

Wine distribution channel systems in mature and newly growing markets: Germany versus China

Tatiana Bouzdine-Chameeva

*Leader of the "Wine and Spirits' Business" Research Group
BEM-Bordeaux Management School, France
tatiana.chameeva@bem.edu*

Wenxiao Zhang

*BEM-Bordeaux Management School, France
w.zhang@bem.edu*

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- **Purpose:** *There is little doubt that the modern wine trade is becoming increasingly globalized. The world wine market presented by the mature markets (as EU) and the newly growing markets (as China, India, or Russia) faces major new challenges in this rapidly evolving situation, as the marketing changes bring along the evolution of distribution channel systems as well. To be more competitive on the market, wineries need to better understand the mode of functioning of different systems. In this study, we aim to shed some light on the hitherto unexplored area of distribution channels in mature and newly growing markets, compare and explain the differences between them. It becomes important to tackle these issues in order to suggest the adaptable distribution channel solutions for channel choices and management in the international markets. We have chosen two countries for our study – Germany and China – the countries both producing and exporting wine, in particular French wines.*
 - **Design:** *Our research is based mainly on the literature review, though we have carried out more than ten interviews with Chinese wine producers in Bordeaux region. We triangulated the latest with the information collected mainly from research papers, online sources, government reports, consultant reports and medial search.*
 - **Findings:** *Basing on these sources, we will present the main characteristics of the both markets, mapping the distribution channel systems for both markets; and explaining the differences between a mature and a newly growing market. The findings show a marked difference between the channel choices on German and China wine markets. First has laid great focus on hard discount channel, while Chinese market is more likely to choose on-trade channels (such as restaurants; hotel...).*
 - **Practical implications:** *Choosing a distribution channel system which fits well to a particular market remains a challenge for wine producers and wine exporters. The presented models distribution channel evolutions both in mature and new developing markets will allow practitioners to better adjust their strategies and therefore manage better the relationships.*
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1. Introduction

The wine industry is one of the most globalized industries in the world. Traditionally, wine has been viewed as a European product. In terms of consumption, the European Union (EU) market is shrinking today. Wine consumption per capita in Europe has declined in average from 53 liters in 1991-95 to 44 liters in 2009 (USDA, 2011). In order to maintain the consumption level, the EU expands wine export to the developed countries (as US, Canada, and Japan) and to BRIC economies (Brasil, Russia, India and China). Impacts of globalization in the wine sector are evident in Asia. Asian countries as China, Japan, Taiwan, Singapore, and Korea have increased their wine consumption significantly during the last five years and today they represent export markets of high potential (Lee, 2009).

Germany, as one of the largest wine consumption countries, with the geographic location in EU, is an example of a typical mature world wine market. Germany has a tradition of more than thousand years in making and consuming wine. In 2010, Germany has possessed about 9.6 million ha of vineyards and imported wines from all over the world. With its total wine production of approximately 9.5 million hl and its import of another 15 million hl, Germany is one of the most liberal wine markets of the world (DWI, 2011). It is ranked fourth in terms of volume consumed (Trade Data and Analysis, 2011).

China, with its large population, and a revealing interest in wine presents an example of the growing market today. The demand for foreign wines is constantly increasing in China during the last five years (Wine Intelligent, 2012). As Stern et al. (1996, p. 502) point out "there is general agreement that the distribution channel is the key to any company's success in China." However, the choice of channel is often made haphazardly, with limited information (Cabaniss, 1995). A cursory search using ABI/INFORM revealed very limited published studies of distribution channels in China, almost all of them being descriptive in nature.

We start with the market characteristics of the both countries and the analysis of the wine supply system. We present further on the existing wine distribution channel systems in Germany and in China, focusing in particular on the channel segmentation, channel price and essentially on the channels for imported wines. On the basis of our findings we assess their major differences and suggest a conceptual model for wine distribution channels in mature and developing wine markets.

2. Literature review

2.1 Distribution channel literature

The role of distribution is to provide a company with the possibility "to accomplish product delivery at a right time, to the right place, and with the right quantity at a minimum cost" (Bucklin, 1966). Typically, manufacturers, intermediaries (wholesaler, retailer, specialized) and end users are perceived as the key actors of a distribution channel (Coughlan et al., 2006).

A variety of approaches has been taken to the analysis of distribution channels, despite that distribution structures and the comparative studies of channels have received little attention in academic research (Rangan, et al. 1992; Frazier and Lassar, 1996; Rodriguez et al., 2005; Gattorna 1978). Accordng to Rosenbloom 1999; Lilien et al. 1992) the structure of channels

requires a set of strategic decisions): the first decision determines the appropriate intermediary type, e.g. wholesaler, retailer, franchise, broker, direct sales force; the second one is distribution intensity (how many intermediaries to include and what is the number of levels in a channel structure). The second strategic decision in a channel, distribution intensity, is a key element of the channel strategy (Coughlan et al., 2001; Lilien et al., 1992; Jain, 2000), and often dictates all the channel structure influencing the type of intermediary, the coverage of the market, and the kind of distribution (direct or indirect).

