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The Incredible Bulk

The Rise in Global Bulk Wine Trade

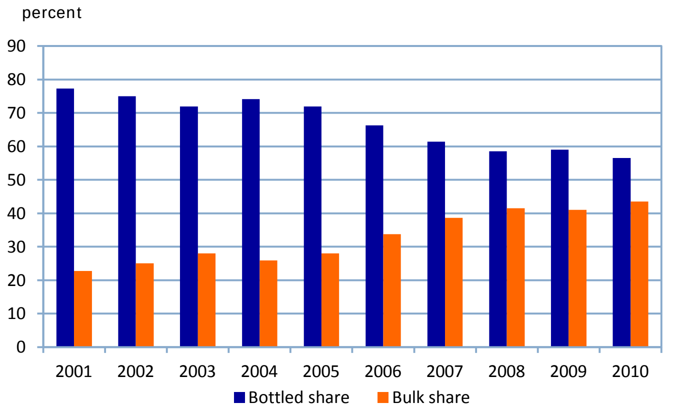
Contents

The past two decades have been a period of great change in the global wine industry. The world map of production and consumption has changed considerably as corners of a typically introspective and fragmented industry have pioneered a whole new look and feel. A steady rate of innovation has transformed many aspects of the industry, ranging from the product and how it is produced, all the way to its marketing and retailing. As global trade flows have changed shape, supply chain logistics have needed to evolve accordingly, and the development of the ability to ship wine in bulk has had growing implications for how the industry conducts its business. The dramatic rise in bulk wine shipments relative to bottled wine shipments over the past decade has been somewhat symptomatic of how the world's major wine import markets have evolved. Shifting competitive dynamics in markets such as the UK, the US and Germany have led to subtle yet significant changes in how value is shared by producers of popular premium wines. As many producers confront the legacy of a decade of oversupply and the convergence in quality in the popular premium wine market segment, the very nature of the bulk wine trade and the competitiveness of the world's major wine-supplying nations have been brought into sharper focus.

Introduction: Recent trends in the global bulk wine trade

Over recent years, many of the popular imported wines consumed in major import markets such as the United Kingdom (UK), Germany and the United States (US) are being exported from the country of origin in bulk shipping containers and packaged in the destination market. Taking the major New World wine-producing countries as the prime example, over the past decade, wine exports in bulk format have grown from approximately one-fifth to nearly one-half of all wine volumes traded (*see Figure 1*).

Figure 1: Bottled & bulk share of New World wine exports by volume, 2001-2010



Source: Rabobank, SAWIS, ODEPA, Instituto Nacional Vitivinicultura, AWBC, New Zealand Wine Growers, The Gomberg-Fredrikson Report, 2011

For New World producers alone, the shift from bottled to bulk wine exports has had a significant impact on how value is attributed along the supply chain. Rather than generating most of the revenue at the source of production, a greater share of the packaging value and wholesale margin is now captured in the destination market. By Rabobank estimates, this shift equates to well over USD 1 billion in annual revenue being generated in the destination market rather than at the source of production (*see Figure 2*).

Figure 2: Estimated transfer of New World wine value, 2001 vs. 2010

	Bulk	Bottled	Total
2010 share	43%	57%	100%
2001 share	23%	77%	100%
2010 revenue	USD 950,000	USD 5,180,000	USD 6,130,000
2010 revenue assuming 2001 share	USD 508,140	USD 6,997,544	USD 7,505,683
Difference	USD 441,860	USD 1,817,544	USD 1,375,683

Source: Rabobank, ODEPA, Instituto Nacional Vitivinicultura, AWBC, Gomberg-Fredrikson Report, New Zealand wine Growers, SAWIS, 2011

Distinguishing between the different categories of bulk wine trade

Understanding who has ownership control once bulk wine is loaded onboard a ship is critical to understanding how the product value is distributed. Naturally, a large proportion of the dramatic growth witnessed in global bulk wine trade comes from export-oriented brand owners shipping their own product to the destination market in bulk for packaging and sale under the brand owners' labels. The brand owner/manufacturer retains the wholesale margin, but the move to bulk wine exports does represent a shift in where the packaging value is added to the product.

The other major category of bulk wine trade, however, has a greater impact on the profitability of the wine producer/exporter. In the case where bulk wine is sold and exported to an independent third party for packaging and sale under an independent brand, the wholesale margin is captured not only by the producer but also by the independent wholesale importer or retailer. The sale of bulk wine to a retailer for bottling under their own private label brand is a primary example. The transfer of value away from the producer/exporter has commonly been due to excessive growth in inventories and insufficient access to distribution. In some instances, however, as is often the case in the US, a wine manufacturer can act as the wholesale importer with the aim of capturing this value through their own proprietary brands and distribution network.

So why ship in bulk?

The advent of bulk wine transportation logistics has provided wine suppliers with a safe and reliable alternative to shipping masses of glass across the world. While this innovation has definite environmental benefits, it must be said that the overriding driver of bulk wine transportation is cost reduction. By shipping in bulk, wine suppliers are able to supply more wine at sharper price points through their own brands and those of third parties such as grocery retailers. Selling more wine at more affordable prices has often been a necessity for many producers over the past decade as wine has been in abundant supply.

For a brand owner, shipping wine in bulk can save on transportation costs, import duties, glass and bottling costs, working capital and even foreign exchange exposure due to the cost of packaging being assumed in the destination-market currency. The magnitude of the cost savings varies depending on the scale and efficiency of the individual supplier, but it is often quite meaningful.

