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Strategic Issues Facing the New Zealand Wine Industry in a Global Environment

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ABSTRACT

The strategic issues facing the New Zealand wine industry are examined. First a brief overview of the New Zealand industry is given and then implications for it are drawn from the trends that are facing the global industry. It is concluded that international links are critical for New Zealand industry. A special challenge will be how the New Zealand industry, with its mix of large, medium and small wineries, can maintain a unique international identity and adopt a collective, national approach to sustaining and developing competitive advantage.

INTRODUCTION

Over the last three decades there has been a rapid expansion of the New Zealand wine industry. This expansion has been driven by the rapid development of export markets for high quality wines and this has led to plans for further increases in production. The purpose of this paper is to focus on the strategic implications of this planned expansion. To achieve this we examine the distinctive characteristics of the local industry. These include the small size of the industry, its dependence on exports, its distance from major export markets, and global trends that threaten its profitability. Also relevant is the strong strategic track record of varietal innovations, quality and branding. It is suggested that these capabilities will be utilised to address the issues and sustain ongoing profitable growth.

The paper is divided into two sections. The first section reviews the New Zealand wine industry in terms of its size and structure, the drivers of its growth and success, growth of exports, and the profile of export markets. The second section then focuses on the global issues and draws implications for the New Zealand industry.

AN OVERVIEW OF THE NEW ZEALAND WINE INDUSTRY

Size and Structure

The New Zealand wine industry is very small and geographically proximate, involving some 33 companies of significant size, within a country with a population of only 4 million. With respect to industry governance, in addition to sharing geo-spatial features clustering within 9 regions of significance, all wine producers are legally obliged to belong to a single industry body, New Zealand Winegrowers. Thus the industry boundaries and participants are clearly delineated and well known to each other.

There is a plurality of views of industry strategy based on the integration of two sets of norms: one rural/farming-based (Moran, Blunden et al. 1993) and one that is marketing based encompassing the retail, agribusiness and hospitality sectors (Rabobank 1999). This leads to complex linkages of many different kinds contrasting from an industry based on an agribusiness/rural/lifestyle to one as a player in global consumer markets. Challenges exist to reconcile these, with sociological and business/economic implications. Further, as the industry evolves, an important question will be whether the industry maintains its historical traditions, which see wine as both 'a processed agricultural commodity' and a 'cultural icon' (Mabbett 1998:3) and which exhibits features of both industrial and agricultural production (ibid:34). In terms of firm size, whist there are a large number of 'boutique' wineries, volume production is concentrated in three wineries, as shown by the breakdown of New Zealand wine companies by size in Table 1.

Table 1: Size Breakdown of New Zealand Wine Companies

Company sales	2003
Annual Sales < 200,000 litres	387
Annual Sales between 200,000 and 2,000,000 litres	30
Annual Sales > 2,000,000 litres	3
Total number of NZ wineries	420

Source: WGNZ, 2003

Table 2 gives some key indicators of the New Zealand wine industry. From it can be seen the strong growth the industry has shown over the ten-year period from 1990-

2000 in all areas, except average yield – which is an indicator of quality whereby quantity is sacrificed for a lower yield of higher quality grapes.

Table 2: Key Indicators Of The New Zealand Wine Industry

Indicator	1990	2000	% change
Number of wineries	131	358	173 ↑
Total vine area (hectares)	5800	12194	110 ↑
Producing area (hectares)	4880	9752	100 ↑
Average yield (tonnes per hectare)	14.4	8.9	62 ↓
Wine production (million litres)	54.4	60.1	10 ↑
Wine exports (million litres)	4.0	19.2	380 ↑
Wine exports ($million)	18.4	168.6	816 ↑
Domestic sales of NZ wine (million litres)	39.2	40	2 ↑
Imported wine (million litres)	4.5	28.6	535 ↑
Imported wine ($million)	27.8	127.3	358 ↑

