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## **Strategic Sustainable Wine Regions: Balancing value creation and value appropriation**

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### ***Abstract***

***Purpose:*** This paper presents the case of Champagne region to illustrate how regions can achieve strategic sustainability when they balance value creation with value appropriation.

***Design/methodology/approach:*** The approach is based on case study research method (Eisenhardt, 1989). The author interviewed different stakeholders in the Champagne region during a study trip and consult secondary sources to triangulate the findings from the interviews.

***Findings:*** Champagne region has in place different mechanisms generating value, e.g. history and key actors, and balancing the appropriation of it through pricing and isolating mechanism. However, the region required long periods of turbulence and conflict until it found its balance cemented on social capital and formal institutions. In other words, stakeholders learned how their strategic sustainability was intrinsically interrelated and depended on each other actions over many generations. Once the balance is achieved, professionally managed institutions take an important role maintaining this balance over time by isolating the main sources of competitive advantage. Thus, strategic sustainability is achieved only after long periods of social learning enhanced, in some circumstances, by external shocks that affected the sustainability of the region and a clear balance between value creation and appropriation.

**Key words:** Strategic Sustainability, International strategies and practice, value of country and region of origin

## 1. INTRODUCTION

The region of Champagne has achieved enormous success in the wine industry. While there are strong brand companies behind the marketing of champagne like Moët & Chandon (part of LVMH) or Vranken-Pommery, the sparkling wine produced in more than 30,000 hectares in the area of Epernay-Reims is globally known and has a strong reputation. The champagne brand is synonym and a reference of luxury consumption for many people. Some key figures for the region of Champagne are:

- 12% of sparkling wine worldwide sales
- Average price per bottle is 20 €
- 200 companies are located in the region performing activities related to the industry: machinery, laboratories, glass, cardboard, printing, corks, etc.
- The average price of grapes per kilo is 5.50 € which is substantially higher than other wine regions.
- The price of land is, in 2008, 850,000 € per hectare compared with the average value of AOC vineyard in Alsace of 120,000 €, Burgundy at 87,000 €, Bordeaux at 64,000 € and Languedoc at 11,000 € per hectare.
- The region generates sales for 2.40 billion € per year, which is larger than many New World countries' total exports.

Some researchers have studied the region trying to uncover the reasons of the success of Champagne. Unwin (1996) and Kladstrup and Kladstrup (2005) made a historical review of the area highlighting the accidents, such as myth of Dom Pérignon, in the discovery of sparkling wine. Guy (2003) followed the historical issues existing in the area between vine growers (vignerons) and wine makers (champagne houses) leading to, many times, violent conflicts which only finished after the Second World war. Beverland (2004) attributes the success of champagne to the concurrence of a series of fortuitous events such as climatic challenges, technical developments and wars to develop the cohesiveness existing in the region. Beverland (2005) also suggests that the success is based on the creation of an impression of authenticity by developing a sincere story that enabled the firms to maintain quality and relevance while appearing above commercial considerations. Charters (2005) suggests that the academic perspectives on the success of generic sparkling wines are based on three concepts: a technical assessment of the wine; sparkling wine as a form of consumption of luxury goods; and the motivation to consume sparkling wines. Charters (2011) provides a detailed analysis of the region from multiple perspectives. However, there are not studies that have been addressed the success of Champagne with the lenses of the Strategic Management field.

To uncover the strategic reasons for the success of Champagne, I employed a case study approach (Eisenhardt, 1989) based on my visit to the region of Champagne as part of a study trip. At the beginning of the study trip, there was no clear understanding of the strategic factors driving the success of the region of Champagne. Thus, case study approach, which focuses on understanding the dynamics present within single settings (Eisenhardt, 1989), was deemed the most suitable research method for the study.

### 1.1 Research method

The research question driving the case study was to uncover strategic factors driving the success of the Champagne region and its sparkling wine. One of the most important facts of Champagne is the high value of its sparkling wine and its sustainability over time. Therefore, value creation (Lepak, Smith, &

Taylor, 2007) was the first construct employed to focus the efforts on data collection (Eisenhardt, 1989). The study involved more than 20 interviews with managers of champagne houses, the association of vine growers, small champagne makers, the local bank manager and members of the local institution responsible of managing Champagne region. The extensive use of multiple respondents helped to triangulate the information and detect emerging topics (Eisenhardt, 1989). As part of the efforts of data collection, I also reviewed secondary data sources such as reports from the different Champagne institutions and historical books such as Guy (2003). After each interview, I reviewed the notes to identify emerging patterns from each actor's point of view and obtain general constructs across them.