The comparative approach to the study of distribution channels involves identifying, classifying, measuring, and interpreting the commonalities and differences in structures and patterns of distribution between nations (Boddewyn 1981). In Rosenbloom and Larsen's (1991) view, a common global strategy does not provide marketing managers with sufficient knowledge and insight on multi-domestic channels of distribution. A customized, adaptive, and situational view is needed for different national environments. However, some of the literatures also suggest that the distribution/retailing systems in developing countries will and /or ought to look more like the countries which have already the mature distribution structure. (Kaynak, 1980, Wadinambiaratchi, 1965, Hall, Knapp and Winston, 1961). This research work suggests that distribution strategies must be developed for the specific needs in each specific national market and puts forward a model explaining the differences between mature and newly developing wine markets, as well as the market evolution from emerging markets to mature markets.

2.2 Distribution channel in wine sector

Miracle (1965) suggests that the distribution policies should be considered as the characteristics of products. The specificity of the wine industry in terms of distribution channels comply with this statement. Many industries have a year-round sourcing, while wine production follows a rigid yearly cycle. Grapes are harvested once a year and bottled subsequently in a few months. Wineries must allocate production across several sales channels before demand is known.

It is crucial to understand the functioning of distribution channels, the advantages and challenges of each. Despite the importance of this issue the literature on distribution channels in wine sector, is quite limited, recent and heterogeneous in terms of the questions raised. In one of the pioneers work treating the distribution channels of wine industry, Perdue (1999) analysed the consolidation of distributors in the United States. The results showed that, due to consolidation the drastic consolidation, the number of distributors available to carry wine and those full line wine distributors have decreased by almost 60% in the past few years. Sarkar (2000) pointed out that midsize wineries squeezed out of the market because of the shrinking number of distributors that midsize wineries could do business with. While at the same time, smaller wine distributors have sprung up (Camp, 2004).

Wineries must identify and implement the key components of building effective relationships with their distributors to gain access to the channel and to continue to have distributor support to move the product at the retail level where they can become available to consumers (Prichard, 2004). The scarcity of intensive studies of the distribution chain in the wine industry has been identified as an important shortcoming by Beaujanot et al. (2004), Orth et al. (2007). Thach and Olsen (2006) remarked that one of the critical success factors for any wine producer is to build effective partnership relationships with its distributors. The three most important factors are “the taste of the wine”, “the dependability of the supplier” and “the price

of the wine". They argued that within the wine distribution channel, the legal requirements have created a situation where distributors maintain a position of power over most wineries. Wineries' commitment to their relationship with distributors appears to be more calculative than affective. There has been little incentive for both parties to build a mutually beneficial relationship built on trust and shared goals.

Chandes and Estampe (2003) modeled the value chain of the four wine segments (Branded wines; Store brands, Grand Crus and wine marked direct by wine-maker), Referring to the case of Bordeaux natural wine exports. Bouzdine-Chameeva and Ninomiya (2010) analysed the distribution wine chain model for the Bordeaux wine suppliers in the Japanese wine market. The study emphasized a marked heterogeneity of the Bordeaux natural wine production sector and considerable differences in distribution channel solutions, which only partly depend on the core competencies of the actors.

The problem of product misallocation may arise and result in surpluses in some channels and lost sales opportunities in others. Postponement can be applied in such cases as a channel management tool. This management tool is applied to larger wineries that have export and private label channels. (Cholette, 2010; Cholette et al. 2011).

The distribution channel decisions are complex because of the widely different social, cultural, economic, and political patterns (Seifert and Ford 1989). Wine distribution is especially challenging due to the complex rules and restrictions (Camp, 2004). While the analysis of channel in one country does not provide sufficient answers for conducting activities in another country, it is crucial for wine companies to understand the different systems behind the wine distribution channels in different markets.

During the last decennia the world wine imports has witnessed a shift from the mature wine markets (Germany, UK) to the new developing wine markets, such as China and Japan. After years of experiences and cooperation, the wine exporters are familiar with the distribution channel in the mature markets, which are more straight and short. However, the new developing wine markets are actually in the process of building their system and therefore imply different kinds of channels. Wine exporting to these countries appears to be puzzling and bewildering as it is also combined with the different drinking cultures. For this concern, we have chosen one typical mature market (Germany), and make a comparison with one new developing wine market (China), to track the similarities and the differences between the two kinds of distribution channel systems.

And this paper will focus on the following research questions:

1. What are the characteristics of Chinese market and Germany market?
2. What are the distribution channel systems functioning in Germany and China? How do they evolve? What are their differences, and how could these differences be explained?
3. What are the evolution trends from the emerging market to the mature market?