Sources: BNZ, 2001; Ministry of Agriculture and Forestry, 2000

Drivers of Growth and Success

Since the 1980s much of the New Zealand economy, including the wine industry, has internationalised rapidly from a small domestic base. Mikic (1998) argues that the growth and success of the New Zealand wine industry has been based on trade liberalisation, whereby the industry moved from producing cheap low quality wines to quality production, and from import substitution to export orientation. As a trade economist, she sees this transformation as a response to two changes. One was the availability of imported wines, arising from the tariffication of a complex wine import system, involving the phasing out of quotas and their replacement with *ad valorem* duties (5 per cent in 2000). The other change was the Grapevine Extraction Scheme of 1986, which encouraged the planting of higher quality vines (principally reducing Muller Thurgau and increasing Chardonnay and Sauvignon Blanc plantings) (Mikic, 1998).

Alternatively, geographers (eg Barker et al, 2001) argue strongly that other factors such as local factor conditions, innovation, historical background, institutional and social linkages have had more influence on the success of the industry. They suggest that the APEC report (Mikic, 1998), which has been influential in legislative circles (eg in New Zealand Commerce Commission cases), gives a distorted picture of the industry by claiming that its success was largely due to trade liberalisation. Instead they point to: the industry's evolution, its record of innovation in terms of viticulture, oenology and products, its structure and the nature of relationships among companies along the value chain (what Barker et al refer to as the *filière*) (Barker et al, 2001). This perspective emphasises the importance of the co-ordination and co-operation among industry participants in the development of both the industry and individual firms within it. This can be seen in the generic umbrella positioning of New Zealand varietals, especially in the UK market under the co-ordination of the Wine Guild (a now disbanded part of the New Zealand Wine Institute), within which individual brands have been developed.

Growth of Exports

Export sales have grown rapidly from those of the 1980s. The first export sales of any significance for the New Zealand industry were around 1963, but the value of exports was still only $41,000 in 1970 and $2 million in 1984. However, by 1991 exports had reached $25 million and in the following ten years grew nearly eight-fold to $198 million in 2001. Export sales are projected by the industry to grow to $736 million by 2006 (BNZ, 2001:45). With the exception of one or two difficult years in terms of vintages, exports have typically shown year on year growth of 30% (1991-92), 39% (1992-93) 41% in 1995-96, and 30% in 1998-99 (WGNZ, 2002).

Export Markets

Table 3 below shows New Zealand's top wine export markets.

Table 3: New Zealand's Top 5 Export Markets

Rank	2001 actual / value*	2006 projected / value	2006 projected / volume
1	UK	US	UK
2	US	UK	US
3	Australia	Australia	Australia
4	Canada	Japan	Japan
5	Other Europe	Canada	Canada

Source: Wine Institute Projection Survey 2001, cited in BNZ, 2001:45-46.

Whilst the UK is projected to remain New Zealand's top export market for wine in terms of volume (from 9.9 million litres in 2001 to 21 million in 2006), the US is expected to overtake it in terms of value (UK $92m in 2001 to $230m in 2006; US $40m in 2001 to $241m in 2006) (BNZ, 2001). In part, projections might reflect currency changes but are more strongly based on differences in the profiles of exports to those markets, with more middle range wines going to UK supermarkets and more top range wines going to the US specialist and on premise markets.

IMPLICATIONS FOR NEW ZEALAND OF TRENDS FACING THE GLOBAL WINE INDUSTRY

The global wine industry is made up of two geographically located sets of players: the 'Old World' producers, comprising the traditional wine production and consumption areas of Europe, and the 'New World', of the Southern Hemisphere and the USA. A recent report (Rabobank, 1999) identified six key trends that are having a major influence on the global wine industry. These are:

1. Changing patterns of and increased production;
2. Shifting patterns of demand;
3. Increasing retail power;
4. Increasing competition between countries;
5. Increasing importance of branding;
6. Changes to wine industry structures

Each of these key trends is now briefly described, and implications for the New Zealand wine industry highlighted.

