Andrew Inkpen  
Rod Phillips

THE WINE INDUSTRY

The Aussies are on a roll, says Millar [CEO of Australian wine producer BRL Hardy]… In 50 years, it is not out of the question for Australia to be the world’s largest wine producer… Jose Fernandez, who runs Hardy’s U.S. joint venture Pacific Wine partners, said the French were a spent force, conceding the U.S. market to Australia. “Only the Italians have put up any sort of fight,” he added.

The Daily Telegraph, September 12, 2002

Faced with the unpalatable prospect of destroying 10 million liters of unsold Beaujolais wine, the equivalent of around 13 million bottles, Maurice Large, president of the Beaujolais winegrowers’ association, has accused modern wine-drinkers of being “Philistines.” On a recent trip to Australia, he explained that “many new wine-drinkers are attracted to Australian or Argentine labels because they know no better than to treat wine like Coca-Cola.”

“Unpalatable Message,” The Economist, October 5, 2002

Not so long ago, I looked forward to tasting a line-up of basic Australian wines. These days, I approach them with a mixture of boredom and distaste. All too often, the whites are bland and unexciting, while the reds, if anything, are worse: confected, sweet and over-oaked… The Australian wine industry has been, and continues to be, plundered by drink multinationals that are obsessed with short-term gain. Australian brands—the very wines that once offered tremendous value for consumers—are being milked for profit.

Tim Atkin, The Observer, October 21, 2001

Robert Mondavi comes from an industrial civilization, not a traditional civilization… The Californians produce wine like other people make yogurt. We respect our landscape and our woods, while he insists on razing native forests to produce Californian wine in the Languedoc… The Mondavis will end up destroying our traditional artisans, just like McDonald’s is destroying French gastronomy.

Aimé Guibert, French winemaker, commenting in 2000 on Robert Mondavi Corp.’s plans (later abandoned) to acquire land in the Languedoc region of France

The wine industry is now globally interconnected. Large companies like E.&J. Gallo are no longer California wine companies. [In the upstream] they are globally connected via contracts and production and sales of bulk wine and concentrate to the world.

Wine industry expert, January 2005

Wine in the Ancient World

The two elements crucial to the development of large-scale wine production were vine cultivation and the invention of a means to conserve wine.1 Vines were first cultivated in the Middle East before 4000 BC. Wine produced in the Zagros Mountains was transported down the Euphrates and Tigris rivers to the Mesopotamian plain to trade. Imported wine was consumed by the Mesopotamian upper classes and used in religious ceremonies. From there, wine trade spread to Greece, Crete, Phoenicia, and Egypt.

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Evidence of imported wine was found in the burial chamber of Scorpion I, one of the early kings who ruled Egypt around 3150 BC.2

The Egyptians began making wine around 3000–2500 BC and left the earliest comprehensive records of winemaking and patterns of wine consumption. Egyptian wine consumption was reserved for the elites. When the Greeks colonized Egypt in the Fourth Century BC, they expanded the local viticulture into larger areas of the country. By then, wine was available to a wide range of consumers, most of them Greek. Egypt and Crete began to trade wine as early as 2500 BC. From Crete, wine production spread to the Aegean Islands and possibly Greece, although wine production could have begun much earlier there (around 3000 BC). Around 1000 BC, the Greeks introduced domesticated vines and winemaking to Sicily, southern Italy, and northern Africa. Wine production was also introduced in France, Spain, and Portugal about 500 years later.3 By the Third Century BC, the Greeks had developed a true wine industry. They not only exported wine but also expanded viticulture in some colonized areas and introduced winemaking to others.

By the time the Roman Empire emerged, wine production was already well established. Unlike the southern region of what is now Italy, where the industry was dominated by Greeks, the Etruscan wine industry in the north was much older. The Romans, like the Greeks before them, extended viticulture and wine production to regions they colonized. By the First Century AD, wine was produced throughout the Roman Empire wherever the climate and environment were suitable. In France, the Romans introduced viticulture and wine production in Provence and then moved further inland. From there, the Roman viniculture (a culture of winemaking) spread to northern Europe, getting as far as Great Britain. Since boats were used for wine transportation, most of the Roman vineyards were located along the major rivers such as the Rhône, the Loire, and the Rhine.

