Exporting wine in a competitive world environment


The big picture

Currently Australia is the fourth largest wine exporter in the world — behind France, Italy and Spain. From 1990 to 2000 the value of Australian wine exports grew rapidly from less than A$10 million to more than A$1.4 billion. By 2005 it had reached A$2.8 billion. Then in 2006 the export value grew by less than 1 per cent — the lowest annual increase for more than 20 years. Much of the recent lack of growth in value has been the result of lower export prices in many markets. From 2005 to 2006 the average price per litre fell from A$3.98 cents to A$3.72 cents. Prices have been falling steadily from the highs in 2000.

The export volume continues to grow, although its annual growth has slowed. From 2005 to 2006 it grew by 8 per cent from 702 million litres to 757 million litres after the spectacular annual compounded growth of 24 per cent in the previous 20 years. Again, the growth over the past year represents the lowest annual increase for more than 20 years.

In the face of this slowing growth Australian wine production has been on an upward trend, although seasonal variations and fruit not picked for crushing in the 2005 and 2006 vintages saw Australian production fall slightly. The adverse conditions faced by many producers in the 2007

Exports of Australian wine by price

Data source: Australian Wine and Brandy Corporation.
 season will also see production decline. Estimates are the crush will be more than 20 per cent below the 2006 level. One estimate is that it will be almost 30 per cent below (Australian Financial Review, 18 January 2007). In an announcement last week the AWBC believes the 2007 crop will be about 1.35 million tonnes, down by 33 per cent on the 2006 crush.

The adverse climatic conditions are likely to have a big impact on 2008 production. Those in ‘cooler’ climate regions will experience the largest declines. These regions were severely affected by frosts and this has been followed by extremely dry conditions. More recently they have had a surplus because of difficulty selling their wines. The other regions likely to have some major declines in production are those that rely heavily on irrigation, including the Riverina and the Riverland. They have less water available and the available water is more expensive. Again these regions have experienced a decline in demand for grapes and a growing surplus. The effect of the current climatic conditions in Australia may result in tank stocks being absorbed and may well result in a wine shortage for a couple of years.

A return to more normal seasonal conditions and better prices are likely to see production levels rise again as many of the recent plantings begin to mature. This growth could again result in an oversupply of wine.

The overall trend in wine production in other countries is continued expansion. However, changes in production levels vary greatly year by year. France, Spain and Italy still account for more than 50 per cent of the world’s wine production and exports. Despite the decline in production in these countries total exports are still increasing.

The countries likely to provide direct competition for Australia in the wine export market include Spain, Argentina, Chile and South Africa. Spain has only recently been able to ‘clean’ up their wine production. With large areas of more traditional red wine grapes they are starting to become a strong force in the supply of high-quality low-priced red wines. Argentina and Chile have also been expanding plantings and are increasing production of low-priced wines. South Africa with its long history of grape growing is also starting to be recognised as a producer of good wines, albeit at prices higher than Chile’s and Argentina’s. China and India, while currently net importers, have been planting vines. They are still however net wine importers.
Prospects for Australia’s wine exports

Australian wines have principally been exported to two markets — the United Kingdom and the United States. In the year ended June 2006 these markets took more than 65 per cent of the volume of Australian wine exported and accounted for more than 66 per cent of its value. Since 2002 the United Kingdom’s share of exports has fallen while the United States’ share has increased.

The third largest export market for Australian wine is Canada, taking just under 7 per cent of Australia’s wine exports by volume. There are many smaller markets that take the remaining 30 per cent of Australian exports. Many of these markets are new to drinking wine and even newer to drinking wines from ‘new world’ countries, including Australia.

In the past much of the Australian Wine Export Council’s (AWEC) promotional expenditure has been directed to Australia’s two largest markets, with the remainder being spent on the other large markets. Failure to promote Australian wine in emerging markets meant that these markets were not getting the recognition they deserved in terms of their potential. Although the levies collected from exporters of wines to these emerging markets may not have been sufficient to fund large promotional programs year after year, instead of spending them elsewhere they could have been accumulated until some effective promotional activities could occur. In February 2006 AWEC addressed this issue by assigning a person to take care of Australian wine promotion in emerging markets such as China, the Republic of Korea, Hong Kong and Singapore.