Four main constructs emerged from the analysis: value creation and appropriation (Lepak et al, 2007), local institutions supporting the balance between value creation and appropriation (Powell and Di Maggio, 1991), and the existence of cornerstones to sustain competitive advantage (Peteraf, 1993). The combination of these four constructs constitutes the basis for the strategic sustainability of a wine region. The following sections explain and provide evidence of the constructs.

## **2. VALUE CREATION**

Value refers to the specific quality of the product as perceived by users in relation to their needs. Such a judgment is subjective and individual specific (Lepak et al, 2007). Value creation depends on the relative amount that is subjectively realized by a buyer who is the focus of value creation and that this subjective value realisation must at least translate into the users' willingness to exchange a monetary amount for the value received (Lepak et al, 2007). Champagne is synonym of luxury and this perception is clearly translated into an average price higher than the rest of the wine industry. How has this value been created? The answer to this question is the focus of this section.

### **2.1. Champagne houses**

The main group responsible for the creation of value in the Champagne region has been the *négociants*, later on known as champagne houses. Their main interest has been in the business of selling champagne. Over the years, communicating with different clients, from the nobility to the rich commercial social class, was a central occupation of *négociants* (Guy, 2003). The *négociants* of champagne offered not simply a fine wine, but an exclusive sparkling white wine (Guy, 2003). While they started as brokers, they transformed themselves into merchant-manufacturers buying large vineyards and investing in bottling and storage facilities. The *négociants* became champagne houses during the French Revolution and aggressively cultivated new clients through personal relationships throughout all Europe. Showing an intrinsic capacity of adaptation to external events, the champagne industry did not become tied up with a pool of diminishing consumers like the nobility when the nobility started declining. They invested in new processing techniques, transportation and communication networks so as to expand their sales to the new social groups emerging in the late 1800s in Europe and North America (Guy, 2003). The current value of Champagne emerged as part of the new mass consumer culture generated at the end of the 19<sup>th</sup> century. Luxury prestige wines became part of the culture of France and, as the centre of the new bourgeois, to the whole world. The UK market, and mainly the City of London, is one the largest markets outside France (personal notes).

While some activities for the creation of value are related to organizational processes, such as wine making, it is important to highlight that social networks externally directed to detect the changing needs

of customers have been critical to the success of champagne. In that sense, the social position of the champagne houses in different social networks in diverse countries and social classes allow them to capture and understand changes in customers' needs. The idea of client relationship was central to champagne marketing before any other wine region and branding the wines using the family name of the founder was broadly used as a tool to maintain the relationship with clients (Guy, 2003; personal notes). The use of the family name was even more important than the appellation 'champagne' as a form of personal assurance of the quality and uniqueness of the product within a distinctive bottle (personal notes).

However, champagne houses were not alone in creating value through their networking activities, historical events also took part on creating value. The evolving social positioning of Champagne as a region was demonstrated in different ways. For example, Reims cathedral was the place where many French kings were enthroned; Epernay was a royal city with the patronage of Louis XIV. Another examples are the set of photographs of some members of the English royal family with the founder of Laurent-Perrier and the patronage of the Russian nobility throughout Champagne history (personal notes).

Other actors have also been important creating value at different levels. In the following section, I will review the work of cellar masters in maintaining quality and facilitating the work of négociants.

## 2.2 Quality guarantee based on wine making expertise

Champagne offers to consumers a sense of continuity in taste and quality, which was an important innovation when wines usually differ from vintage to vintage, and, in many cases, make them unique. The ability to offer continuity, which runs against the idea of vintage and offers a different value proposition, comes from the art of assemblage of different wines, which resides in one very interesting actor: the cellar master. *Cellar masters work for decades with the same house* (interview notes) maintaining the tradition of the champagne house in taste and quality.