Changing Patterns Of And Increased Production

While globally wine production fell slightly during the 1990s, the production among the New World Wine Producers (NWWP) increased over that period (Parminter, 2002). At the same time, world trade in wine increased by 5 per cent per year in terms of volume, with NWWP's share growing by 500 per cent (to 16 per cent by value) (Anderson, 2001). Anderson (2001) indicates growth in global premium wine production (40 per cent of the total) of over 38 per cent from 1999-2005. This includes Australian production doubling, that in the US growing by just over 50 per cent, but Europe's only growing by one-fifth.

Implications for New Zealand Industry

New Zealand's production area[1] of 13,200 hectares in 2002 has grown by around 1,000 ha over the last five years and is expected to increase to 18,000 ha in 2006 (Parminter, 2002), thus increasing our wine production in the longer term. A major issue for New Zealand producers will be the associated growth of processing facilities and marketing and promotional efforts which will be required. The quantity of New Zealand wine for export is forecast to grow by 160 per cent over the period 2002-2006, as domestic consumption is kept steady (Parminter, 2002). Thus, New Zealand is a full participant in the relative growth of NWWP production.

Shifting Patterns Of Demand

The world wine markets are undergoing major changes due to the shifts in consumer tastes (Parminter, 2002). Demand has also been falling during the 1990s (Parminter, 2002), especially in traditional wine consuming countries. This can be explained by health concerns and increased competition from other beverages, both alcoholic (ready mixed drinks, for example) and non-alcoholic (see www.justdrinks.com). Hence a global consumption/production gap of as much as 15-20 per cent is emerging (Parminter, 2002; Pretorius, 2002). However, demand in non-traditional wine drinking regions has been growing, with the demand for New World wine. High quality of single varietal wines, such as New Zealand Sauvignon Blanc, has been associated with this shift in tastes.

Implications for New Zealand Industry

As a highly priced discretionary item, New Zealand wine exports are dependent on consumer preferences and economic growth. However there is a risk that the growth in world premium wine productions may overtake the growth in demand and the premium prices currently obtained (Rabobank, 1999) could fall. For example Wittwer, (2001) has forecasted a drop in price over 10% by 2005. This highlights the critical need for the New Zealand industry to understand the demand structures in its targeted international markets and have the ability to control supply to maintain price premiums.

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[1] Area in vines (Anderson, 2001).

Increasing Retail Power

The importance of supermarkets in wine retailing has been growing in Europe, North America and Australia (Advanced Business Research, 1999; Rabobank, 1999), as has the impact of their lower margins (15-25 per cent) (Wittwer and Anderson, 2001). In the UK, New Zealand's most important market, 60 per cent of wine sales are through 'grocers' (supermarkets). 94 per cent of those sales are below the critical price point, in terms of profitable trade for New Zealand producers, of £5.00. The average selling price for New Zealand wines in that market is above that amount, at £5.14 (Mikic, 1998). The focus for UK supermarkets is thus on the higher volume end of the market.

Implications for New Zealand Industry

Whilst New Zealand wines are highly regarded and can attract higher margins for quality and differentiation, this trend will increase the pressures to reduce margins to achieve retail positioning. However, the New Zealand industry has a relatively high cost structure and depends on current price positioning to achieve satisfactory margins. Hence, this trend could reduce significantly the profitability of exporting. New Zealand's high cost structures are in part attributable to:

- Lack of scale economies (for volume production options);
- Climatic conditions – the cooler climate in the Lower South Island prevents ability to ripen as much fruit as in the North;
- The higher cost of equipment and inputs, such as bottle (relates to distance and lack of scale);
- The cost of land (Barwell, 1990).