United Kingdom

The United Kingdom is still a very important market for Australian wines. The market is probably the most competitive of all wine markets in the world. Essentially it is a low to middle price market as more than 98 per cent of all wines in this market sell below 10 pounds a bottle. At the prevailing exchange rates this is equivalent to A$100 a dozen free on board. To put this into a retail perspective, in Australia this wine would be around A$15 a bottle on shop shelves. The relatively low price of wine being shipped to the United Kingdom is reflected in the average value per litre exported from Australia to that country. In 2005–06 this was A$3.56, down from A$4.38 in 2003–04.

Most of the major brands are beginning to experience increased price pressure. Major retail players are switching to buyers’ own brands (BOBs). This is understandable as the margins for large commercial brands are being squeezed by the proliferation of discount offers. Major retailers continue to try to out-do each other with these offers. Many ask how long campaigns such as ‘buy 2 get 1 free’ can last.
The top 50 brands have 40 per cent of the market and BOBs account for another 48 per cent of the market. This leaves only 12 per cent for the others (AWBC, Annual report 2006 p. 19). This effectively leaves many Australian producers without economies of scale fighting at this end of the market.

It is unlikely the UK market will change in the short term and, if anything, it will become even more competitive, putting further downward pressure on prices and volumes.

**United States**

Since 2000 Australian wine exports to the United States have grown spectacularly. Much of this growth has been due to the rapid expansion of the ‘Yellowtail’ brand. Estimates are that more than 10 million cases of this brand will be sold to the US market in 2007. This alone is more than what France sells to the US market. With the help of ‘Yellowtail’ Australia is the number one wine exporter, with more than 28 per cent of the imported wine category in the United States.

The value per litre of wine exported to the United States has been falling rapidly. In 2003–04 it was A$5.27 and in 2005–06 it was A$4.21. This drop was largely in response to the rapid increase in exports of ‘Yellowtail’.

Even with the rapid growth in exports of lower priced wine to the United States there is still a significant market for premium wines. Reviewers and wine writers drive much of this sector. In particular, the influence of Robert Parker, jnr, and his publication Wine Advocate on demand for many wines is enormous. Since the first reviews on Australian wine — back in 1999 — many boutique Australian labels that were unknown previously in the US market have experienced strong demand.

It is likely that demand for Australian wines will begin to level out as competition from other countries’ wines strengthens.

**Canada**

Canada is an intriguing wine market. Because each provincial government controls its alcohol market Canada can be viewed as many separate wine markets. Each province has different regulations and methods of operation governing wine sales and imports. For example, the Alberta wine market is partly privatised, with all retail stores operated by private companies but with the government controlling all warehousing, distribution and imports of wines. While in Ontario the government imports, distributes and sells all wines at retail. The Liquor Control Board of Ontario is the largest single purchaser of alcohol in the world and is the second largest single purchaser of Australian wines.
The total Canadian market for Australian wines had been growing strongly for several years, but that growth slowed in 2005–06 in the face of increased competition. Nevertheless, some provincial markets are growing very strongly. For example, Quebec’s imports of Australian wine increased by 29 per cent in 2005–06 and will continue to show strong growth but it is from a small base. Some of the provinces that are mature wine markets (British Columbia, Ontario and Alberta) are likely to increase their imports of Australian wine only moderately as other countries, in particular Argentina, South Africa and Chile, target the Canadian market with competitively priced wines.

**Japan**

The Japanese market for wine is one of the most discerning in the world. Consumers are affluent and are very brand conscious. Traditionally the Japanese market has regarded wines as ‘French’. This has made the penetration of Australian wines in the market slow. Australian exports have been growing strongly from a very small base and it is likely the market will grow as the economy is expected to strengthen.

**Singapore**

Singapore is a very high-value wine market. The main reason for this is the high fixed duty per litre. This compresses the price points in the lower price range. Wines in the medium price range are considered very good value. Wines in the higher price brackets are generally considered to be at some of the lowest prices in the world. Imports of Australian wines are the largest of all countries and continue to grow. Some of the growth is occurring because Singapore is used as a transit point for other markets (mainly Indonesia and the Philippines). This growth is expected to continue because of its strong economy and as consumers develop a stronger wine culture.