Another aspect that makes this factor unique, and source of strategic sustainability, is that the art of assemblage is transmitted only by apprenticeship. The different interviews offered a common perspective: the knowledge existing in Champagne about the key factor for success, the style of the sparkling wine, is highly tacit (personal notes). For example, cellar masters have to blend many different wines, in some cases from many years ago, in order to obtain a constant quality over time. The art of assemblage is very specialized and can only be learned by performing the task. For example, Pierre Cheval of Champagne Gatinois, a small grape grower and champagne producer, has engaged his son in blending wines for five years and expects he will need yet more time before transmitting the business to his son (personal notes). The cellar master of Dom Pérignon, who has been in the company for 18 years, has also been working with an apprentice for many years (personal notes). The long delay in learning the production process is also an important isolating mechanism that avoids the slippage of value and creates a barrier to labour turnover.

Cellar masters also create value by acting creatively to make their job more novel, launching diverse versions of sparkling wine. For example, Pommery's main cellar master works with four masters responsible for different champagne style (personal notes). For example, an important innovation launched by Pommery in 1999 was POP, champagne in a small bottle. A new version of POP is launched every year (which includes a new label and a different wine) with diverse themes e.g. 'collector', 'silver',

'gold', 'blue' and 'maxi'. Other new sparkling wines are seasonal champagnes (Springtime, Summertime, Falltime, Wintertime). Even though they continuously innovate, Pommery still maintains its traditional styles like Brut Royal, Rosé and Grand Cru Millennium.

### 2.3 Creativity and innovation

Innovations to create value are welcome but under an umbrella determined by the traditions established in the region. One interviewee said: "*people and history is what matters in the region*" (interview notes). Strong traditions generated by generations living in the same area and producing the same product were key determinants for the adoption of some innovations generated by some actors and adopted later by the rest of the region generating successive waves of innovations that imprinted the character of champagne.

Champagne was a result of innovations while maintaining a traditional approach even today. Dom Pérignon's purported 'famous discovery' was an incredible innovation for the region when its main consuming market, Paris, switched towards Burgundy and Bordeaux wines in the 1700s. The Dom Pérignon myth was later employed to distance champagne from the innovations that turned sparkling wine production worldwide into a huge scale industry (Guy, 2003).

Assemblage allowed the Champagne region to be innovative and oriented towards multiple customers. For example, during a visit to Laurent Perrier champagne house they claimed that initially champagne was assembled from pinot noir and pinot meunier, but a cellar master subsequently added chardonnay in order to improve the elegance, freshness and finesse (personal notes). This change in taste allowed champagne to reposition itself from consumption at the end of the meal, as a dessert wine, to the beginning of the meal as an aperitif - or even to be part of a meal. This innovation opened a new market for champagne. However, there is not common formulation for champagne *since each producer (large or small) has its own style determined by the proportions employed of each grape in the assemblage* (interview notes). The lack of a unique recipe facilitates the position of champagne across different customers.

While assemblage seems a key factor nowadays for champagne success, its origin comes from a challenge faced by the region. *Champagne is the northernmost wine region which suffers sometimes a late freeze in May* (interview notes). Thus, the art of blending originated from the complexity of grape production due to weather variability (personal notes). *This variability in grape quality led to the development of assemblage to maintain wine quality and made the cellar master's sensitivity to different wines fundamental to maintain a constant quality from different wines and years* (interview notes). While there is variability in grape quality each year, the cellar master maintains the concept of the product every year.

Cellar master's tradition is also accompanied by investment in technological innovations. For example, the development of proprietary yeasts adapted to different type of grapes. Innovations in production techniques have also been very common. For example, the style of vinification changed when they abandoned the oak barrels for the concrete tanks employed by beer brewers (personal notes). Later on, they introduced the stainless steel replacing concrete tanks (personal notes). Another innovation in the production process was the introduction of gyropalettes, an automatic process for riddling champagne bottles in large quantities, mainly employed by mass market champagne producers. However, many

houses still maintain their process of riddling manually inside large underground tunnels for many reasons: different bottle shapes, tradition or exclusiveness. Other innovations like new bottles and packaging were also common in the history of champagne. The development by Pommery of POP has already been noted. This is a small bottle of champagne (200 ml), with different new labels every year. This innovation opened a completely new market segment in the youth market almost immediately as it was sold through night clubs and discotheques. However, *some new types of champagne, like Rosé, are taking many years to become established still offering new opportunities to the region* (interview notes).