The spread of viticulture, wine production, and consumption throughout the Mediterranean and much of southern and western Europe during the Greek and Roman empires was attributed to four major factors. First, knowledge about growing grapes and making wine was part of the technology transfer among cultures as they came into contact with one another. Second, wine became endowed with powerful cultural meanings that were both religious and secular. In almost all ancient cultures, wine was associated in some manner with specific deities and became an integral element in religious rituals. Offering wine to the gods was common in Mesopotamia, Egypt, Greece, and Rome. Like the Greeks, the Romans made wine an important part of their religions and rituals. The Romans worshipped Bacchus, the god of wine, and influenced Christians in their practice and belief of wine used in the Sacrament. The importance of wine in Christian observance helped maintain the wine culture in Europe through the Dark Ages following the decline of the Roman Empire. At the secular level, the scarcity and cost of wine made it a luxury drink in many societies. A third factor was that wine evolved into a profitable agricultural product and an important commodity in Europe and the Mediterranean region. Finally, the growing demand for wine created new consumer markets. In ancient Mesopotamia and Egypt, only the elites drank wine, but in the Greek and Roman times, wine consumption was enjoyed by all social classes, including slaves.

The Middle Ages

With its need for wine, the Catholic church helped keep wine production going throughout the Dark Ages. During this time, most of the greatest vineyards were owned or created by monasteries, churches, and cathedrals.4 The monks not only made wine, but they helped improve it. Among them were the Benedictines from Italy and the Cluny from Burgundy, whose names were associated with the best-

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cultivated vineyards throughout Europe. The Cistercians, an order founded by Saint Bernard after he left the Benedictines, became highly successful in winemaking. The Cistercians of Burgundy were the first to systematically study the soil of Côte d’Or, transform vineyards by selecting the best vines, experiment with pruning, and choose plots without frost and in which grapes ripened best. As Europe came out of the Dark Ages, the wine trade revived. Throughout Europe, peasants emerged as important players in wine production to keep up with growing demands since many monasteries did not produce wine for the general market. Wine and beer were not a luxury but a necessity since water supplies in most major cities were often unsafe.

The Bordeaux region became a thriving wine-producing region as large shipments of its wine were exported to Great Britain in the period between the Twelfth and the Fifteenth centuries. Mediterranean wine also penetrated markets in Eastern Europe and the Baltic region. This trade route was dominated by merchants from Venice and Genoa. Also, German wine from Cologne was exported down the Rhine to northern Germany, Scandinavia and Baltic areas, as well as to Great Britain.5

The Evolution of Fine Wine

With increasing global trade and colonization in the Seventeenth Century, Europeans discovered new sources of wealth along with a variety of new drinks: chocolate from Central America, tea from China, and coffee from Arabia. In addition, hops were added to ale to make beers more stable and major cities began to pipe clean water that had been lacking since Roman times.6 Facing powerful substitutes, along with a growing demand for better quality in France and Great Britain, European winemakers began to improve their wines.

In the mid-1600s, a Bordeaux producer, Arnaud de Pontac, applied new techniques that were later to become commonplace: small crops, careful grape selection, and new barrels instead of using old ones over and over again. He is also credited with mastering the art of maturing and improving wine. De Pontac’s wine commanded a high premium and appealed to the status-conscious London wine market. Within a generation Latour, Lafite, and Margaux followed suit, leading to a new age of large-scale fine wine. The development of fine wine was enhanced by another innovation: the introduction of glass wine bottles sealed with cork. Previously, wine had been stored in barrels and poured into jugs just prior to serving. These innovations not only helped wine last longer but also made it age better. Until then it was younger wine, not older, that was highly valued, because wine often went “off” within a year.

Problems in the Industry

The production and consumption of wine expanded well into the mid-nineteenth century until the wine industry was afflicted with a series of crises that crippled it for many decades. The first of these started in the 1860s, when an epidemic of phylloxera (an aphid that feeds on the roots of vines and indirectly kills the plant) reached southern France. Between 1875 and 1889, wine production in France dropped by almost three-quarters. The epidemic also spread to Italy, Spain, Portugal, Austria, Switzerland, and Turkey.7 The cure, discovered in the 1870s, was to graft vines onto disease-resistant American roots. The grafting technique saved the vineyards but turned away many wealthy British consumers who were suspicious that the American roots tainted the great flavor of the Burgundy and Bordeaux wine. Furthermore, the epidemic drove the British to look elsewhere, including California, for a more robust supply of wine.

Nineteenth Century Europe witnessed many social changes, and alcohol was implicated as the source of many problems, leading to temperance campaigns aimed at curtailing or banning alcohol.

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consumption. In the U.S., the anti-alcohol movements culminated in the Eighteenth Amendment to the Constitution, which introduced nationwide Prohibition and banned the sale of alcohol from 1920. It was repealed in 1933.