For suppliers interviewed, estimates of cost savings have ranged from USD 1.50 to USD 3.00 per case, which is highly compelling for high-volume, low-margin brands. This equation has led many companies with substantial investments in local bottling operations, especially those facing significant adverse currency movements, to reconsider their packaging strategies.

Figure 3: Estimated supply chain cost savings by shipping in bulk

Total New World export volumes in 2010 (thousand litres)	2,846,000
Bulk export volume in 2010 (thousand litres)	1,223,780
Bulk export volume using 2001 share (thousand litres)	654,580
Difference (thousand litres)	569,200
Equivalent number of 9-litre cases	63,244,000
Estimated avg. cost savings (USD per case)	2.25
Estimated annual cost savings (USD)	**142,300,000**

Source: Rabobank, 2011

Hypothetically, around 570 million additional litres (or 63 million cases) of bulk wine was shipped in 2010 than would have been the case if bulk shipments were still only 23 percent of total exports. Assuming an average estimated cost saving of USD 2.25 per case, as much as USD 142 million in costs has been stripped out of the supply chain for New World wine over the past decade (*see Figure 3*). These savings will have been shared across a mixture of growers, wine suppliers, retailers and consumers, depending on the nature of the bulk wine trade in question.

For lower volume, higher margin labels, brand owners have generally found the idea of bottling in-market to be less attractive. Not only are the scale economies nowhere near the same proportion, but often the incompatibility of the process with an 'estate-grown' brand identity or loss of quality control will outweigh any potential cost savings. That said, as options for in-market bottling expand and the process becomes more commonplace, there is a strong possibility this trend could extend to more premium brands as well. The dramatic growth of bulk wine in the export trade mix of the New Zealand wine industry is a case in point.

Demand side drivers—A new pricing dynamic

Part of the shift from bulk to bottled wine exports reflects important changes that have occurred in the demand for wine over the past decade. The global wine industry is challenged by its direct exposure to lumpy supply cycles at one end of the supply chain, and brand-focused consumer product markets at the other. This dynamic has driven fierce price pressure over the past decade as oversupply has coincided with the evolution of wine consumer demand and grocery retail consolidation around the world.

The democratisation of wine

Greater supply availability combined with production- and marketing practices that are more geared to consumer demand have led to the democratisation of wine over the past two decades. New World wine companies in particular have brought keenly priced, increasingly well-made and well-marketed wine products into the reach of more consumers around the world.

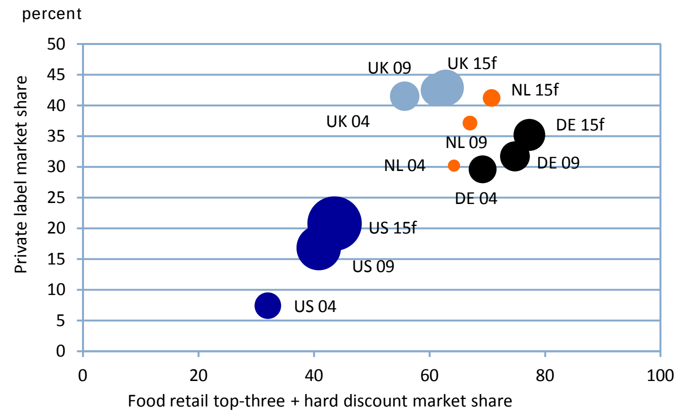
The demand for lower-priced wines has been shown to be generally more price elastic than that for premium wines. As such, as wine consumption has become more mainstream in major import markets, the price elasticity of that demand is anticipated to have increased. That is, demand has become slightly more price sensitive, making it more costly for retailers and wine companies to take pricing higher.

The rise of the retailer

The growing share of wine purchases being made in the off-premise channel in combination with retail consolidation across most major developed economies has become a major challenge for traditional wine companies. Leading retail chains have been leveraging their scale and consumer insights to pressure suppliers for better pricing, and have strategically employed private-label product lines in direct competition with major brands.

With abundant global supply at their disposal over the past five years and the comparative lack of brand distribution and marketing costs, grocery retailers have been able to drive pricing down to levels that are extremely challenging for traditional brand manufacturers to match. Access to scale economies in a market, often driven by high levels of retail sector concentration, is a necessary precursor for growth in private label (*see Figure 4*).

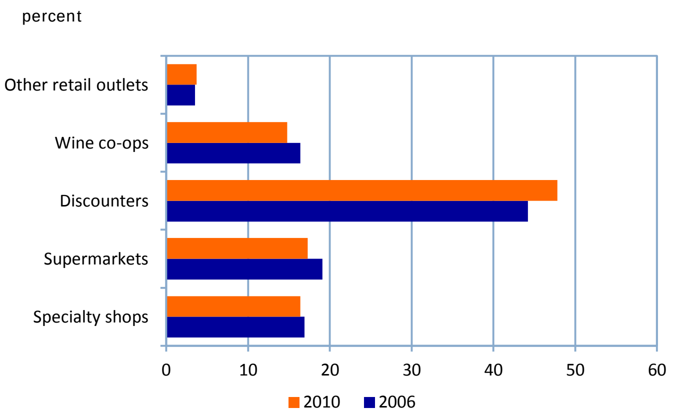
Figure 4: Private label grocery market share vs. food retail concentration by market, 2004-2015f



Source: Rabobank, Euromonitor, 2011

The wine category is especially attractive to retailers due to its role as a primary driver of shopper foot-fall in their stores. Accusations of retailers selling wine below cost have abounded in markets such as the UK and Germany, which only act to accentuate the pricing pressure placed on leading popular premium brands. Consumers have followed the deals, fuelling demand for bulk wine, as illustrated in the German market by the growth in discounters' share of the off-premise wine trade at the expense of other often higher margin outlets (*see Figure5*).