Our further presentation is based mainly on the literature review, though we have carried out more than ten interviews with Chinese wine producers in Bordeaux region.

The purpose of a literature review is not only to identify and analyze all information written about a topic, but also to gain insight and understanding into the problem at hand. We triangulated the data from interviews with the information collected mainly from research papers, online sources, government reports, consultant reports and medial search. Basing on these sources, we were able to present the main characteristics of the existing distribution channels in wine

sector, observe the differences between a mature market and a newly growing one. We will present below a conceptual view on the distribution channel systems for both markets (Germany and China respectively) and explain the differences between a mature and a newly growing market.

4. Discussions

3.1 Wine supply and market characteristics differences:

Germany: The German wine sector is still dominated by small wine growers, with more than 30,000 wine businesses. Nearly half of these businesses cultivate less than 1 ha of vineyard while only about 2,000 wine growers own more than 10 ha. The majority of wine growers are members of cooperatives (Schweickert, 2007). Wine cooperatives produce over 3 million hectoliters wine, accounting for nearly 35% of the total wine production in Germany. Today, there were over 200 active wine cooperatives. However, only 147 of them possessed their own vinification facilities (Schweickert, 2007).

Wine cooperatives sold the vast majority of their wines directly to the consumers or sold them via small local retailers in their neighborhoods. However, due to the changes in consumer behavior and in marketing channels, cooperatives must use different distribution channels to market their products (Hanf/Kühl, 2008). The large demand of the retailers has led to some structural adjustments in the cooperative sector.

78.7% of wine imports to Germany still come from old world wine countries such as Italy, Spain and France. New World wine imports are led by South Africa with a value of €72 million followed by Chile and USA – Australia ranks fifth after Austria (AWBC, 2009). The majority of imported wine is red wine (60%), compared to 25% white wine and 7 % rosé.

China: China has 560 thousand hectares of wine grape (OIV, 2012) and over 940 wineries in operation, ten of which are major producers. The top four domestic companies control over 27% of the entire grape wine market in China - COFCO; Changyu; Dynasty; Weilong. In general each company has nationwide distribution, high brand recognition, customer loyalty, and a well-defined niche market.

Wine represents 14 % of China's alcoholic beverage sales and expands at a compound annual growth rate (CAGR) of 20 percent over the past five years. The aftermath of the global financial crisis, when spending on wine in traditional markets slowed substantially, has only sharpened the wine world's focus on China. France continues to be the lead exporter into China, representing 44% of imported bottled wine by volume followed by Australia at over 20%. The Chinese wine market has experienced a 20% annualized growth rate between 2006 and 2011, and is forecast to grow by another 54% by 2015.

3.2 Wine distribution channel systems

Germany:

As a traditional wine market, Germany shows a pattern similar to other traditional wine countries with the major focus on the retail market. However, the situation of the German wine distribution appears to be more complex due to the market splitting into mass market and the specialist market channels.