In the aftermath of the phylloxera epidemic, the French wine industry encountered two other sets of problems: overproduction and fraud. Many French proprietors replanted their vineyards with new and high-yield vines, contributing to an overall increase in productivity. Together with the lower cost of transportation, increased wine productivity led to a surplus and hence lower prices. In 1906, the prices of French wine dropped by more than 50% compared to the period of shortage during the phylloxera epidemic.8 During the epidemic, many wine merchants had blended French wine with foreign wine to compensate for the shortage. This practice remained long after the epidemic, prompting French winemakers to protest and demand protective actions from the government.

After the First World War, the French government took steps to protect and strengthen the wine industry, which was ailing from declining exports caused by Prohibition in the U.S., increased tariffs in England, the collapse of markets following the destruction of the Russian, German, and Habsburg empires, and the Great Depression that began in 1929. The French government began to protect its industry by providing financial assistance to cooperatives of small producers in the form of grants to subsidize the capital costs of buildings and equipment.9

Starting in the early 1900s, a series of laws were developed in France that eventually led to the Appellation d’Origine Contrôlée (AOC; which means controlled name of origin) regulations. By 1935, this system of legislations not only defined the regions and grape varieties, as the previous appellation contrôlée system in 1908 did, but also controlled the yield, minimum alcohol levels, and particular methods of growing and wine producing. The central belief underlying the AOC regulations was that particular wine-producing regions and plots of land had their own distinct characters, reflecting the soil and the climate conditions, and that these distinct characters had to be protected. The French refer to the general environment where grapes are grown as terroir, and argued that it is reflected in the taste and style of each wine. The French Vin de Pays regulations were written to regulate more generic wines from broader regions and were much less restrictive that the AOC laws.

Elsewhere in Europe, during the period between the two world wars, wine production faced both economic uncertainty and political instability. Focusing on self-sufficiency, the fascist regime of Italy promoted wine production to increase wine export. Many vineyards in Spain, including those in the Valencia and Catalonia regions, were devastated during the Spanish Civil War of 1936-1939. In Portugal, the wine industry was organized into cooperatives, leading to a general decline in wine quality. The outbreak of the Second World War in Europe severely disrupted wine production and trade.

Wine in the New World

In North America, wine was first made in California by Franciscan priests in 1769 in the San Diego area. Viticulture reached the Napa and Sonoma regions north of San Francisco in the 1820s. Later, many European immigrants became pioneer wine producers and introduced vitis vinifera varieties to the region. The Gold Rush of 1849 helped fuel the establishment of the California wine industry. In 1859, California produced more than one-and-a-half million liters of wine.

In Chile, vinifera grapes were first planted in the 1850s, when wealthy aristocrats developed a thirst for the fine wines of France and took Bordeaux as their model. Dutch settlers started to grow vines

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near the Cape of Good Hope in South Africa in 1658. The Dutch were later joined by the Huguenots who had fled France to avoid religious persecution. Many of the Huguenots had experience with winemaking and contributed significantly to the growth of viniculture in the region. The Cape eventually became a major wine-producing region, due to the favorable climate. By the 1750s, the Cape was exporting substantial quantities of wine, mainly to the Dutch East Indies.

Vines were planted in Australia by British settlers in 1788, and the first wine was produced in 1792. By the 1890s, the Hunter, Barossa and Yarra Valleys were producing wines. German and Italian immigrants played a key role in the industry’s development. The 1970s saw the invention of the wine cask (“bag in a box”). In the late 1980s, Australian wine broke into the traditional markets of Europe. In New Zealand, the first vineyards were planted about 1850. However, serious winemaking did not begin until the 1970s and 80s, and exports began to rise from that time.

Modern Wine

In the fifty years after the Second World War, the wine industry experienced several major changes. Growing economic prosperity resulted in increased demand for wine, especially outside Europe and in many developing nations. Wine producers throughout the world emphasized quality to satisfy an increasingly educated and demanding market.

During the same period, wine consumption declined in several other countries, especially in France and Italy where wine became less of an integral part of everyday meals. In France, annual consumption of table wine plummeted from more than 100 liters per person in the 1970s to 60 liters in the 1990s. This change was attributed in part to the availability of more affordable substitutes, such as bottled spring water. Furthermore, social perceptions about alcohol changed along with the realization that alcohol consumption in the workplace affected productivity. Similar declines took place in other large wine-consuming countries, like Italy, Chile, and Argentina. The decline of their domestic market helped fuel the export drive in these countries.