**Hong Kong**

The wine market in Hong Kong is currently extremely strong, reflecting a booming economy and strong stock market. It is also the market where some of the wines are brought in for re-export to Mainland China and Macau. Last week it was announced the wine duty in Hong Kong is being reduced from 80 per cent down from 40 per cent with immediate effect. Retail prices in Hong Kong are likely to fall by more than 20 per cent. It is expected this change will stimulate demand for wines and benefit the higher priced producers such as Australia.
Potential growth markets

South Korea, Taiwan, China, India and Thailand are the markets likely to provide Australian wine exporters with increased demand over the next few years.

South Korea is a country with relatively high incomes and where alcohol is an important part of the culture. Australian wine exports to South Korea have increased over the past five years by more than 29 per cent and are likely to continue to grow. One major impediment to growth in that market may be the preferential tariff provided to Chile under a free trade agreement.

Taiwan is a country with rising incomes and, although Australia’s share of its wine market is still small, the growth rate is very high. With a growing wine culture imports of Australian wines are set to continue to grow. With its increasing incomes and the perceived health benefits from drinking wine China is importing more wine. Much of this wine arrives in bulk to be blended with wines produced domestically. As the wine culture develops it is expected demand for bottled wine will rise.

India, like China, has a very strong and growing domestic wine market. Imported wines are subject to tariffs, which has slowed the rate of growth in imports. However, with a rapidly expanding middle class it is expected that demand for imported wines will continue to rise.

Thailand’s wine market is subjected to extremely high duties and tariffs. Under the free trade agreement Australia’s wines experienced some relief but generally wines remain expensive and are affordable to only the more affluent and tourists. There are rumours that the government is considering reductions in the duties and tariffs. If this happens the growth for imported wines will be stronger than it is now.

The hidden costs of exporting wines

Labelling

Almost every country in the world has labelling requirements for wine and these are different in every market. This means that, to comply, producers have to either print labels for each market or adopt the costly process of ‘overstickering’. It is generally the smaller exporters who face extremely high label costs because of small label runs for each country.

Recently there has been some progress on label requirements. Major wine-producing countries have agreed to a standardised front label. This was announced as a major breakthrough, but in reality the impact of the agreement will do little to alleviate the costs of labelling as the importer rather than the producers enforces the label requirements. While the move is positive, more work needs to be done on gaining acceptance of a standard wine label.
Different destinations means different labelling

**Australia**

**ROLF BINDER**

**2006**

**Barossa Valley**

**Shiraz**

Wine of Australia

PRODUCED BY:

ROLF BINDER WINES PTY LTD

STELZER ROAD TANUNDA, SOUTH AUSTRALIA

WINE OF AUSTRALIA

14.5% alc./vol.

APPREH & A STANDARD DRINKS

PRESERVATIVE (220) ADDED

750mL

**Canada**

**ROLF BINDER**

**2006**

**HALES**

**Barossa Valley**

**Shiraz**

RED WINE - VIN ROUGE
PRODUCT OF AUSTRALIA

PRODUCED BY:

ROLF BINDER WINES PTY LTD

STELZER ROAD TANUNDA SA 5352

AUSTRALIA

CONTAINS SULPHITES

CONTENT DES SULPHITES

RETURN FOR REFUND

WHERE APPLICABLE

CONSERVER LA OU LA LOI

LE PRESCRIT
EXPORTING WINE IN A COMPETITIVE WORLD ENVIRONMENT

PAPER PREPARED FOR ‘OUTLOOK 2007’, CANBERRA, MARCH 2007
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United Kingdom

Rolf Binder

2006
Hales
Shiraz

Barossa Valley

Wine of Australia

Produced by: Rolf Binder Wines Pty Ltd
Stelzer Road, Tanunda, South Australia

Imported by: Stockford Wine Agencies Ltd, Colchester, CO7 7FQ, UK

ALC 14.5% vol
750mL

United States

Rolf Binder

2006 Hales
Shiraz

Barossa Valley

Wine of Australia

Produced by: Rolf Binder Wines Pty Ltd
Stelzer Road, Tanunda, South Australia

Imported by: Joshua Tree Imports, 1801 Highland Ave, Suite E, Duarte, CA 91010

Government Warning: According to the Surgeon General, Women should not drink alcoholic beverages during pregnancy because of the risks to the fetus. Consumption of alcohol by a pregnant woman can result in birth defects.