Other actors, such as the main bank in the area the Crédit Agricole, also support regional innovation. For example, *it funds research in the cluster for 82 million € in water, vineyard and environmental scientific research, as well as supporting academic chairs and programmes* (interview notes). Additionally, the bank invest in the region with its own equity becoming a shareholder in some houses, for example when they helped the Taittinger family to repurchase their family house.

At the level of the region, the process of value creation can also be perceived in government and other institutions programs and incentives for entrepreneurship and innovation intended to encourage new entrepreneurial ventures to innovate or increase their value for the benefit of the region. For example, the Syndicat Général des Vignerons de Champagne (SGV) support entrepreneurial actions encouraging the new generation of vignerons, the sons of the current landowners, to become small champagne producers. Among different actions of the SGV to encourage entrepreneurs is the launch of an umbrella brand in 2001 'Champagne des Vignerons' - a generic umbrella brand created in 2001 for 4800 grape growers affiliated to SGV. The SGV wants to build and develop brand awareness around growers unifying members around strong values and targeting marketing segments with this brand. Among the values implied in the brand are quality and tradition as well as the representation of the terroir. The new entrepreneurial vignerons produce more than 100,000 bottles per year and understand the concept of marketing and position their champagnes in different distribution channels in France and abroad through diverse strategies: restaurants, newsletters to hundreds of previous customers and to distributors (personal notes). Moreover, they are aware of the danger of commoditisation and work strongly to differentiate their champagne. One of the entrepreneurial vignerons said *each village has its own personality and quality* (interview notes) to differentiate clearly their wines.

In other cases, innovations came from the arrival of new entrants, like Taittinger in the 20<sup>th</sup> century. Even though Mr. Taittinger bought a 1734's champagne house, he brought innovations to the business model like the exploitation of historical assets like an abbey and a chateau to promote his wines' brand. Mr. Taittinger did not remain as an outsider to the region since he took a social and political role showing commitment to Champagne. Reputation and location matters to be successful in the region. One interviewee said: *'the secret of Champagne - we live here'* (interview notes).

#### **2.4. International recognition supported with an expensive marketing budget**

Champagne is known globally for its position as luxury consumption good, but a very special luxury good. Different interviewees suggested that champagne is positioned as *'an affordable luxury'* (interview notes) since everyone can enjoy it at least once a year. While affordability seems to explain the growing consumption of champagne, advertising explains the image of a luxury and festive wine. For example, the existence of Royal Patronage for some houses and participation in key events like car races clearly position the wine of Champagne as a celebratory wine.

Since champagne houses invest additional resources, like branding and distribution channels, champagne houses mainly operate export markets like Britain, USA, Germany and Japan appropriating most of the largest markets. Small producers only invest in the production of grapes so most of the small producers target local markets and France. Prices reflect these differences between investment and market segments. This is very interesting in terms of value creation since most of the champagne is produced cooperatively.

Champagne has been a very successful area generating value in the long term through learning processes, highly innovative firms and strong social networks. However, the creation of value has to be accompanied by good appropriation strategies, otherwise the economic actors in the region will not have the high standard of living that they currently have.

### **3. VALUE APPROPRIATION**

In the strategy literature, two key concepts operate across all levels of analysis to determine which actor captures, or appropriates, the value that is created: competition and isolating mechanisms (Peteraf, 1993). The creation of novel products often produces a situation where there is limited supply and high demand. Competition will follow, as other suppliers of the product seek to replicate the value created and participate in the profits. A consequence of competition (increased supply) is that exchange value (price) will decline to the point where supply equals demand. Competitors may also be unable to retain value as consumers benefit from the lower prices brought by increased competition. Isolating mechanisms implies that competition is limited and supply is not above demand. Isolating mechanisms can be knowledge, physical or legal barriers which prevent replication of the value created by a competitor. In essence, isolating mechanisms operate to limit value slippage, thus enabling sources of value creation to capture the majority of the value created. The existence of an isolating mechanism raises the potential bargaining power of the creator of value to retain this value, although the nature of the isolating mechanisms may be quite different.

In the case of Champagne, there is a key legal barrier determined by the AOC laws that control the sparkling wine's content and linkage with a delimited territory but the best indicator of success in the appropriation of value is the price obtained for champagne. I will review these factors in this section.