In response to increasing global demand for quality wine and to facilitate trade, governments in many wine-producing countries adopted the quality regulations similar to the French AOC rules. These regulations were aimed at providing sufficient information for consumers to make informed decisions about the quality of wine. Italy developed DOC (Denominazione di Origine Controllata) regulations that were as comprehensive as the French AOC rules. German regulations included regional classification and quality designations that emphasized grape ripeness. Australia’s Label Integrity Programme ensured that certain percentages of the wine came from the designated regions and the stated vineyards. In the U.S., the American Viticultural Areas (AVA) defined only a designated region of wine production, such as Napa Valley, and had no reference to the grape varieties or maximum yield. Unlike the other regulations, AVA designation did not appear on bottles of American wine.

Besides the controlled appellation systems, labeling in the New World differed significantly from that of Europe. New World labels simply described the grape varieties from which the wine was made, such as Cabernet Sauvignon, Pinot Noir, and Chardonnay. This was contrary to the European tradition that stressed geographic location such as Bordeaux, Burgundy, and Beaujolais. The European vineyards usually grew a limited range of varieties, while those of the New World typically had a broad spectrum. This variation enabled a New World winery to produce many different types of wine. With wine ingrained deeply in the cultures, the European system of labeling assumed that a typical consumer could infer the grape varieties from a delimited region, e.g., that a Pomerol (such as Petrus) consisted mainly of Merlot and a little Cabernet Franc.

The major revolution in the wine industry in the Twentieth Century was the transformation of traditional winemaking methods into an industrial process. Winemaking involved fermentation, and fermentation was a process that could be easily regulated. Modern refrigeration techniques enabled

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warm countries in the New World to successfully produce quality wines of different varieties. In addition, the University of California at Davis and Roseworthy Agriculture College in Australia opened academic departments dedicated to the study of viticulture and winemaking. Combining technology and new-found expertise, modern wineries of the New World became capable of producing wine of a quality that rivaled those of the Old World.

How Wine is Made

Most winemakers agree that high-quality wine begins with the land and the natural environment of winemaking or, as the French say, the terroir. Although terroir as a concept was not easily defined, terroir involved how the land and climate interacted to shape the defining characteristics of wines from a specific viticultural site. In The Oxford Companion to Wine, a lengthy discussion of terroir began by stating it is a “much-discussed term for the total natural environment of any viticultural site. No precise English equivalent existed for this quintessentially French term and concept.”

After the grapes are harvested, they are put through a crusher/destemmer machine, which removes the stems and gently breaks the grape skins. In red wine production, the skins are fermented with the crushed grapes to give the juice color and flavor. Unless a full-bodied white wine is desired, the skins and seeds are usually removed after only a few hours. After the crushing, yeast is added to the juice for fermentation in tanks or barrels of oak or stainless steel. Stainless steel barrels provide a sterile, easily controlled environment that adds nothing—desirable or undesirable—to the wine. Fermenting in oak barrels contributes gentle tannins and vanilla flavor from the wood, which renders fuller-bodied wines with complex flavors.

During fermentation, winemakers monitor the extraction of pigment, flavor, and tannins from the grape skins, and may remove the skins when the wine has reached optimum character. This involves manipulation of the cap, or the mix of grape skins, stems, and other solids that rise to the top of the tank during fermentation. If the wine needs greater exposure to the solids for further extraction, the cap is punched back down into the wine, or the wine is pumped over the cap. Most red wines are fermented until completely dry or until all sugar has been converted to alcohol. With white wines, the winemaker may stop the process to preserve some sugar so as to produce off-dry or sweet wines. Wines with higher sugar levels are referred to as sweet, while wines with low or no sugar are dry.

Wine drawn off the solids after alcoholic fermentation and prior to pressing was called free-run wine. The remaining solids, called must, moved through either a basket or balloon press, and the resulting wine is called press wine. What is left of the solids after pressing is called the pomace, and this is returned to the vineyard for soil enrichment. The free-run wine and the press wine are kept separate, though they may be blended prior to bottling. The wine is then aged, with the breakdown of the yeast during aging contributing to the wine’s complexity and richness. Red wines are typically aged from one to three years. White wines are aged for a shorter period, usually a year or less. When the aged wine exhibits the desired flavors and aromas, the wine is then finished, filtered, and clarified before bottling.

The Producers

The international wine industry was highly fragmented, with a proliferation of producers of various sizes, locations, and specialties. The world’s five largest wine companies in terms of volume produced about 6% world production. The world’s largest premium wine company, Constellation Brands, had $1.8 billion in branded wine sales in 2005. The Bordeaux region of France alone had over 12,000 producers. In contrast, the New World (outside Europe) was much less fragmented. The top four Australian companies controlled 80% of the market; in the U.S. the five biggest producers had more than 60% of the market and the top 30 had 90%; and in Chile the top five companies commanded 50% of the market.

