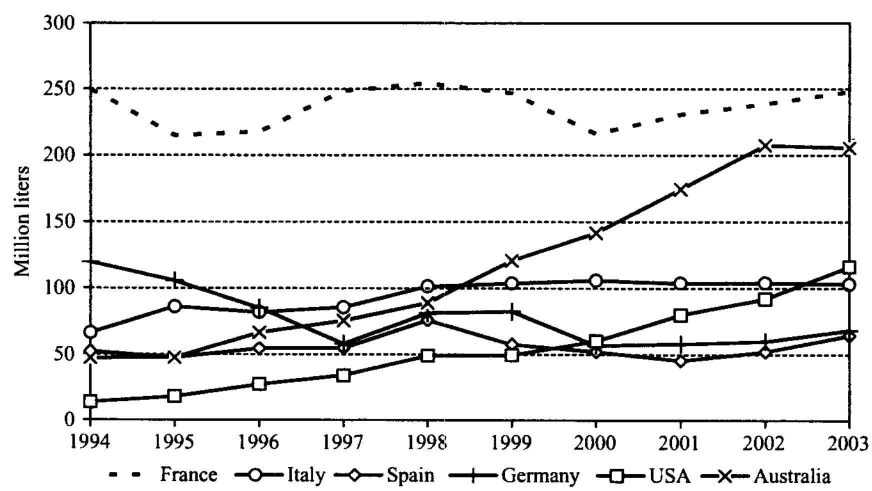
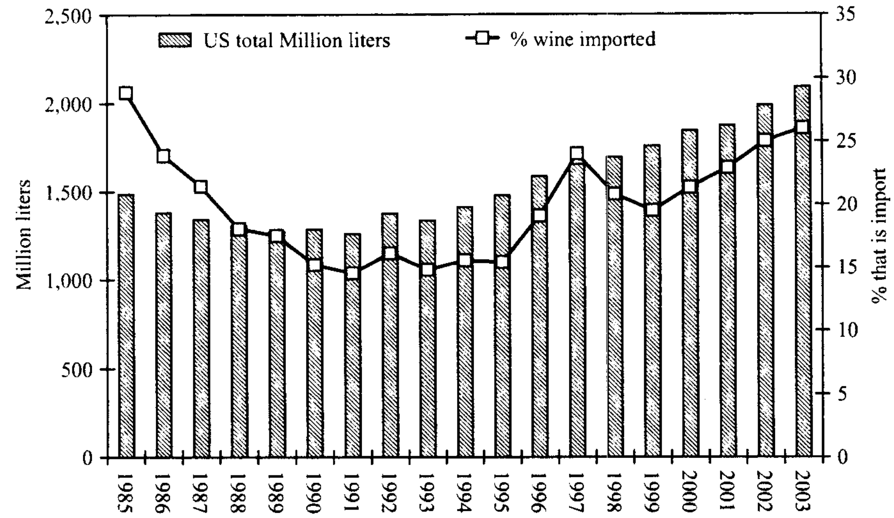


Figure 4.
Wine imports to the UK by selected countries

Source: www.onivins.fr

place on the retail shelf. In many states, supermarkets and other high-volume retailers are not allowed to sell wine; creating a necessity to reach smaller, independent specialized retailers. Figure 5 shows the long-term trends in the consumption of table wine and the proportion that is imported. This shows a steady growth in consumption, with average annual growth of 4.3 percent for the last five years, and an increase in imports.