Figure 5: Off-premise wine sales in Germany by volume, 2006 vs. 2010

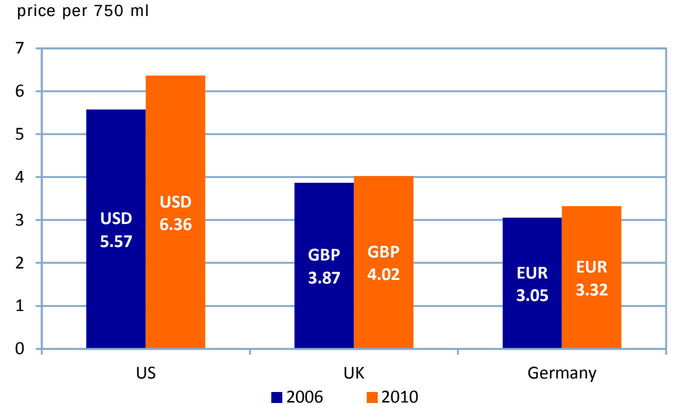


Source: Deutsche Weininstitut, 2011

Notably, the pressure on suppliers from grocery retailers located in the US market is significantly less acute and more amenable to growing value alongside volume. The legislated three-tier distribution system critically acts to maintain some margin structure, and makes private label strategies somewhat less attractive as retailers still need to act through a wholesale distributor. Needless to say, retailers are looking for ways in which to manoeuvre around the system, as evidenced by Costco's recent efforts to open up direct-to-retailer sales in Washington State.

The growth in average prices observed in the world's three major wine import markets since 2006 tells the story (*see Figure 6*). The average price of a bottle of wine sold in the UK grocery market rose by a meagre GBP 0.15 between 2006 and 2010 after the roughly GBP 0.53 increase in excise tax is removed. In the German grocery market, the price increase has been only slightly more positive and average prices remain extremely low.

Figure 6: Average grocery retail still wine prices by major import market, 2006 vs. 2010



Source: Rabobank, Nielsen, Deutsche Weininstitut, 2011

Increasingly price sensitive consumers, powerful retailers and tough economic conditions have seemingly left little meat on the bone for wine producers in these grocery markets. Conditions in the US grocery market have been somewhat more favourable for reasons already discussed, with some consumers still migrating to higher price points in recent times, though this trend has been driven to some degree by price promotions.

Chasing consumers down-market in a troubled global economy

The poor state of the economy in major developed markets has fuelled the headwinds created by already challenging market dynamics. In an environment of extreme economic uncertainty, it is unsurprising that households have upped their savings and become increasingly value conscious, obligating suppliers and retailers to chase them down-market. Given that demand for wine has been found to be highly income elastic, or responsive to changes in income levels, the category is particularly exposed to the prevailing economic climate.

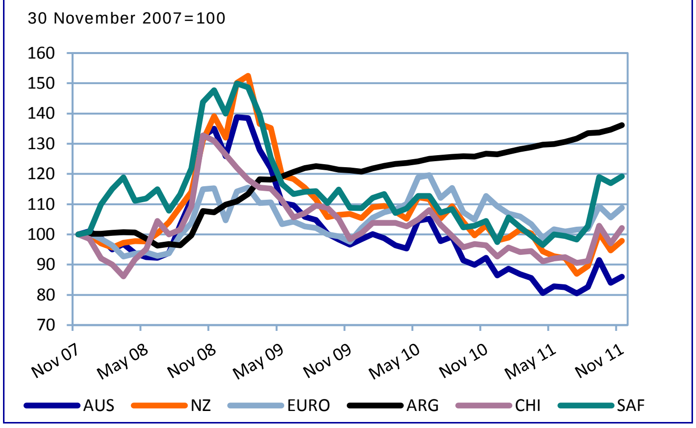
Pressures on the household budget have also led to changing consumption patterns as lower discretionary incomes have provided impetus to the already evident trend from on-premise consumption to off-premise consumption. Where added pressures such as excise tax reforms in the UK are involved, the greater ability of major retail chains to force such cost imposts onto suppliers has only further accentuated the pricing disparity and consumer migration between the on-premise and off-premise channels.

Growing evidence of bifurcation in markets such as the US suggests that there is still some life at higher price points despite the generally dire economy. The typical demographic profile of a regular wine consumer in the US in terms of ethnicity, age and education levels, corresponds to a segment of the population that has been least affected by the economic downturn. While many wine consumers have sought improved value at lower price points, others have been willing to trade up to higher price points. In the USD 25 per bottle and above segment, consumers have been lured by the offer of much improved value on many wine labels that have lowered prices or improved pricing promotions in order to stimulate sales.