In the major wine-producing countries, consumption was primarily domestic wines. Imports to France accounted for less than 5% of the wine market. About 90% of wine consumed in Australia was home-grown. Italy and Spain had similar preferences for domestic wine consumption. Australian wine made up just 1% of the German market. Unique among the wine-producing countries, Americans tended to be more open to wines imported from other countries, although 82% of all wine consumed in the U.S. was American.

About 70% of the world’s wines were made and consumed in Europe (Table 1 shows production by country; Table 2 shows consumption by country; Table 3 shows per capita consumption). Although Australia had joined the ranks of big producers, total volume output was only about 20% of the size of France (see Tables 4–7 for information on the Australia industry). Nevertheless, New World producers were having a significant impact on the world wine market. In the late 1980s, 85% of all the wine exported in the world came from four West European countries: France, Italy, Portugal and Spain. By 1997, their share of international sales had dropped to 72%. Britain was the world’s biggest importer of wine. New World producers held over a third of the British market (see Tables 8 and 9). Wines from Australia and New Zealand sold at higher average prices in Britain than wines from France, Italy, and Spain.

The large New World firms marketed wine product lines that spanned a wide range of price and quality (Table 10 shows the shift in U.S. shipments towards premium wines). One strategy was to get new consumers interested in cheaper wines, then tempt them to trade up while sticking with the same winemaker. One key difference between the Old and New World was climate. The New World producers tended to operate in more predictable climates that produced consistent grape harvests. As well, New World winemakers invested heavily in technology and innovation, which allowed them to produce a range of wine styles and ensure consistency. Also, New World wines were often blended to ensure consistency. As evidence of its commitment to scientific advancement, Australia produced about 20% of the world’s scientific papers on viticulture and oenology (the science of wine and winemaking).

**Economics**

The U.S. wine industry operated with a three-tier system that was a leftover from Prohibition: wineries sold to distributors who sold to retailers. About 98% of U.S. wineries produced less than 1,000,000 cases per year. Large producers had hundreds and even thousands of different labels (E.&J. Gallo had about 4,000 labels). About 350 new labels appeared every year, and more than 60,000 labels had been approved by 2005.

Using an example of a U.S. wine with a retail price of $13, the estimated breakdown of costs was as follows:

<table>
<thead>
<tr>
<th>Cost Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail price</td>
<td>$13</td>
</tr>
<tr>
<td>Retailer margin</td>
<td>4.16</td>
</tr>
<tr>
<td>Distributor margin</td>
<td>2.99</td>
</tr>
<tr>
<td>Winery profit, marketing, OH</td>
<td>2.47</td>
</tr>
<tr>
<td>Bottling and packaging</td>
<td>.65</td>
</tr>
<tr>
<td>Winemaking</td>
<td>1.30</td>
</tr>
<tr>
<td>Grapes</td>
<td>1.43</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

The technology to produce wine was simple and, according to one expert, “with today’s technology, it is very difficult to make bad wine.” However, making high-end wines that could command top prices remained a very difficult and challenging endeavor. High-end wines incurred substantially higher costs. The very best grapes could be found in a small number of places in the world, and in Napa Valley could cost more than $10,000 a ton (versus a few hundred dollars for grapes from California’s Central Valley). French oak barrels cost about $750 each versus $300 for American. Distinctive packaging could add several dollars of cost per bottle. High-end wines used corks that cost 75 cents or more; entry-level
corks were about 10 cents. The grapes for high-end wines were carefully handpicked and required small containers so the grapes were not crushed by the weight of other grapes. Some high-end wines used wooden boxes for distribution, as opposed to cheap cardboard for most wines. Finally, setting the right price was always a challenge. The right price was one that would create a high demand from consumers and distributors and that would send the appropriate message about quality and prestige.

Entering the wine industry was easy. In 2005, the U.S. had about 4,700 wineries, of which about 1,400 were virtual or semi-virtual. A virtual winery owned limited capital assets and was basically a marketing organization that subcontracted most of the production and distribution activities. In 2001 Ravenswood, a semi-virtual wine company in the super-premium segment with only 65 full time employees, was acquired by Constellation Brands for $151 million. Ravenswood owned no vineyards and did not use long-term supply contracts. Ravenswood purchased grapes from independent growers and incorporated bulk wine acquired through short-term contracts and spot market purchases. Ravenswood spent 4-5% of revenues on marketing and promotion, double the percentage reportedly spent by larger publicly traded wine companies.

The valuation of a wine company involved an assessment of a complex set of factors, including: the wine brands' quality reputation, markets segments and relative position in those segments, distribution network, workforce, asset mix (such as vineyards, production facilities, and inventory) and quality, and profitability and potential growth.