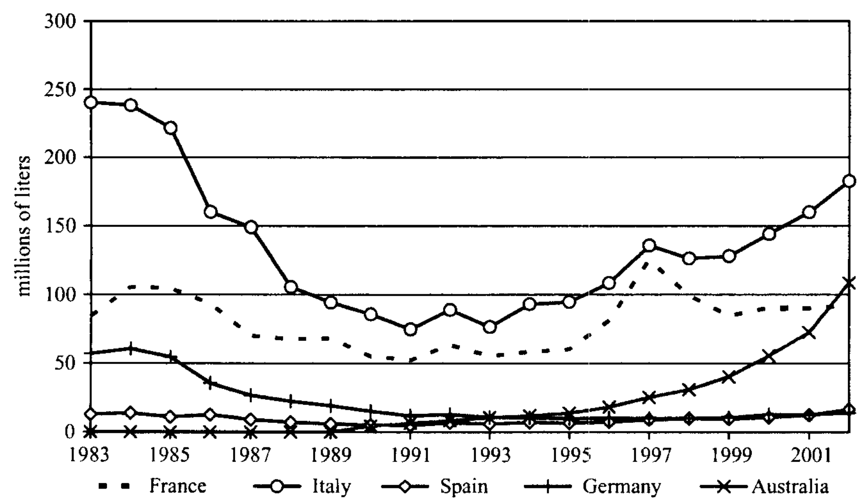
The biggest changes in recent years have been in the percentage of the US market which comes from imports, which tend to be sold at the more expensive price points.



Source: Adams wine handbook

Figure 5.
Consumption and import trends for the US market

This conforms to the earlier suggestion that lower cost wines are consumed domestically and higher value wines exported. Figure 6 shows the shift in the specific countries which supply wine to the US market. The total amount of imports to the US market peaked in 1997, which appears to be caused by a spike in imports from France and Chile. Since, then, Italy, the market share leader, has maintained its strength, while France has been losing market share. Australia is the clear winner, increasing its market share of imports from nothing in 1989 to 22 percent in 2002 (equivalent to



Source: Adams wine handbook

Figure 6.
Volume imported to the USA by selected countries

5.4 percent of the total US market). In doing so, it became the second largest importer of wine to the USA, a position France has held at least since the 1970s.

The data in Figure 7 show that the value of the quality wine market segment has been steadily increasing, especially in the USA, suggesting that the French wine is obtaining a higher price as shown in Figure 8. The average price per liter of all French imported wine is consistently higher in the USA than in the UK, and since 2000, this gap has widened. Over the last ten years, the average price per liter for all French wine imported to the USA has risen 94 percent and to the UK 51 percent, an increase that has been dominated by the high-quality VQPRD wines: 102 percent in the USA and 83 percent in the UK.

Comparison of French and Australian strategies using the concepts of Porter and D'Aveni

French wine producers appear to have successfully applied a differentiation strategy in both the UK and US markets as evidenced by the sharp rise in price obtained for premium wines in both markets. This increase in average price per liter and total value of the market for French wines is far above the rate of inflation and compares starkly with Australian wines whose average price has remained static as shown in Figure 9. A recent article by Robinson (2005) sheds some light on why these trends might be observed for French wines in the British market. She observes that although the majority of wine sold in the UK is through supermarkets, there is a still a niche for the differentiated wine store: "This has left the field clear for what seems to me to be a veritable flowering of small, independent wine merchants all over Britain." Indeed, she notes that the "great majority of these new wine retailers specialize in French wine," partly due to the ease of visiting the region and sourcing from more eclectic producers. Many are also pursuing a strategy of "buy(ing) particular wines that are currently