Exchange rates and shifting competitiveness

Not only have market dynamics forced brand owners/manufacturers to contend with increasingly skinny margins, but the dramatic swings in foreign exchange rates over the course of the global economic downturn have had a critical impact on relative competitiveness. Producers in Australia, New Zealand and Chile have faced major headwinds from the appreciation of their currencies against those of their trading partners in recent years (*see Figure 7*).

Figure 7: USD exchange rate against currencies of major wine export countries, Nov 2007-Nov 2011



Source: Rabobank, Bloomberg, 2011

By contrast, the weakness of the euro has provided European producers with a major boost in export competitiveness at a time when their local markets are under mounting pressure from a fragile economy. For producers in the US, the relatively weak US dollar has provided greater competitiveness not only in markets abroad, but also in the US domestic market by making imported bulk and bottled wine relatively more expensive.

One factor that acts to somewhat counter the impact of the low US dollar on the demand for foreign bulk wine is a tax arrangement in place in the US known as 'duty drawback'. Duty drawback permits wine import duties on a given style, volume and value of wine to be offset against local wine excise taxes provided that a similar style, volume and value of wine is duly exported. Hence, wine companies with significant export operations can receive a rebate on the cost of imported bulk wine that maintains its attractiveness as a source of supply.

Supply side drivers—A decade of oversupply

Important changes in the structure of global supply over the past decade have played a critical role in the growth in global bulk wine trade. The increased availability and growing standardisation of varietal wine supply around the world have complemented changes in global wine demand and given rise to new supply chain strategies.

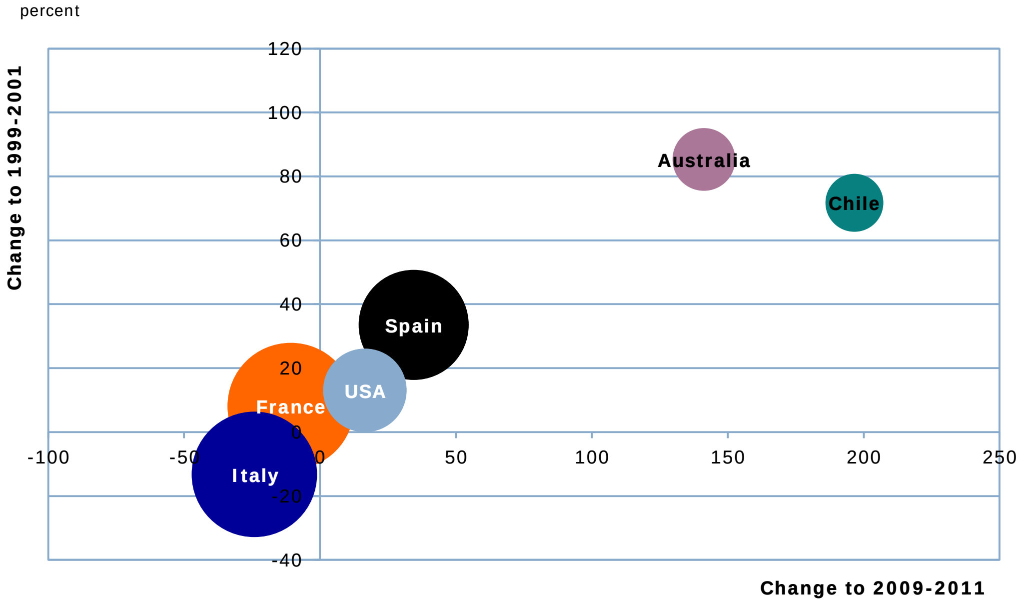
A New World of supply

The growth in global bulk wine trade has taken place, not coincidentally, during a decade of oversupply fuelled by dynamic changes in global wine production and declining consumption in the traditional wine-producing countries of Europe.

The dramatic vineyard expansions across the US, Australia and Chile in close succession to each other led to growth in New World production of almost 45 percent over the past 20 years (OIV, 2011). Over the past 15 to 20 years, Chile has experienced the largest proportional rise in average production of these major wine export nations (*see Figure 8*).

In the case of Australia, rapid supply growth eventually forced producers to increase discounting activity on their brands and to trade increased volumes of surplus bulk stock in an attempt to maintain control of inventory. Not only does systemic discounting jeopardise the health of proprietary and country-of-origin brands, but placing supply into the hands of competitors such as grocery retailers typically acts to undercut and cannibalise shelf space once allocated to weaker manufacturer brands in the market.

Figure 8: Change in wine production volume from 1991-95 average level to 1999-2001 and 2009-2011 average levels



Note: Size of bubble representative of estimated average production volume from 2009 to 2011

Source: Rabobank, OIV, 2011

New World countries are not the only ones to have experienced dramatic growth in supply. Spain, the world's third-largest wine producer, has also grown its production strongly over the past 20 years. It is no surprise that Spain has faced many of the same challenges in marketing this increased supply as its New World counterparts, with Spanish bulk wine sales having grown strongly in recent years. Spanish growers have also been the largest recipients of European Commission grants to grub vines under the three-year industry restructuring agenda.

While average wine production in France and Italy has declined on average over the past 20 years, periodical seasonal fluctuations in supply such as the boom crops experienced in the period from 2004 to 2006 have also acted to tip these industries into oversupply. The structural decline in consumption in their domestic markets and lost market share to New World producers in major markets such as the UK has meant that they have also had to pursue wide-sweeping reforms to correct more structural supply imbalances in popular premium wine production.