The Market for Wine

The commercial success of wine relied not only on production of fine wine but also on marketing strategies. With better technology, wine producers in the New World continuously enhanced the quality of their wine to better adapt to consumers' tastes. In addition, advertising played a crucial role in boosting demand and building brands for the wineries. The linking of technology and modern business practices enabled the New World's wineries to capture a sizeable share of the global wine market from the traditional and well-established wineries. With brand names like Cockfighter's Ghost and Jacob's Creek, the Australian wine companies, in particular, were bringing well-honed marketing skills to global markets.

The distribution of wine from winemaker to market varied significantly from country to country. For example, in many countries, such as Sweden and most of Canada, state-run monopolies controlled retail distribution channels. These monopolies could buy direct from the wine producers and had strong bargaining power over distributor/wholesalers and the wine producers themselves. In Britain, the large supermarkets such as Tesco dominated retail sales, and large firms such as Wine Importer and Corney & Barrow dominated the import/wholesaler business. The supermarkets had the ability to buy directly from producers and increasingly preferred to deal with a smaller set of producers with broad product lines. Smaller winemakers relied heavily on importers and non-supermarket wine retailers. In the U.S., wine was sold in many different outlets depending on the state and local alcohol regulations. The largest wine retailer was Costco, a large warehouse retailer. Imports were handled mainly by a mix of importers and distributors. In the 1990s, the wholesale business became much more consolidated. It was estimated that the largest distributor, Southern Wine & Spirits of America, distributed about 10% of the total wine sold in the U.S. Some of the bigger Australian wine producers, such as Southcorp and BRL Hardy, owned their own U.S. distribution companies, cutting out the middleman.

The marketplace for wines was broadly divided into three major segments, on the basis of price: (1) low-cost, high-volume, and low-margin “peasant” wines, often referred to as “table” wines; priced at less than $8 in the U.S.; (2) premium wines priced at about £5-8 in Britain and between $8-$15 in the U.S.; these wines targeted a more discerning wine consumer and yielded a higher profit margin to the winemaker; and (3) ultra-premium; this segment included wines above $15. The top end included wines produced in scarce quantities with no limit to price, such as the Premiers Crus wines from the Medoc region of Bordeaux like Château Lafite-Rothschild and Château Latour and Screaming Eagle
from Napa Valley. The top end had various descriptors, such as super luxury, icon, cult, and trophy. (Note: The price points for segmentation and labels for the different segments varied depending on the source.)

The market was further segmented by classification of grape varietal, e.g., Chardonnay and Cabernet. This approach, introduced by California vintners, helped consumers distinguish between types of grapes and taste. A more recent marketing trend for New World producers was to differentiate wines not only by the variety of grape, but also by region, place, and even winery. The determination of quality was a difficult issue in the wine industry. Although there was a strong correlation between the perception of quality and price, quality was not just a function of taste. The taste of a wine was only one element in determining its status and market position. Many wine consumers could not distinguish the taste of different wines. Two other key elements that influenced quality perception, especially at the trophy wine level, were scarcity and wine critic ratings. Ratings such as those by the American wine critic Robert Parker could have an enormous impact on wine sales.

The Situation in France

Although France was the world’s largest producer and consumer of wine, and by far the leading producer of high-priced trophy wines, all was not well in the French industry. Consumption within France was falling (see Tables 11-14 for consumption in France and other countries), as were exports to traditional markets like Britain and Germany (see Table 15 for the import trend in Germany). Although France was the world’s biggest wine exporter and sold the most wine in Britain by volume, with about 25% of the market, Australia was closing the gap. Moreover, Australian wine dominated the £5-8 price category, whereas French wines often had lower prices.

Wines classified by Institut National des Appellations d’Origine Contrôlée were strictly regulated, including rules on irrigation (not allowed) to the type of barrels that must be used (oak) to the amount of information allowed on the labels (very little). Any violation of the regulations could have serious consequences and lead to declassification, which meant the “stamp of approval” was lost. In 2001, four Bordeaux producers were fined for using oak chips to flavor their wine. In another case from Bordeaux, three châteaux were ordered to sell part of their 2000 crop as vin de table rather than as superior appellation contrôlée. Their “crime” was having used under-vine plastic sheeting to protect their vineyards against excess rain. Despite the fact that the châteaux used the plastic sheeting to improve the quality of its wines, the practice was ruled illegal and the wine was declassified.

At the top end of the market, a small number of châteaux with official sanction, or classification, dominated the market and were highly profitable. In some areas of Bordeaux, the classifications were made in 1855 and only one change has been made since, the promotion of Château Mouton Rothschild in 1973. Wines that did not have a classification had no chance of getting one.