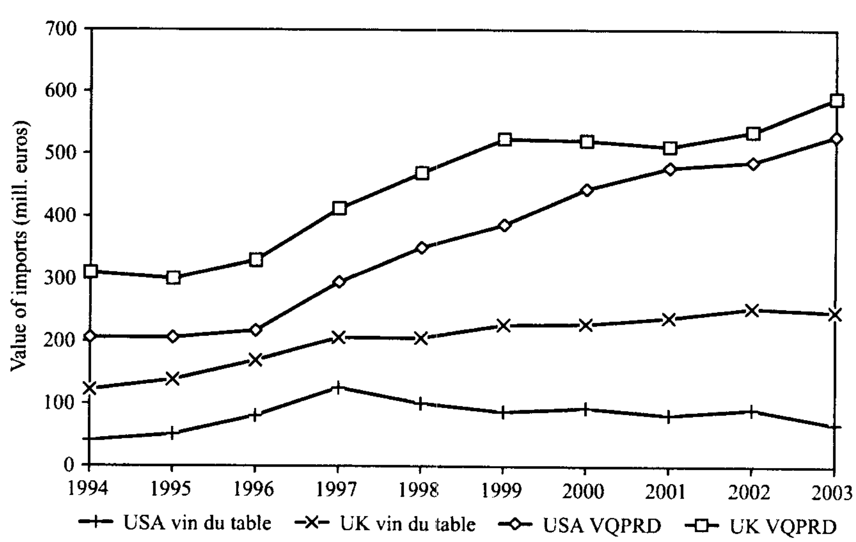


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Figure 7.
Comparison of French imports to the UK and US wine markets

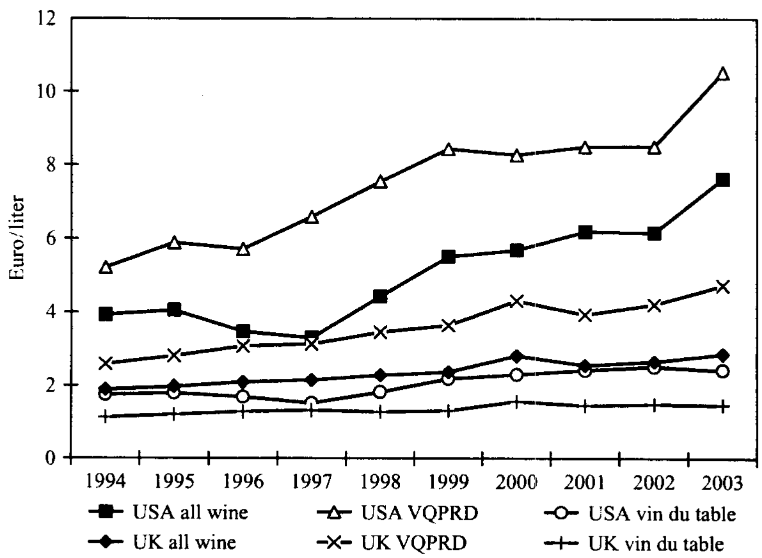

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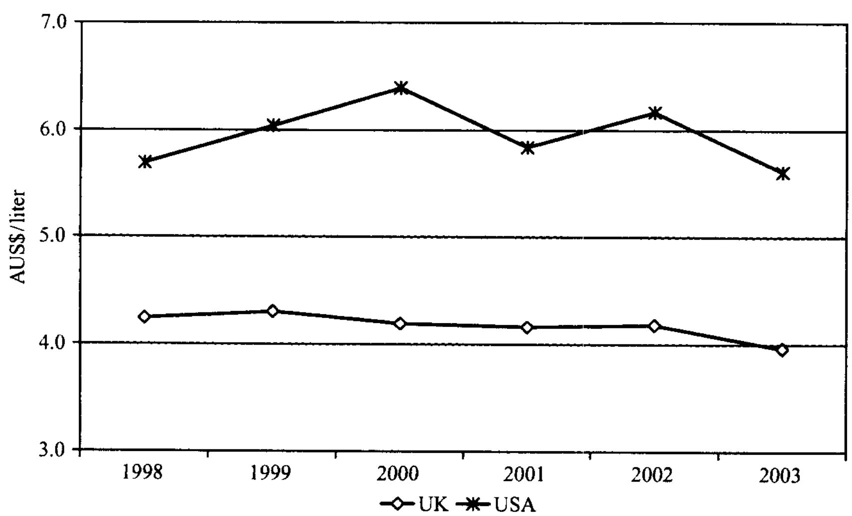
Figure 8.
Average price per liter of French imports to the UK and USA



Source: www.awbc.com.au

Figure 9.
Average price of Australian exports to the USA and UK

tasting well – rather than following the old wine trade model of representing specific companies over the long-term."