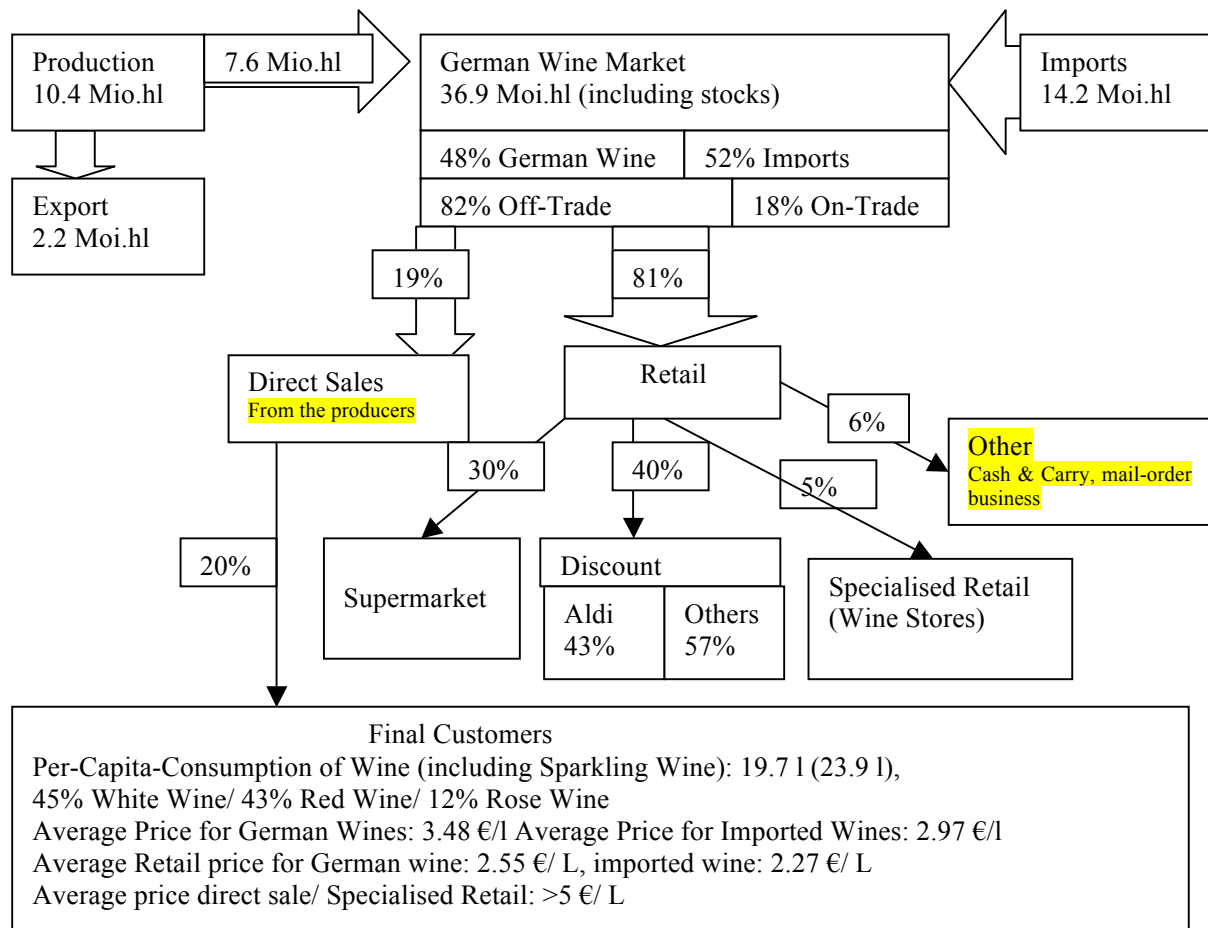
Discount shops, supermarkets, wine stores and directly at the winery are the most important sales channels in the German wine market (DWI, 2011). Off-trade consumption accounts for approximately 80% of the German wine market (Deutsches Weininstitut, 2011). Off-trade consumption is especially successful due to discounters and private label offerings (one third share in volume). Discounters have a relatively strong position in the German market compared to other countries, with Aldi being the leading sales channel, with 43% of the total hard-discount channel sales. Supermarkets and discounters accounted for 70% of the sales volume of wine but for only 54% of the sales value in 2009, thus illustrating their focus on low pricing, which is particularly successful during the current economic downturn.

Wine has become fashionable in German restaurants, and wine bars have emerged in the country. At least some wines are available also in regular pubs and restaurants (Wine Business International, 2009). However, since wines sold via on-trade channels still have a high mark-up (of around 3 to 5 times the purchase price), consumers easily switch to off-trade consumption in times of economic downturn.

The wine industry in Germany is also characterized by many small wine producers, who often market their wines themselves. There are no large wineries with well established brands and 19 percent of wine is sold directly from the cellar to the consumer, making Germany the country with the highest share of direct sales of wine in Europe (Stricker et al, 2007).

The new distribution channel Internet is rapidly developing, it is an increasingly interesting market for established players on the wine market as well as for professional newcomers. The new technologies, the growing transfer rates, and the growing professional competition make it more and more attractive. However, it represents still very low ratio compared to other distribution channels.

Figure1. German distribution channel system (taken from Hanf. J et al. 2012)



China:

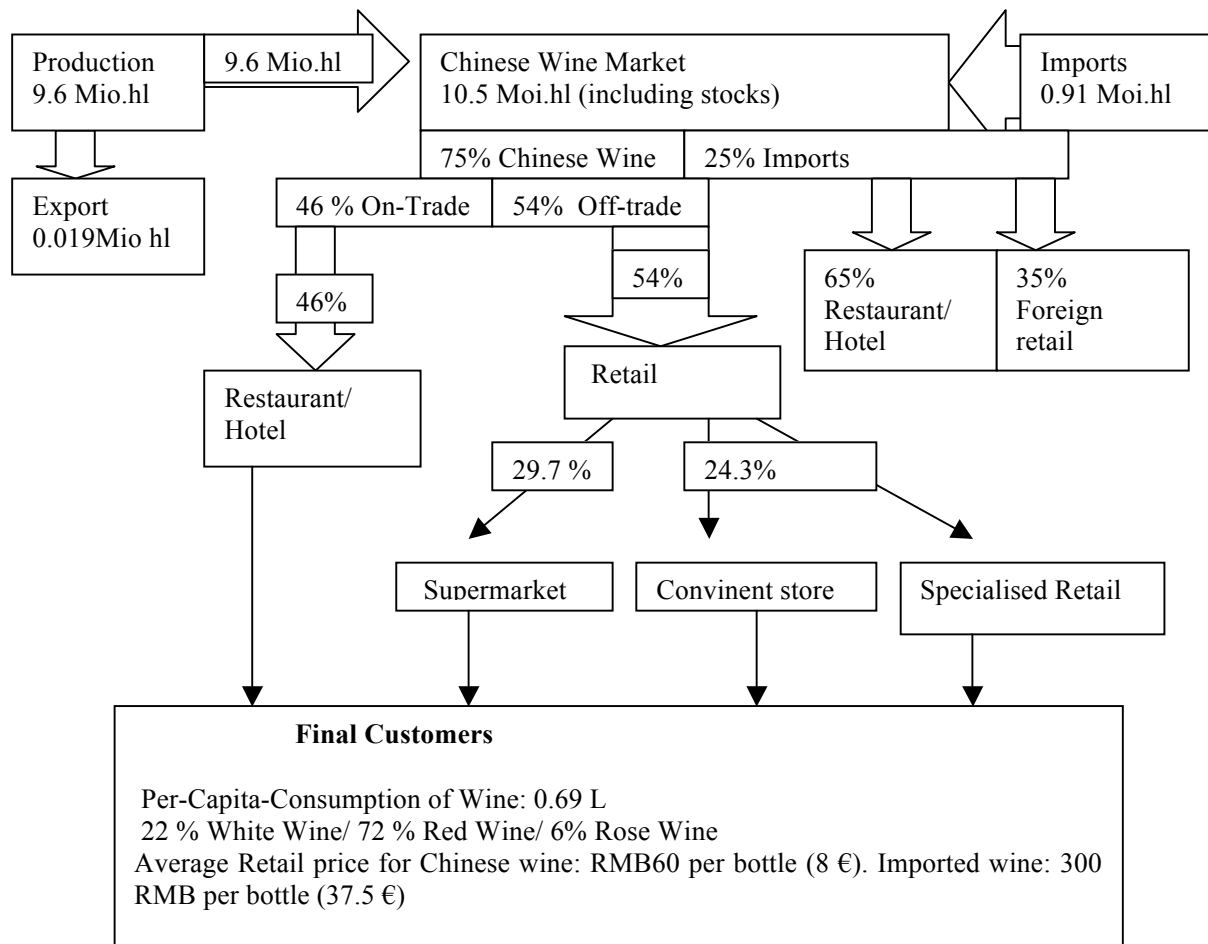
Chinese domestic wineries distribute their wine mainly using three channels: 1) restaurants and liquor stores by securing deals with the help of agents; there are also some state-owned distributors who deliver nationally. 2) Supermarkets, and 3) by setting up a large warehouse in big cities and having agents or businesses approach them for direct purchases.

The growth of leading retailers will expand the off-trade – supermarkets (62% share) and smaller specialized wine stores (14%) are slowly gaining market share. Around 54% of wine sales in China were sold through retail chains (supermarkets, discounters, other outlets). Wine retail sales increased volume share slightly in 2009 (Euromonitor, 2010). Discount channel seems really rare. The channels in China are more decided by the producers' part, especially the four biggest wine producers. Small wineries are mainly controlled by the big wine companies, and the big companies prefer to use their established and mature national distribution channels rather than direct sales.

Chinese New Year and Mid-Autumn Festival account for around 60% of annual wine sales in China. Holiday season sales account for about 60% of annual sales in supermarkets. The significant increase in wine sales during the holiday season is primarily due to family and business gatherings during these festivals. Gift boxes are popular during the festival periods while off-trade sales are mainly for gift giving and family visiting. The top11 cities are estimated to account for 76% of imported wine sales and 60% of domestic wine sales by volume. And also 40 billion USD wedding market has also become a cake for wine now.

Booming B2C wine sales, websites are going to educate Chinese consumers and increase their knowledge of grape wines and stimulate grape wine sales in the long term. Some B2C website such as Womai or Yihaodian do not specialize in selling grape wines, but list grape wine as one of their product types on their websites. Certain websites have evolved into grape wine specialists, such as Yesmywine and Nicewine. More wine information, such as wine and brand history and taste features, help consumers to select the wines. Therefore, people become more knowledgeable about grape wines. Frequent promotions on the websites have also an objective to attract and keep customers, and contribute into an increase of wine consumption in the future.

Figure 2: Chinese distribution channel system



Data from Euromonitor, 2010 and Wine China online & Wines-info.com

3.3 Channels and prices:

Germany:

The average price of the wine sold in German is 3.70 €/ L. However, different channels have different prices, the retail, no matter local wines or imported wines are below the average price, which the average retail price for German wine is 2.55 €/ L and 2.27 €/ L for the imported wines. In contrary, the direct sales prices as well as the retail prices are more than twice higher than retail prices, so they are usually hold close to 5€/L.