The AOC regulations were coming under increasing criticism. As a British commentator said, “Since their creation in the 1930s, European appellations have favoured authenticity over quality. At the top end, I can see the justification for this. But lower down the scale, I’d rather have a bottle of wine that tastes good than a bottle of plonk with a guarantee of origin.”12 Within the vin de pays category, which represented about one third of all French wine exports, many wines were doing much better than the supposedly higher quality appellation contrôlée wines. A similar situation occurred in Italy several decades earlier with many consumers and producers rejecting the system of Denominazione di Origine Controllata. In 2002, many of Italy’s best wines were labeled vino di tavola, table wine.

One perspective was that the AOC system seemed incapable of coping with consumer demands for wines that were defined not by geographical origin but by grape variety and the reputation of the

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12Atkin, T., Mixed blessings: Appellations are totally against regional wine blending, but who wants to drink pedigree plonk? The Observer, March 10, 2002, p. 65.
company producing them. In response to this concern, the head of the Institut National des Appella-
tions d’Origine Contrôlée said: “If we allowed the names of the varieties on the label, we would have lost
our major advantage and would be competing on level terms with the rest of the world’s winemakers.”
Nevertheless, he also said that much of the problem was with the producers themselves, in that quality
was not always maintained and that producers were controlling the AOC criteria rather than the regu-

   lators.\(^\text{13}\)

Within France, there were various calls for change. The French Agriculture Ministry released an
80-page report in 2001 that called for sweeping changes in the industry. The report called for a boost in
branding and said that consumers were confused by the hundreds of labels and the classifications used
to characterize French wines. In 2004, an agreement was reached to erase centuries of tradition by
permitting non-APC producers to label Bordeaux and Burgundy wines according to grape varietal.

Recent Industry Developments

One of the most significant trends was continuing consolidation in the New World markets. In 1995,
Foster’s Brewing, Australia’s largest brewery, bought its first wine company. Over the next decade, the
company acquired more than 20 wine producers, including Beringer of California and Southcorp of
Australia. U.S.-based Constellation Brands was one of the most aggressive acquirers. Constellation
acquired major wineries such as BRL Hardy (itself the product of a major merger in Australia) and
Robert Mondavi, as well as a range of smaller companies. In the U.S., many small producers were being
acquired by the large companies. Another important U.S. trend was the increased emphasis by small
wineries on hiring outsiders for managerial positions such as chief financial officer. A third trend was
the emphasis on innovative advertising. For example, until a few years ago, Mondavi used no television
advertising to support its Woodbridge brand. In 2002, the company spent about $14 million on televi-
sion advertising. Movie star Jackie Chan was used in marketing Southcorp’s Lindemans wines, and
Greg Norman lent his name to a Beringer wine called Greg Norman Estates. Finally, brand segmenta-
tion was becoming increasingly important. For example, the Australian Wolf Blass brand was seg-
mented into five tiers: South Eastern Australian range, South Australian Selection, President’s Selection,
premier Platinum range, and top-level Black Label wines.

Another important trend was a global shift towards higher-priced wine. In the rapidly expanding
U.S. market in the early 2000s, revenue grew at double the rate of volume. In 2004, the greater than $15
retail segment became the largest revenue segment despite making up only 10% of volume. This trend
resulted in a chronic undersupply of high quality grapes in the U.S. and a glut of low-end grapes.

Clearly, various forces were driving change in the wine industry of the 21" century. Historically, a
plethora of products and fragmented international markets made it nearly impossible for a company to
establish a dominant international position. In addition, because wine is an agricultural product and
subject to the vagaries of the weather, reliability of supply was unpredictable. However, well-capitalized
international winemakers were emphasizing global presence and brand recognition. The tremendous
success New World producers had experienced in markets traditionally dominated by European
winemakers was leading to increased emphasis on creating recognized brands, stable distribution ar-
rangements, and focused advertising campaigns. Demand in traditional non-wine consuming countries
like Japan, China, and Korea was steadily increasing. Only time would tell if the wine industry re-
ained one where terroir and the mystery of the wine prevailed or global brands displaced the local and
regional winemakers.