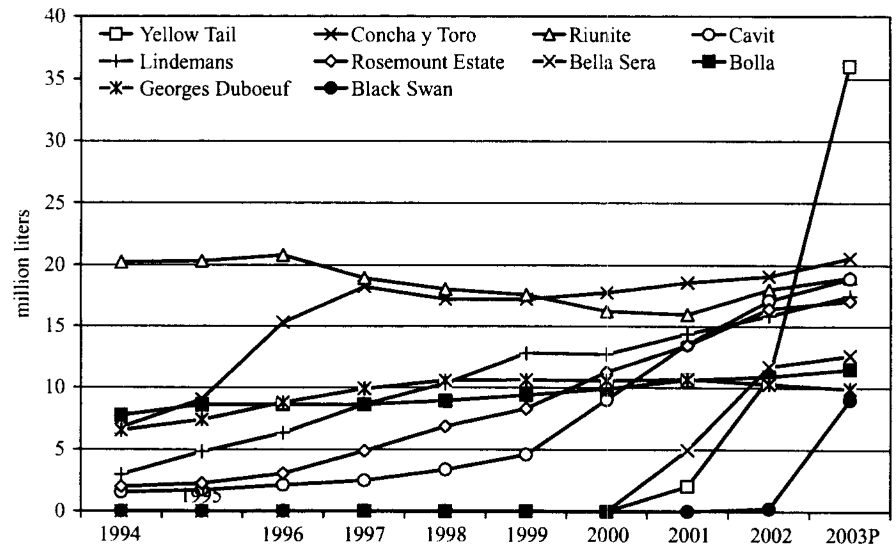
Australia has instead seen a substantial increase in the volume exported into the American and British markets, but not in the average price per bottle. Apparently, they are pursuing a cost leadership strategy, whereas the French have benefited from a differentiation approach. But the D'Aveni model of hypercompetition also offers an interesting way to view the wine industry, especially the impact of market disruption in the middle price range.

Within the D'Aveni framework, the wine industry can be viewed as competing in the Cost-Quality arena and seems currently to be moving away from a period of quality and price positioning where low-cost producers of jug wines and high-cost producers of premium wines operated in different parts of the market and on the basis of totally different industry segments. With the rise of mid-priced, but high-quality wines of consistent tastes such as those from Australia, the wine industry is moving into a period of "covering all niches" and may eventually reach D'Aveni's "ultimate value" position when a market is "perfectly competitive," that is, overall there is no economic profit. This occurs when firms are forced to offer high-quality goods at low prices and all are at similar levels of price and quality. As described by D'Aveni: "Ultimate value offers better quality for the same low price to customers seeking low prices, and it offers a lower price for the same high quality for those seeking quality" (D'Aveni and Gunther, 1995, p. 28). This means that all competitors have to pursue cost reductions and quality improvements and severely limits the differentiation between products. D'Aveni admits that for many markets there is unlikely to be one single ultimate value point, but rightly points out that in many market segments, it is increasingly important to offer high quality at a low cost.

Consistency in wine is an interesting dimension which means very different things to different people, and this may prevent the market from moving towards true ultimate value. For many connoisseurs, a large part of the wine experience is the differences between vintages, vineyards and even bottles, but the knowledge base needed to navigate such product possibilities is a challenge to many newer drinkers. This is in part why many of the lower end New World wines have been so successful; they offer a consistent taste from bottle to bottle and often from vintage to vintage for a reasonable price. However, this homogenization can only go so far; there is still a need for the grape varietal and something of the terroir to shine through. An Australian Shiraz should always taste different from an Australian Chardonnay, and likewise there is an advantage in an Australian Chardonnay tasting different from a Californian Chardonnay. So, although the price that can be achieved for a given quality of wine is likely to begin to reach something of an ultimate value point, there will always be a need for multiple producers of different varietals grown in different parts of the world.