China:

The price of wine varies a lot in China; domestic wines are sold primarily at the lower end of the pricing spectrum, while imported wines are sold at the mid-to-higher end. The average retail price at the lower end is RMB20-30 (2.50 €-3.75€) per bottle. Mid-range wines sell for RMB30-80 (3.75 €-10 €) per bottle and are aimed at consumers with higher disposable incomes and more exposure to wine. Premium wines sell for RMB80 (10 €) and up per bottle. Imported wines typically range from RMB80-400 (10€-50€) per bottle and are in direct competition with high-end domestic wines.

3.4 Imported wine distribution channel**Germany:**

Importers and retail trade with their specific assortment structure and price ranges have focused on special target groups. It is of utmost importance for foreign suppliers to understand the particularities of the German distribution and to find adequate partners. Mueller and Szolnoki (2010) observed a similar proportion of German and imported wines, and they did not find any differences between the wine types and the wine distribution channels. That means the imported wines mainly follows the similar channels as German local wine and are sold by the general wine distributors.

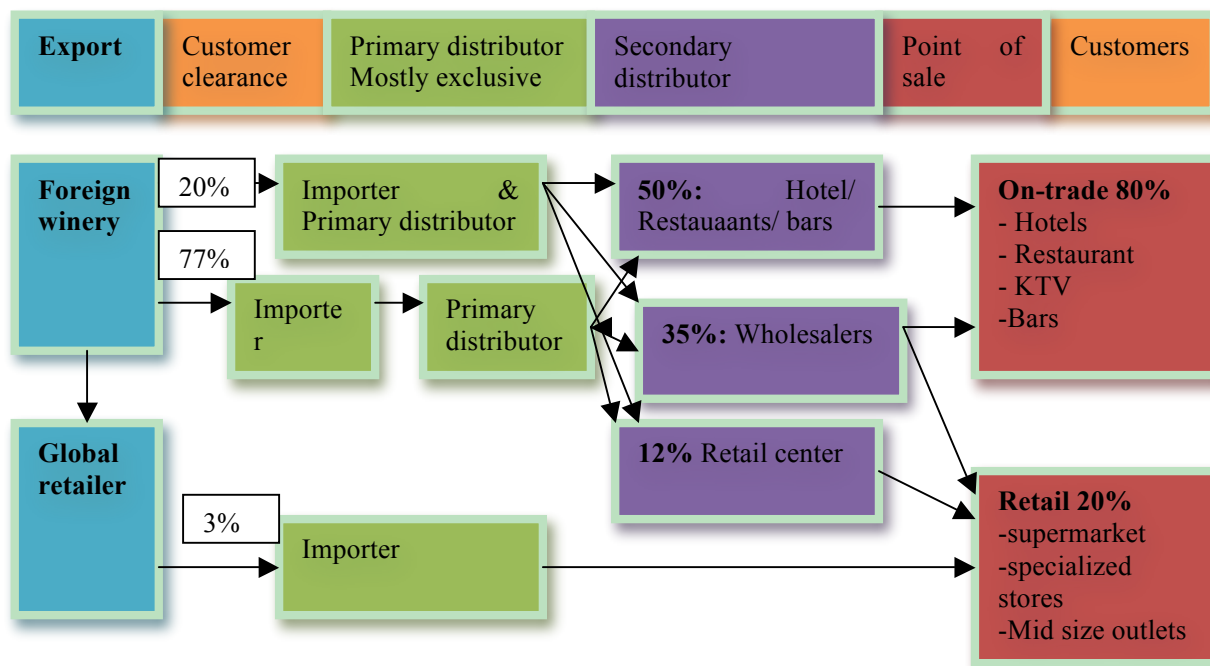
China:

In contrast to Germany Chinese imported wine goes through distribution channels totally different from those used for the local wines. The majority of wines sold in supermarkets are local wines. Imported wines, which accounts for 25% of the Chinese total wine consumption, are sold mostly in hotels restaurants and foreign retail. The major foreign retail (156 Carrefour, 39 Metro, 30 Auchan ...) represents 35% of sales of imported wines (Wine intelligent, 2012). Chinese consumers trust international supermarket chains for two main reasons: awareness of international supermarket chains, and a symbol of quality of international supermarket chains. A customer can be assured that there are no fake products or fake bottles in the store.