\(^{13}\)Faith, Nicholas. The great French wine anomaly: Nicholas Faith meets Rene Renou, a man who wants to
start a revolution in the staid and structured world of French wine appellations.\textit{Financial Times}, October 27,
2001, p. 15.
Table 1

<table>
<thead>
<tr>
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<td>Canada</td>
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E = Morgan Stanley Research Estimates

Table 2

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<th>Nation</th>
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<td>UK</td>
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<tr>
<td>France</td>
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<td>Italy</td>
<td>15%</td>
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<tr>
<td>US</td>
<td>8%</td>
</tr>
<tr>
<td>Germany</td>
<td>8%</td>
</tr>
<tr>
<td>China</td>
<td>7%</td>
</tr>
<tr>
<td>Argentina</td>
<td>6%</td>
</tr>
<tr>
<td>Japan</td>
<td>6%</td>
</tr>
<tr>
<td>Russia</td>
<td>3%</td>
</tr>
<tr>
<td>Portugal</td>
<td>2%</td>
</tr>
<tr>
<td>Romania</td>
<td>2%</td>
</tr>
<tr>
<td>Brazil</td>
<td>1%</td>
</tr>
<tr>
<td>Australia</td>
<td>1%</td>
</tr>
<tr>
<td>Others</td>
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</tr>
</tbody>
</table>

Total World Wine Market Value: US$158.5 Billion
Total World Wine Market Volume: 26.0 Billion Litres

Source: Euromonitor
Table 3  Global Wine Industry Per-Capita Wine Consumption, Selected Countries, 1999


Table 4  Australian Wine Exports (Volume and Sales), 1987–2001

Source: Australian Bureau of Statistics Cat. 1329.0
Table 5  
1992 Australian Wine Exports (Volume) by Key Market

<table>
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<tr>
<th>Market</th>
<th>Export %</th>
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<tbody>
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<tr>
<td>Japan</td>
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<tr>
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<td>21%</td>
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<td>2%</td>
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<tr>
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<td>1%</td>
</tr>
<tr>
<td>Germany</td>
<td>1%</td>
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<td>Canada</td>
<td>7%</td>
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<td>NZ</td>
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<tr>
<td>US</td>
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<tr>
<td>UK</td>
<td>32%</td>
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Source: “Wine Export Approval Reports,” Australian Wine Export Council

Table 6  
2001 Australian Wine Exports (Volume), by Key Market

<table>
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<tr>
<th>Market</th>
<th>Export %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rest of World</td>
<td>10%</td>
</tr>
<tr>
<td>US</td>
<td>21%</td>
</tr>
<tr>
<td>NZ</td>
<td>6%</td>
</tr>
<tr>
<td>Canada</td>
<td>4%</td>
</tr>
<tr>
<td>Germany</td>
<td>3%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2%</td>
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<tr>
<td>Ireland</td>
<td>2%</td>
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<tr>
<td>Sweden</td>
<td>1%</td>
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<tr>
<td>Japan</td>
<td>1%</td>
</tr>
<tr>
<td>UK</td>
<td>50%</td>
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Source: “Wine Export Approval Reports,” Australian Wine Export Council
Table 7  U.S. Wine Export Volumes Relative to Australia

Source: Adams Wine Handbook

Table 8  Wine Demand: Great Britain Consumption Trends

Source: Drink Pocket Book 2001
Table 9: Market Share of Selected Great Britain Table Wine, by Volume and Country, 1987–2002E

Source: The Drink Pocket Book: NIC Publication

Table 10: Domestic Shipments of California Wine by Category CY1985–2001A

Table 11  Total Alcohol Consumption in France
Alcohol Consumption (l. pure alcohol '99)

Table 12  Total Alcohol Consumption in the United States
Alcohol Consumption (l. pure alcohol '99)

Table 13  Total Alcohol Consumption in Great Britain
Alcohol Consumption (l. pure alcohol '99)

Source: World Drink Trends
**Table 14  Total Alcohol Consumption in Japan**

Alcohol Consumption (l. pure alcohol '99)  

<table>
<thead>
<tr>
<th>Alcohol Type</th>
<th>Consumption (%)</th>
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<tbody>
<tr>
<td>Spirits</td>
<td>48%</td>
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<tr>
<td>Beer</td>
<td>47%</td>
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<tr>
<td>Wine</td>
<td>5%</td>
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**Alcohol Consumption Over the Years (1980 = 100)**

<table>
<thead>
<tr>
<th>Year</th>
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<tbody>
<tr>
<td>80</td>
<td>130</td>
</tr>
<tr>
<td>82</td>
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<td>84</td>
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<tr>
<td>94</td>
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</table>

*Source: World Drink Trends*

**Table 15  Wine Demand: German Old and New World Import Trends**

<table>
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<tr>
<th>Year</th>
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<tbody>
<tr>
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<td>0.06</td>
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<tr>
<td>1997</td>
<td>0.07</td>
<td>0.07</td>
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*Source: Berger, Spahni, & Anderson, Deutsche Weininstitut*