In more recent times, a process of structural and seasonal supply rationalisation has played out across the world's major wine production zones. Ironically, moving forward, the continued growth in the trade of bulk wine may be driven by the trend of tightening global stocks. The tightening of the global supply situation is leading to increasing grape and bulk wine prices in many key supply countries, raising the cost of goods sold for wine companies. With rising costs and difficulty raising prices in the current consumer environment, wine companies will be aggressively seeking ways to reduce costs, and bottling in-market may become an increasingly attractive option.

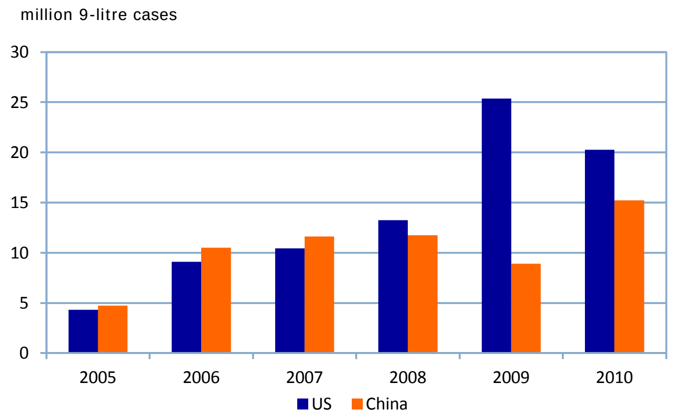
The commoditisation of wine

The advent of new wine production technologies and the fresh, fruit-forward wine style that stimulated the growth of industries across the New World are now more global than ever before. This convergence process over the past decade has enabled popular premium commercial-quality wines, of a common variety but produced in different countries, to become far more comparable and easily substitutable. With an increasingly similar style and lack of regional distinction, commercial wine has become much more like a commodity than a differentiated good.

The advent of commodity wine has opened up a whole new world of supply strategies for global wine companies seeking new ways to smooth out the production cycle and lower their product cost base. Many wine companies have duly initiated global wine sourcing strategies for their commercial brands, supported by laws permitting a certain portion of blending without affecting label claims, and the added realisation that consumers in the popular premium segment often have more regard for the quality promise of the brand and the price than for the origin of the wine.

Bulk wine from all corners of the world has flowed into markets such as the US and China as the demand for foreign wines and a low-cost complement to domestic production requirements has emerged (*see Figure 9*). In terms of the demand for complementary blending stock, seasonal impacts on wine production have meant that there will most probably be one country that is long in stock and willing to meet a price on the global bulk wine market. Importers can source from different countries in different years and still continually service demand at a given price point, which has become ever so important to retailers.

Figure 9: Bulk wine imports into the US & China, 2005-2010



Source: Rabobank, Gomberg-Fredrikson & Associates, China Customs, 2011

Some wine companies located in major import markets have gone as far as investing directly in commodity level production assets in other parts of the world to shore up the supply chain for blending material and brands of foreign origin. This is having the effect of not only globalising the demand for bulk wine, but also injecting global competition into local grape markets.

In terms of the emerging markets, growing demand for wine from the expanding middle classes is likely to increasingly influence global bulk wine market dynamics. While China is the obvious case in point, markets in other large developing economies such as Russia are becoming more significant, and any trade liberalisation such as a reduction of prohibitive tariffs in India or the removal of the import ban on bulk wine in Brazil, could provide added stimulus. Demand for bulk wine in such markets is, however, especially price sensitive, and producer countries located in closest proximity are likely to possess a real cost advantage depending on relative tariff and exchange rate dynamics.

Global competitiveness—How does the New World compare?

The country of origin of a popular premium wine is commonly recognised as playing a role in forming the preferences and purchase decisions of consumers in the world's major import markets. That said, this relationship is far stronger in more premium wines, where greater differentiation becomes possible. In the popular premium segment, the low level of engagement that consumers display for these wines and the growing commoditisation of basic wine from around the world, means that any price premium accepted by consumers for a given country-of-origin brand has become relatively small.

Benchmarking the competitiveness of New World wine suppliers

The greater the commodity perception of a product in a market, the greater the focus needs to be on the cost of supplying that product. Consequently, identifying the relative cost structures of the key suppliers in a particular market is increasingly crucial to understanding prevailing market dynamics. Rabobank has performed this analysis for five major New World supplier countries across three markets, the UK, China and the US, focusing on the vineyard end of the supply chain, which determines the primary raw material cost.