#### **3.1. Price**

Value creation requires more than simply understanding what the customer or society is willing to pay for (Lepak et al, 2007). Instead the firm must recognize the existence of multiple targets – whether intended as such or not - that exist in concert and not in isolation. Champagne, as a region, has numerous ways of creating value for different customers that want a luxury product: large houses aiming at highly selective customers, large co-operatives targeting the mass market, or small-scale vigneron who target the French market through relationships lasting generations. However, the variety of offerings may not be sustainable if everyone feels that the appropriation of the value created is not fair. In the case of champagne, there is a delicate balance between value creation, the wine, and value appropriation, the price obtained for the actors in Champagne region.

While the most important value generators are the champagne houses, which sell 66% of the wine and command the higher prices, there are gentlemen agreements with grape growers to buy their grapes at a fair price (personal notes). One champagne house buys grapes directly from up to the 4th generation of grape growers in 17 villages using contracts lasting between 5 to 18 years. A manager of another champagne house said *'there is no competition for grape growers but a gentlemen agreement'* (interview notes) and another manager said regarding the fairness of grape buying deals *'we live here so we know very well'* (interview notes). The social fabric, which was generated by history and tradition, facilitates this behaviour. Social capital acts as an important restriction to free riding behaviour for either houses or growers wanting to improve their appropriation of value. The price paid for grape is 5.50 € per kilo, which is one of the highest in the wine industry, and allowed a fair share of the value created in the market.

While champagne houses have all the resources, brand and distribution channels, to be able to appropriate the value from the French market, they target markets abroad. External markets are inaccessible in large scale for most of the vigneron unless they heavily discount their prices or ask someone else to manage their sales, which may erode the value of the champagne brand. Strong social capital has been built through resource investment by houses. *'Growers understand that the situation of privilege (in terms of grape value and income obtained) comes from the work of houses. For example, [when] phylloxera destroyed the vineyards, (champagne) houses subsidised the growers to plant new vines.'* (interview notes)

Therefore, different actors in Champagne target different markets avoiding price erosion in gentlemen agreements that lasted for hundred years while sharing the value created through high prices paid for the exploitation of the resources of the region to diverse stakeholders.

### **3.2. Controlled origin appellation**

The land devoted to grape growing under the champagne appellation has grown over years. However, the capacity of the region to grow grapes under the appellation has reached a limit in the last few years. There is an extension of the appellation (AOC) planned by 2015 but growers are opposed to the revision and extension since new villages will be added to the AOC and the revision will add new people with the right to grow grapes, thus diluting the economic position of existing growers. Negotiations have occurred between champagne houses and vigneron to achieve a sensitive arrangement but negotiations were not always fruitful.

The history of the development of the AOC has shown the importance of the learning process which has occurred in the area amid conflicts between houses and vigneron. These conflicts occurred due to misunderstandings of the process of value creation and free riding by some actors during the 1800s and the beginning of the 1900s (Guy, 2003) such as the control of champagne was contested between vigneron and maisons (champagne houses) as vigneron's feared that house brands would be more important than 'terroir' (the vigneron's unique resource). These conflicts only finished when a single territorial name - champagne AOC – was set, as well as boundaries, to guarantee the consumers' confidence in the product, which was plagued with fraud from unscrupulous merchants, and protect the terroir.



The battle over the control (appropriation) of the economic and cultural heritage of champagne (and more importantly over the value created) was based on different interests over the issues and boundaries of the community. There are always tensions between economic actors in the appropriation of value. However, these tensions have reduced by the definition of a territorial boundary to be managed through formal institutions such as CIVC. The next section explains in more detail the CIVC.

#### **4. THE INSTITUTIONS SUPPORTING THE BALANCE BETWEEN VALUE CREATION AND VALUE APPROPRIATION: THE ROLE OF THE CIVC**

In Champagne, growers and producers maintain the balance between the creation of value and its appropriation through a third institution - the CIVC, with balance guaranteed by the co-presidents and a board of Directors composed by five directors from the SGV and five directors from the union of champagne houses (UMC). The board usually meets eight times per year. In our meeting with CIVC managers, they suggest that *'houses and growers are interdependent: one cannot survive without the other'* so *'decisions are taken in common'* (interview notes). CIVC managers saw themselves as instruments of economic progress (personal notes). *'The economy [in Champagne] is balanced because the system is fluid'* and *'this is the success of champagne and its manager: CIVC'* (interview notes). The CIVC can sanction a producer if its product is not under the rules of the AOC and can declassify a producer from the AOC label.