Yellow Tail: an Australian disruption of the wine market

Yellow Tail became the leading imported brand into America during 2002 and had sales nearly twice that of its nearest import rival, as dramatically shown in Figure 10. The President of a competitor told one of the authors of this paper that Yellow Tail was the greatest success story in the history of wine. This phenomenal brand of mid-priced wines selling for around US$7-8, is the brainchild of John Casella of Casella Wines in New South Wales, Australia. Historically, Casella wines was a small, family owned winery producing wines for the huge Australian company, Southcorp. In 1994, the winery decided to produce specifically for the American market a series of easy-drinking, fruit-forward wines which are slightly richer than many commercial-premium wines. The brand name, bold logo and distinctive styling came from a design firm in Adelaide, Australia, which, knowing that this market had growth potential, had designed a library of different brand identities for wine.



Source: Adams wine handbook

Figure 10. Sales of top 10 imported wine brands to the US

Casella needed a US distributor and entered into an agreement with WJ Deutsch & Sons, a national US importer and distributor. Deutsch got a 50 percent equity stake in all Yellow Tail sold in the USA (Coffey, 2002). This was the first major brand of Australian wine that Deutsch carried (much of its business is in high-end wines), but it was able to use its experience with the success of the Beaujolais brand Georges Duboeuf, the only French wine in the top ten imports to the US.

It was expected when it was launched that 25,000 cases would be sold in the last half of 2001. Instead 225,000 cases were sold in 2001, rising to four million cases in 2003. This made Yellow Tail the highest volume imported brand of wine in the USA. Yellow Tail was released to the UK market in 2002 and the Australian market in late 2003. Casella Wines is now attempting to expand its product offering with a reserve line that has won awards for its Cabernet Sauvignon.

As the leading imported wine, Yellow Tail is still relatively small compared with the major domestic brands. But it does appear to be closing the gap; a major US brand in the same category, Mondavi's Woodbridge, sold 6.6 million cases in 2003 (Adams Media, Inc., 1997). The Yellow Tail brand was heavily marketed to the trade, and a large amount of marketing support was given to retailers in point of sale displays, selling cards, and ratings information (Coffey, 2002).

The Yellow Tail wines are not particularly complex, nor do they show much evidence of terroir. Indeed, the rapid expansion in volume suggests that much of the wine is made from grapes that were available rather than ones specifically grown for that winery. Although most Australian wineries produce much of their wine from purchased grapes from a variety of vineyards and geographic locations, the grapes are usually grown with a large amount of influence from the winery that will ultimately buy them. In the case of Yellow Tail, the grapes come from all over South-eastern Australia. According to the company's web site, some grapes travel for 12 hours across the country to reach the winery. These grapes are carefully blended to produce a consistent product. The Casella winery is now one of the largest in Australia, employing 320 people, and is capable of processing 120,000 tons of grapes during one vintage.

The success of Yellow Tail can be considered as indicative of wider changes in the US wine market. Two E&J Gallo brands, Black Swan (Australian) and Bella Sera (Italian), are also growing extremely rapidly (Figure 10). These brands are varietal based, mid-quality wines which meet the developing desires of the US consumer. In terms of D'Aveni's hypercompetition, Yellow Tail and the mid-price Gallo brands are taking market share away from the lower-end wines and could actually represent a move up the price-quality ratio line.

Conclusion

The forces of globalization, entrepreneurially exploited by Australian companies, have caused significant changes in a historically stable industry. Yellow Tail has demonstrated how a focused strategy with the right product, distribution and marketing can cause significant industry disruptions. As a result, the D'Aveni framework of hypercompetition may now be operating in mid-price wines due to the momentum of ultimate value dynamics. More specifically, the availability at low prices of high-quality wines has created pricing pressures to the extent that the average value of wine sold is now stagnant, and industry profits are limited.

The generic strategies of Michael Porter may still be applicable, especially for France. In terms of differentiation, upscale French vineyards are increasingly able to demand higher prices. But in low-price wines, France has lost market share, perhaps because its country cost structure has become too expensive in comparison to other continents.

About 25 years ago, the wine industry was essentially a collection of national markets with wine mostly produced and sold in the same country. Since, then, the forces of globalization have led to a more unified international marketplace. Nonetheless, the natural differences in geography have created a wide variety of wines, which means that there will also be some level of diversity in taste and experience. As consumers around the world become more educated, the wine industry may grow increasingly complex – like the best wines.

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