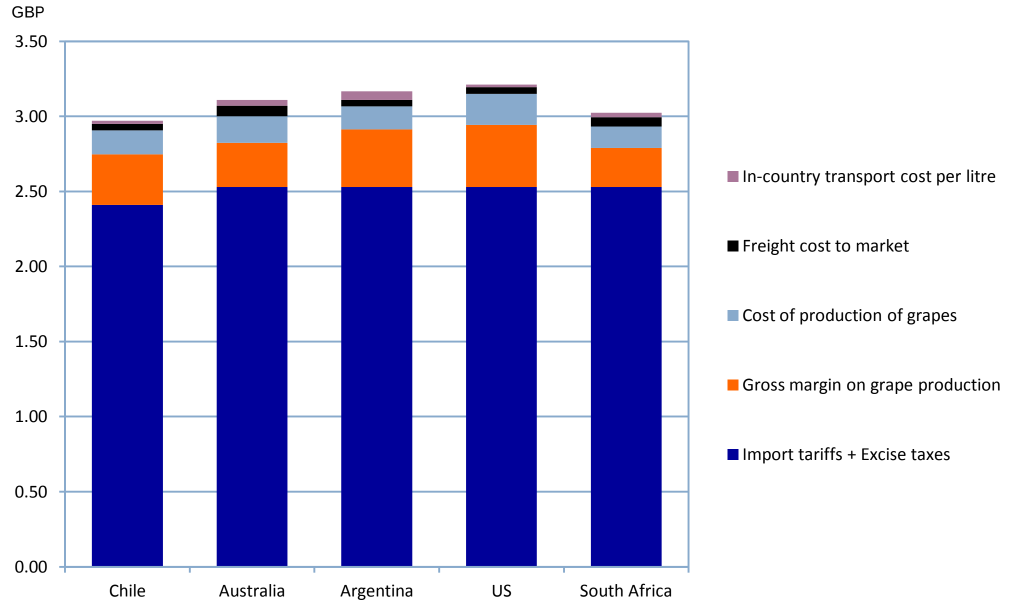
The production of internationally traded bulk wine varietals (e.g. Cabernet Sauvignon, Chardonnay and Syrah) in each country's lowest-cost production zone was considered as the basis for the comparison. To arrive at a measure of the landed cost of grapes per litre, wine processing costs have been omitted, but key logistical costs—including ocean freight and import tariffs—have been scrutinised.

In brief, the analysis highlights six major determinants of a supplier country's grape cost competitiveness within each given market:

1. Vineyard yield and direct operating costs
2. Grower gross margin
3. In-country transport costs (moving product from production centres to export ports)
4. Sea freight costs to the destination market
5. Import tariffs
6. Currency strength relative to markets and competitors

In the UK market, import duties and excise taxes far outweigh other grape supply costs for bulk wine suppliers, an imbalance that has significantly impacted the value of the popular premium market for all importers (*see Figure 10*). In terms of grape production and wine transportation costs, Chile and Australia are comparably positioned in the UK market. However, Chilean producers face GBP 0.12 per litre lower import duties due to the country's bilateral Free Trade Agreement (FTA) with the UK, giving them a slight cost advantage.

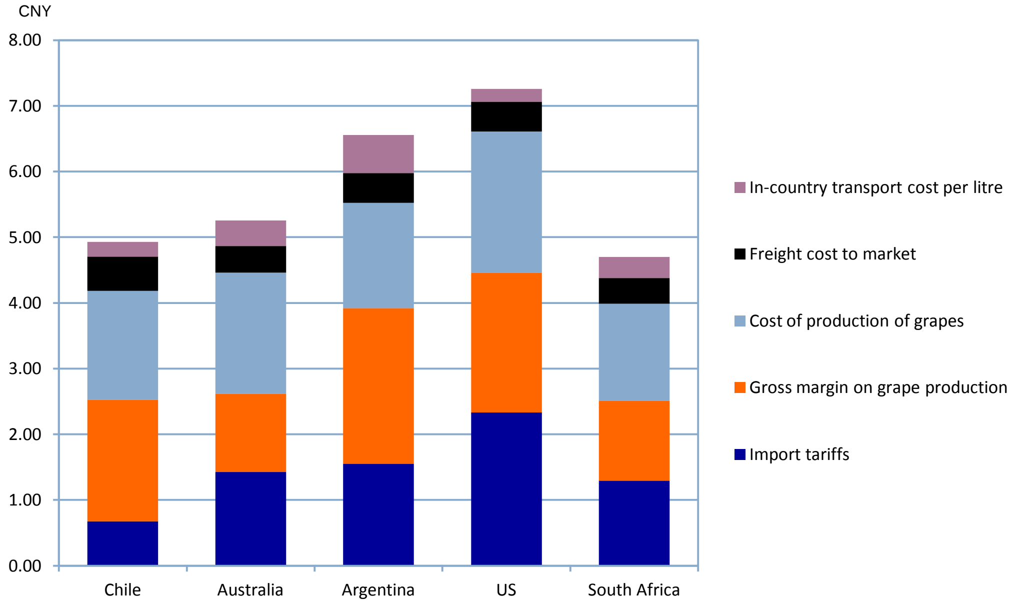
Figure 10: Cost components of bulk wine* landed in the UK for selected New World suppliers, 2011



*: Reflects grape component of bulk wine, excluding processing costs

Source: Rabobank, Ciatti Company, industry sources, 2011

Figure 11: Cost components of bulk wine* landed in China for selected New World suppliers, 2011