Imported wines hold the highest volume share in the tier 1 cities¹ of Beijing, Guangzhou, Shanghai and Shenzhen. This four cities account for 53 percent volume of imported wines sales, with the on-trade channel representing 80 percent of total sales (Rabobank, 2011). Going forward, it is expected the majority of growth in wine consumption in China to be in Sales of imported wine in the tier 2 cities still mainly rely on top grade hotels, however, the off-trade retail channel will be increasingly important. In line with the government's plan to focus economic development on China's interior instead of the more affluent coastal areas, improving distribution and disposable incomes will give rise to more consumers beyond Tier 1 cities having access to imported products, including wine. As these 'new' wine consumers enter the market, price will be an important consideration in addition to packaging. Tier 1 cities are gradually diversifying sales through retail and specialized shops. Competition in the imported wine sector in China's Tier 1 cities is increasing rapidly; there are signs of saturation and over service already. The Tier 1 cities remain still the main market for imported wines. However, it is likely that consumption will grow faster in the Tier 2 cities as their economies expand.

¹ There is no "official" definition of city Tiers in China, for simplicity, the ranking mainly based on population and GDP. The result is that Tier 1 cities include the largest cities as Beijing, Shanghai, Guangzhou and Shenzhen, and Tier 2 cities include the next 20 cities ranked by GDP. Tier 2 cities include the cities with a population more than 1 million.

Figure 3: Distribution channel Structure of imported wine in China





Data from Rabobank, 2010

3.5 Comparison of the two systems

According to wine production and consumption figures, Chinese market is still rapidly growing whereas Germany wine market is more or less stable during the last twenty years.

We listed the major differences of the two wine markets in Table 1:

TABLE 1: The main different of German and Chinese wine market

	 Germany	 China
Wine production	10,4 Mio hectoliters No.10 of the world production (2011)	13 Mio hectoliters (2011) No.6 of the world production
Vineyard	102,000 ha; 78 376 members	560 000 ha, 940 wineries
Export	2, 2 Mio.hl	0.019 Mio.hl
Wine consumption	20 Mio.hl, No.4 of the world consumption (2011)	16.1 Mio.hl; No.5 of the world consumption (2011)
Imported wine	Imported wine 14,2 Mio.hl 65% of total consumption, (2010)	Imported wine 25% of total consumption
Origin of the imported wine	78.7 % from France, Italy and Spain 2.6% from Australian	62% from France, Italy and Spain 20% from Australian
Consumption 2012	20.7 L per capita. 80% drink, 10% stock	1.21 L per capita (2012) 70% for gift, 10% drink

Share of wine type	63% red wine 29% white wine 8% Rose wine (Datamonitor 2011)	72% red wine 22% White Wine 6% Rose Wine
Distribution channel	65% sales via retail (super market, hard discount) Very strong hard-discount channel	20% sales in retail, 80% Restaurant, hotel, bars, <i>While for local wine : 54% sales via retail</i> No hard-discount channel
Increase rate (2007-2011)	Production 3.56% Consumption 0.3%	Production 8.97% Consumption 20%
Market characteristics	Mature market, production and consumption stable	New developing, production and consumption quick increasing

Data from OVI (2012), Euromonitor (2010): Deutsche Wein Statistik 2010/11; Vinexpo (2011), Chinese government data (2012) and the IWSR (2011); OIV (2012).