The cost structures for the New Zealand industry are unlikely to change significantly. Eddy estimates that 40 to 45 per cent of total production costs are accounted for by grapes, followed by the cost of barrels, then cellar processes and bottles (Eddy, 2001). Whilst grape prices are forecast to increase in 2003 due to bad weather, they are expected to fall in the medium term as more plantings come into production and export prices go down (Parminter, 2002). In the longer term, however, production per hectare is expected to decrease because of increased plantings in lower producing areas (for example the Lower South Island) and a focus on quality rather than quantity in production. Hence, a future strategy for New Zealand wine companies may be to focus even more on high quality/high price market niches, with the associated requirement for very high standards in wine making and brand management.

Increasing Competition Between Countries

As international trade in wine has increased and, through WTO Rounds and such agreements as TRIPs (Trade-Related Intellectual Property) trade has been liberalised, new barriers have arisen as competition has increased from new entrants. New entrants to the global market over the last 15 years have included: Argentina, Australia, Chile, New Zealand, South Africa and the US. The Old World European producers have attempted to protect both their own market, through such means as tough new legislation on geographical indications and production standards as well as subsidies to wine producers (though it has to be recognised that some of these are not new) and their export markets, for example, the EU's attempt in 2001 to introduce the distinction between "industrial wine" (New World) and "agricultural wine" (Old World) (Anderson, 2001). New consuming countries have included: the Netherlands, Scandinavia, Japan, and the UK, with new emerging consumers in China, and other parts of Asia.

Implications for New Zealand Industry

New Zealand companies, along with those in other countries that depend on export markets, must expect increasingly fierce competition in target markets, while the industry as a whole must be vigilant concerning non-tariff barriers, and work with Trade Policy initiatives to avert these moves. There is also the risk that New Zealand's position as a new producer may be emulated and challenged by other new entrants. This especially the case in the UK and US where New Zealand winemakers and the wines they produce are seen as new and innovative. This provides both production and marketing challenges for the New Zealand industry. Consideration also needs to be given to balancing production constraints with changing market demands and servicing existing markets whilst maintaining awareness of new ones.

Increasing Importance Of Branding

Marketing is now the force driving wine production of any significant scale, overcoming the production led approach that had characterised the wine industry in the past (Eddy, 2001). Eddy argues that marketing and financial objectives should come first for wineries, assessing the resources available to them and only then "talk about winemaking" (2001: 68). The heart of any successful marketing strategy is the strategic management of brands (Keller, 2003). With the country and particular regions within a country playing such a vital role in branding of wine, major issues occur about how this can be coordinated with individual winemaker's identities and distinctive brand positioning. Further as global production faces oversupply an issue facing the global industry is the pressure for brand rationalisation, especially for white wines, and principally Chardonnay (Price Waterhouse Coopers, 2000).

Implications for New Zealand Industry

As mentioned, the New Zealand industry has a higher cost base relative to its competitors meaning it requires ultra/super[2] premium brand positioning that only cater for niche segments of the market. Price Waterhouse Coopers estimates that New Zealand wines are only purchased by 5-10 per cent of consumers in most of our international markets (Price Waterhouse Coopers, 2000:31).

The alternative strategy, to produce 'to a price' for supermarkets, could damage the focused differentiation strategy pursued by much of the New Zealand industry. Furthermore, the volume strategy (selling at below £5 per bottle in the UK market) is only viable for the largest 3-4 New Zealand wine companies and those associated with large international distributors. Major issues exist about how to protect ultra/super premium brand positioning, that only caters for niche segments of the markets, yet also cater to the simplified branding needs of the larger 3-4 companies that market through supermarkets.

The initiative of the New Zealand Winegrowers in developing a generic promotional programme has important implications for consolidating New Zealand's quality position. The aim of the programme is to build awareness of the umbrella brand "New Zealand wine", with the logo of "the riches of the greens land". The promotional programme is guided by the industry's strategic vision for "*New Zealand to be internationally recognised as the leading producer and marketer of premium*

[2] The six levels of wine positioning may be labelled: Icon, Ultra Premium, Super Premium, Premium, Commercial and Commodity (Pretorius, 2002).

quality wines". Thus the challenge is to provide a platform to support and achieve this vision through a strategy that is focused and unified with the marketing activities of industry participants. Current marketing activities include PR and media activity, buyer visits, wine fairs in key strategic centres, new release tastings, generic stands at trade and consumer exhibitions, and sponsorship of wine awards.