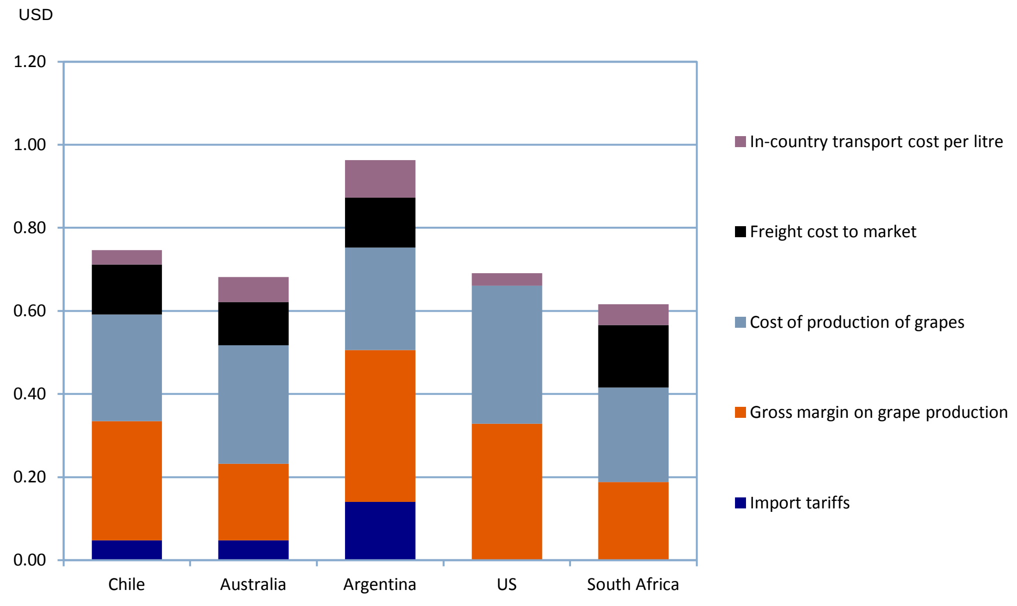


*: Reflects grape component of bulk wine, excluding processing costs

Source: Rabobank, Ciatti company, industry sources, 2011

In the US market, local bulk wine suppliers are positioned as low cost suppliers despite relatively high costs of production, due mainly to freight cost and import tariff advantages (*see Figure 12*). This is a relatively new development, resulting in large part from exchange rate fluctuations.

Figure 12: Cost components of bulk wine* landed in the US for selected New World suppliers, 2011

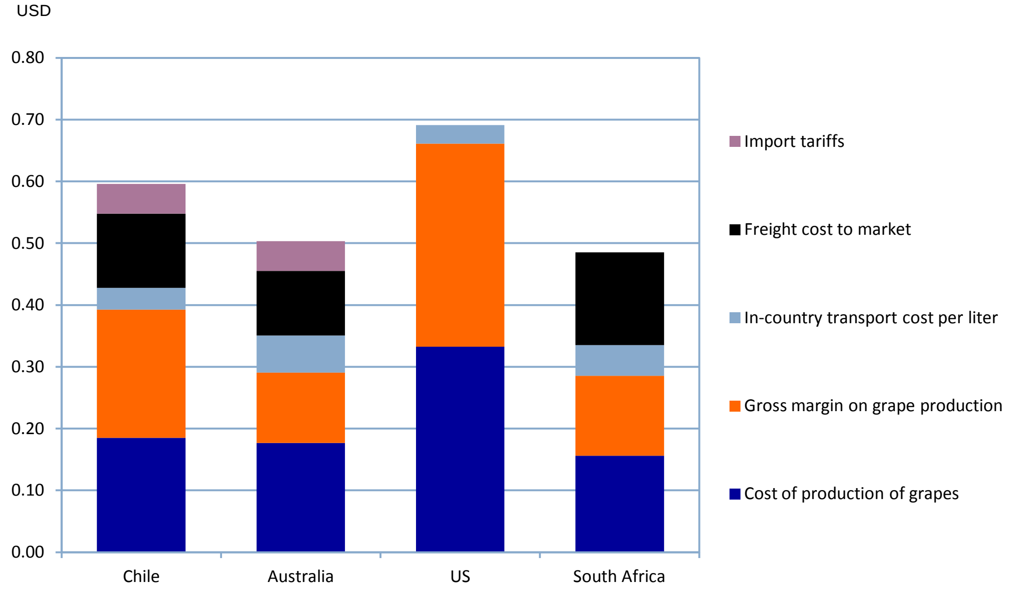


*: Reflects grape component of bulk wine, excluding processing costs

Source: Rabobank, Ciatti Company, industry sources, 2011

When less favourable exchange rates are used as the basis for comparison (i.e., the lowest exchange rate of the past three years for each import supplier), the US falls back to being a high-cost supplier in spite of some clear cost advantages (*see Figure 13*). Argentina has been deliberately excluded from this analysis because exchange rate fluctuations are not the root cause of recent changes in its competitive positioning. The Argentine peso has in fact depreciated and costs of production have been rapidly increasing in recent years due to inflation. Although inflation and exchange rates are related phenomena, viewing Argentina's costs of production through past exchange rates does not accurately reflect the erosion of its competitive positioning as it does with the other competitors.

Figure 13: Cost components of bulk wine* landed in the US for selected New World suppliers — high US dollar scenario, 2011



*: Reflects grape component of bulk wine, excluding processing costs

Source: Rabobank, Ciatti Company, industry sources, 2011

The analysis presented above provides a quantitative basis upon which to map the cost competitiveness of New World popular premium wine suppliers in three key global import markets. Moreover, it also facilitates a deeper understanding of each country's key competitive advantages and disadvantages that should drive their market positioning in years to come.