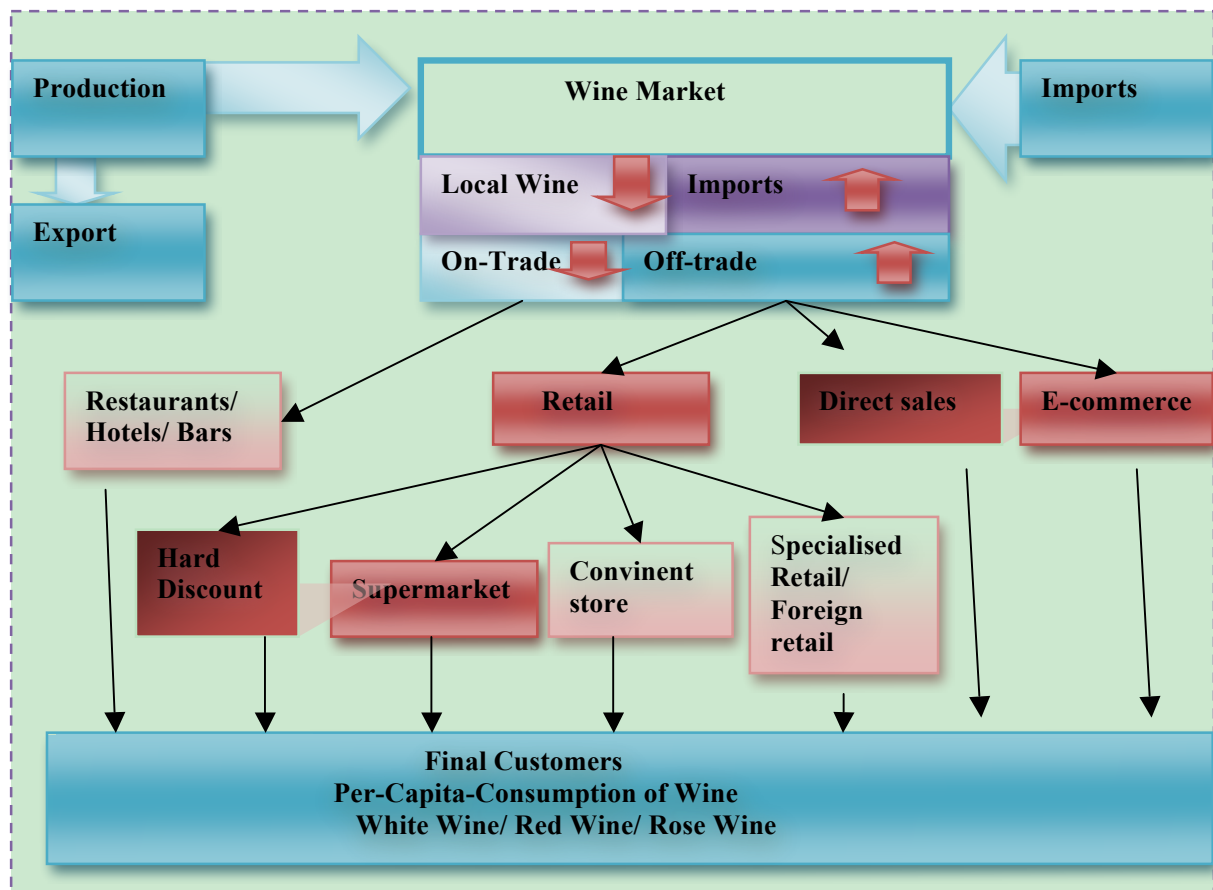
Both countries are in world top 10 wine production and consumption countries. The ratio of between imported and local wine in German wine consumption is 65 to 35, which is more than opposite to the Chinese ratio of 25 to 75. However, it is easy to observe that China, as a new developing country, evolves into a more balanced rate revealed on the German wine market. The percentage of imported wine keeps increasing in China (more than 65% growth each year during the last four years), the percentage of the imported wine consumption increased from 5% (in 2008) to 25% (in 2011), at the same time, the export of Chinese wine increased 23.8% in volume, and 52.5% in value in 2011 (China government report, 2012).

In both countries, there is a focus on off-trading channels (Supermarket, discount stores) for the local wine sales (Germany 80% compare to China 54%). Besides, direct sales play an important role in German market because 35% of the German wines are produced by wine cooperatives, which have a higher possibility to sell wine directly to customers. Whereas, in Chinese wine market, holiday season sales account for about 60% of annual sales in supermarkets because wine is seen traditionally as a gift which is an important social element in Chinese life.

What concerns the imported wine; we observe strong differences between China and Germany. Germany uses the same distribution pattern, with similar retail prices as for local wines, while 80% of the Chinese imported wines are sold by on-trade channels (restaurants, hotels, bars, etc.) with a price three to six times higher.

Nevertheless both markets show a switch to off-trade consumption. The share of wines sold in the on-trade declined from 19% in 2008 to 16% in 2009 in Germany (Deutsches Weininstitut, 2010 /2011). In 2010, on-trade accounts in China for 80% of the import wine sales in China, but the major foreign retails (156 Carrefour, 39 Metro, 30 Auchan stores) gain larger shares in wine sales during the last two years. In 2012 they present 35% of sales of imported wines (Wine intelligent, 2012).

Figure 4: Comparison of the distribution channel in new developing and mature markets.



The figure above highlights the differences and the evolution of wine distribution channels in emerging and mature markets. The light colors correspond to the channels preferred in developing countries; while dark colors refer to the mature markets; and the colors intermediate between light and dark show the channels used by both types of markets.

From this figure, it becomes clear that, the more mature a market becomes more imported wine is present, until the level of the imported wine approaches the level of the nationally produced wine, and therefore reach certain equilibrium between exported and produced wines. Whereas for distribution channels, the more mature market is, the more off-trade develops, and the shorter the channel becomes.

4. CONCLUSIONS

The implicit assumption of this research is that the Chinese wine distribution channel system differs from the German wine distribution channel systems. Our study supports this assumption to a certain degree. The distribution channel of the two countries shows different systems because of the consumption culture, wine supply system and marketing maturity differences. However it also becomes clear that the evolution of channels in emerging markets generates certain bottlenecks, the auto regulation promotes transparency and the development of other channels comes into view, in particular those channels which are favoured in mature markets.

For the future research, we plan to perform a survey on both markets coupled with simulation modeling, basing on the results of the interview analysis. The aim of the survey will be a deeper understanding of different distribution channel systems and their evolution in time.

Through the modeling we hope to get the optimal solutions for the wine companies to find the best ratio for each channel on both markets.

This study compares only two markets: German and Chinese one. We are also interested to expand this to other mature (as Belgium or UK markets) and growing wine markets (as US, Australia or Russia).

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