Contains sulfites
Product of Australia
ALC 14.5% by vol. / 750mL

Joshua Tree Imports, LLC
Wine testing

Before any wine can be exported from Australia it is required to go through stringent testing procedures. These include a full analysis by a certified laboratory and tasting by a selected committee. Yet when we export the wines to some markets — Ontario and Quebec in Canada, for example — the same tests are carried out again. The exporter pays the costs involved. In the future it is to be hoped that the test results of the Australian certified laboratories will be sufficient and accepted.

The current wine testing and wine export system imposed in Australia allows any wine to be exported as long as it is tested. To obtain export approval three bottles of wine must be tested annually. One of these is used for analysis and the other two are used for tasting. The wine bottle label must also be approved for the market the wine is going to. This system effectively precludes exports of aged high-value Australian wines — for example, Grange Hermitage. Internationally many find it difficult to understand why this system is imposed. Imagine the uproar if the wine exporters in France were asked to go through this process to export one of its first growth wines. The important question to be answered is: if Australian wines are world class, why do they need to go through this procedure?

WET rebates

Recently the Australian government decided to allow wine producers to retain up to A$500 000 collected from the wine equalisation tax (WET). With this tax being applied to only domestic sales this change provided an incentive for many smaller producers to sell in the domestic market rather than export or to dramatically reduce the domestic wholesale prices. As a result, the Australian retail market has seen some wines selling for less than A$2.00 a bottle as producers pass on the rebate in the form of reduced wholesale prices. However, for producers who were selling all their wine this policy provided a dilemma — to earn less and maintain an export market or to sell greater amounts on the domestic market. Some producers attempted to raise their prices in a competitive international environment and have begun to struggle. This was never the intention of the policy change.

Costs of regulations

Exporting wine from Australia is one of the most tightly regulated Australian export activities. The level of regulation has been increasing. This is evident by the more than 26 per cent increase in AWBC staffing over the past two years. Over the same time the number of export document approvals rose by 17 per cent.

Not only is wine testing required but also the compliance procedures that follow have attached costs. While the costs of wine testing that are paid by the exporter are transparent,
the costs of compliance such as time spent on the applications are hidden. In general, the smaller the exporter the greater the cost per litre it is to export. This is because many of the charges are fixed.

Using the rough calculation of AWBC income derived from producers divided by export volume, the cost of exporting Australian wine per litre in 2005–06 was on average about 1.5 cents. The real cost of regulations is probably more like 3.0 cents per litre. In a competitive world market where cents can mean the success or failure of a deal this cost can be significant.

The above is a very simple analysis of the costs of regulation imposed by the current legislation. With the wine industry at the crossroads with declining prices and large potential for increasing production, it is time to have an independent study of the impact and effectiveness of the legislation in strengthening Australia’s position in the world wine market. From a small producer’s viewpoint it is not good enough to have policy dictated by large companies. In the wine industry, regulatory policies dramatically increase export costs and place the small producer as a distinct disadvantage. Only an independent review will establish by how much.

The wine glut

This is a plea to those in the industry to stop talking of a wine glut. How many times have you read about this in the press? These reports reach consumers and the international market and dampen the market. Furthermore there is little or no understanding by consumers that there is excess wine in only a few categories. Unless we provide full information, such reports only mislead.

Anyone in the industry will confirm that there is no excess premium wines from the Barossa, McLaren Vale and to a lesser extent Clare Valley wineries. This is clearly evident when looking at the bulk offerings by brokers. Most of the excess is of wines from irrigated areas and the true cooler climate regions. Irrigated wines on the world market compete with wines produced in low-cost countries such as Chile and Argentina, which have the capacity to undercut our prices and always make export sales difficult. The true cooler climate wines are generally more expensive due to higher production costs and in many instances are perceived not to represent ‘value’. With the demand for Australian wines generally for the bigger wines styles these wines will be difficult to sell.

The adverse seasonal impact on the 2007 vintage will exacerbate the shortage of premium wines but will reduce the excess of wines in stocks from the cooler climate regions. But in the irrigation areas the impact on yields may be less and have a smaller impact on the excess.