Changes To Wine Industry Structures

These may be analysed at the level of governance (regional and international) or in terms of firm and industry level. At the global level the industry body, the *Office International de la Vigne* et *du Vin* (OIV), tends to be dominated by the 'Old World' producers and notably the French. The 'New World' producers' grouping, the New World Wine Producers' Forum[3] (NWWP) promotes the international trade and market access of its members. At the firm level, cross-border mergers and acquisitions are driving increasing concentration within the global industry.

Implications for New Zealand Industry

In New Zealand, the industry body formed in 1975 to self-regulate, promote and represent the interests of wine companies, the New Zealand Wine Institute, merged in 2002 with the body representing grape growers, the Grape Growers Council, to form Winegrowers of New Zealand, thus institutionalising the close co-operative relationship and common membership which has developed over the last 15 years of the industry. At the company level, we are seeing the emergence of very large scale wine corporations, particularly in Australia (which include New Zealand subsidiaries) and the US, which resemble transnational organisations in that they are associated with ownership driven strengthening of the vertical integration of production and distribution, with multiple site production. New Zealand wine companies are being targeted by larger companies in the formation of global drinks conglomerates (Campbell, 2002). An implication of this trend is that an increasing proportion of New Zealand wine companies will be wholly or partially owned by offshore interests that will integrate production and marketing of New Zealand wines into their own

[3] The New World share of global wine exports (excluding intra-EU) is 29% compared with the EU's 55% (Anderson, 2001).

international strategies. These strategies will not necessarily coincide with the best interests of the New Zealand industry as a whole. A challenge for the New Zealand industry will be how to manage its national competitive advantage in the light of global industry and firm consolidation and concentration, whilst acquiring the resources needed to achieve sustainable growth.

SUMMARY AND CONCLUSIONS

In concluding, the New Zealand wine industry is in many respects unique in the global context. It is very small but occupies a strongly differentiated position based on local innovation and the transfer of knowledge from international connections. It has a geographically based advantage and has built a brand based on location advantages (Porter, 1990). The culture of the country and its businesses is reflected in its wine industry – the lifestyle features of the country and its own particular structure within the global and company-based *filières*.

Among the key challenges for the industry's future are how to develop its position globally and maintain its identity and characteristics on which its differentiation is based. The current closely connected structure of the New Zealand industry may be breaking down. Network roles may be sustainable strategic resources (Uzzi, 1996). In the climate of global industry rationalisation, and merger activity, these roles and positions may be overlooked. In terms of the unique characteristics of the New Zealand industry, it may possess dynamic capabilities which arise from its local and international network management (Moller et al, 2002).

In order to arrive at more specific implications and strategic options facing the New Zealand wine industry we focused on six key global trends. These were explored in the New Zealand context, by analysing the interaction between production, consumer demand, retailing and channels, international competition, branding and industry structure, especially ownership issues. The following table summarises these global issues and their implications for the New Zealand wine industry.

Table 4: Summary of Global Issues and Implications for the New Zealand Wine Industry

Global Issues	Implications for NZ
Changing patterns of and increased production	-Managing increased competition in existing markets -Managing growth: processing/marketing challenges -Planning NZ’s long term production goals
Shifting patterns of demand	-Demand falling -Challenge of developing new markets -Pricing in over-supply situation
Increasing retail power	-Strategic pricing decisions: premium versus volume -Managing NZ’s high cost structures -Building new distribution channel relationships
Increasing competition between countries	-Increased competition from new entrants -Challenging trade and market entry barriers -Collective action through international lobbying
Increasing importance of branding	-Ownership of NZ brands -Managing brand rationalisation -Managing the role of generic brand NZ
Changes to wine industry structures	-The future of collective NZ industry development -Managing the ownership and growth of NZ companies -Managing the identity of NZ wine.

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