Even though the institution seems to have a political role, its daily operations run by a set of commissions and professional managers are fairly independent and highly technical. The members of the CIVC have long-term appointments. The institution has a number of specialist commissions related to technical matters, communication and the champagne appellation, the equipment of the vine-growing area, champagne and health and after-sale quality. It employs more than 200 technicians and is composed of the vineyard department, export department, and the trade department. Nowadays, the organisation has a number of additional functions which include the following: registration of transactions between vigneron and houses and the provision of statistical information and economic analysis to the level of a balanced scorecard for the chairs of the CIVC. An important activity, close to the role of asset management in firms, is to register each land parcel in the region. CIVC mapped the whole region in 50 sq m size parcels within the AOC Champagne. The CIVC also records vineyard ownership from vines planted to shipping of finished product, delivering professional licences to négociants or developing certificates of origin for exports. The CIVC does not only have activities related to controlling the adequate balance between demand and supply or the assets in the region, CIVC is also responsible for innovations to improve standards in the region

The area related to innovation is formed by a Technical Research and Development section with more than 45 engineers and technician, a Viticultural and Oenological Department, which uses experimental vineyards and cellars, laboratories and vinification equipment, as well as collaboration agreements with universities in applied research.

Finally, the CIVC is responsible for building the image of champagne in France and other major markets by controlling the way of promoting the image through websites such as [www.champagne.com](http://www.champagne.com), providing educational brochures, maps, DVDs, etc., as well as contacting the press for neutral information and the protection of the appellation in the World Trade Organization and bilateral agreements with countries.

Since champagne is not a generic noun, CIVC is responsible for promoting abroad laws and regulations regarding the name, systematic surveillance and legal action against wrong use of the brand.

In other words, CIVC is responsible for maintaining the current balance between value creation and value appropriation.

## **5. CONCLUSIONS**

Once Champagne, as a region, has achieved an adequate balance between value creation and appropriation, it has also managed to achieve strategic sustainability as a leader in the wine industry. Four factors are responsible for its current success: heterogeneity, ex post limits to competition, imperfect mobility and ex ante limits to competition.

Heterogeneity, which refers to the presence of superior productive factors that are in limited supply, is achieved by a unique 'terroir' combined with a cultural heritage that is impossible to imitate. Another factor is the existence of a multiple set of styles determined by the proportions employed by each grape in the assemblage, which can assure champagne's survival as champagne is not one homogeneous product but many heterogeneous products catering to different tastes and markets.

Ex post limits to competition relate to the forces that limit competition for the rents obtained from value creation activities. Champagne obtained these limits by the legal protection for its regional brand by CIVC and the existence of large firms responsible for marketing its wine: Moët & Chandon, Vranken-Pommery, etc. which create barriers to the development of stronger competitors in sparkling wine outside the region.

Imperfect mobility indicates the factors that are specialized and whose opportunity costs are lower than the value of the product in the current strategy. First, the opportunity costs for employing the land located in Champagne in other types of productions are clearly lower than its usage in grape growing for sparkling wine. Therefore, the grape growers have an incentive to continue producing high quality grapes and negotiate with houses for grape supply. Second, the costs of opportunity for the brands developed by champagne's houses are clearly lower when they are used in generic sparkling wine, or even in other countries. Therefore, champagne's houses do not currently have an incentive to replace the sparkling wine production in Champagne with that from other regions. Finally, the historic relation of the region with royalty provides the region its reputation as a luxury product/wine drinkable in very special occasions.

Ex ante limits to competition, which limits competition for the establishment of a competitive position using the same resource, is obtained by the existence of a centralized regulator for land transfers meaning

a limitation to local houses and foreign firms buying land in Champagne. Finally, the social networks existing inside the region are effective deterrence to free riding competitive behaviour.

These four factors have not been achieved instantly but it was a long process of social learning and reaction to opportunities and threats in value creation and value appropriation. The achievement of the four factors, jointly with value creation and appropriation, is related to the development of strategic sustainability for Champagne.

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