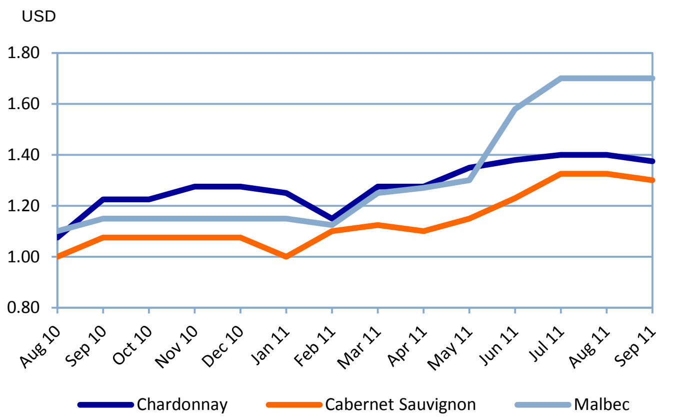
Review of competitive positioning by supplier

Chile

In two of the three markets reviewed, Chile emerges as a clear low-cost bulk wine supplier despite not always being the lowest-cost producer. While labour costs are often touted as the key source of Chile's competitive advantage as a supplier, it would appear that this is only one part of the equation and certainly not a distinct advantage. Other, more unique competitive advantages include the proximity of Chile's major production regions to major shipping ports (low cost of in-country transportation) as well as its liberal approach to negotiating bilateral FTAs.

Chile consistently pays the lowest, or among the lowest, import duties in each market, which bodes well for it to remain a competitive supplier of bulk wine to the world market. Growing demand for this supply helped to drive up Chilean bulk wine prices in the 12 months to September 2011 (*see Figure 14*). This global demand is creating a margin squeeze for those Chilean branded wine companies with greater exposure to the bulk wine market for sourcing their supply.

Figure 14: Chilean bulk wine prices for key varietals, Aug 2010-Sep 2011



Source: Ciatti Company, 2011

Australia

Perhaps no other bulk wine supplier has experienced such a dramatic shift in its competitive positioning over recent years as Australia. Having achieved great success as a supplier of reliable quality wine at very competitive prices, shifting exchange rates have dramatically altered its position in the market (*see Figure 15*). The deterioration in Australia's relative competitiveness over time is stark, and has caused many Australian suppliers to dramatically rationalise their supply base and retreat from positions at lower price points that were once highly profitable.

Should the Australian dollar remain elevated for an extended period, as is presently anticipated, restoring profitability to popular premium Australian wines will be a process with wide-ranging implications for the industry. In the near term, the volume decline associated with transitioning to higher price points will be commensurately reflected in reduced demand for wine grapes at the farmgate.

The degree to which any further supply rationalisation is required to maintain market balance for popular premium quality wine will be a test of the strength of the Australian brand in core markets. The degree of rationalisation is also contingent on future demand from emerging markets and the supply strategies of foreign wine companies. In the longer term, shifting more Australian wine into higher price points will have the much desired effect of changing consumer perceptions of the quality of Australian wines, provided the Australian product can find a way to once again differentiate itself from the competition.

Figure 15: Production costs per tonne 2011 at average USD exchange rates and 3-year low exchange rates for each competitor

USD

	Chile	**Australia**	**Argentina**	**US**	**South Africa**
2011 average USD rate	198	204	176	237	162
3-year low USD rate	142	126	171	237	112

Source: Rabobank, industry sources, OANDA, 2011

Argentina

In spite of its position as a low-cost producer of wine grapes, Argentina struggles to compete as a cost-competitive supplier of bulk wine. While other countries have dealt with adverse exchange rates, Argentina's challenge has centred more on domestic inflation in the order of 25 percent to 30 percent per year, which has fuelled excessive increases in production costs. And while production costs have indeed been rising, gross margins on grape production remain high. It appears that government interventions to keep grape prices high ensure that Argentine producers remain profitable, but inevitably squeeze margins for exporters.

Aside from inflation, the remote geographic location of Argentina's major wine grape production centres (Mendoza, San Juan, etc.) tends to drive up in-country transportation costs. Product must be either shipped across the country to east coast ports, or over the Andes mountains via Chile. In addition, Argentina's current lack of FTAs with major wine import markets creates a significant cost disadvantage in many markets, one unlikely to be overcome in the near future as the country's membership in MERCOSUR will make it difficult to negotiate any additional FTAs with other markets in the future.

Argentina's high rate of inflation has led suppliers to take pricing higher over the first 10 months of 2011. Packaged wine volumes have declined by 6 percent as the average price of packaged wine has increased by over 15 percent, mainly at the expense of low-priced wines that are no longer profitable to export. Argentine bulk wine exports have an average price per litre that is roughly one-quarter of bottled wine prices, a discrepancy that has increased the relative demand for bulk wine exports, which have more than doubled in the space of 10 months. This dynamic would suggest that bulk wine is likely to continue to gain share of total wine exports.

US

Due to the high cost of labour in the US market, production costs for wine grapes in the state of California are roughly 30 percent above the average cost of the other suppliers. In most markets, the US cannot compete on price as a competitive supplier of bulk wine. However, given that US suppliers pay no freight cost or import duty within the US, they emerge as an extremely cost-competitive supplier within that market. This is a relatively new phenomenon, driven by the decline in the relative value of the US dollar, and has led to a dramatic rise in wine grape and bulk wine pricing in California's Central Valley.

South Africa

Out of the countries included in the analysis, South Africa demonstrates the lowest cost of production per hectare. While bulk wine is quickly gaining share of total South African wine exports, bulk wine pricing and grower gross margins remain extremely low. Pressures in core markets and a lack of market diversification have squeezed pricing for South African wine companies and growers in recent years.

In its mainstay UK and European markets, South Africa has a material cost disadvantage relative to Chile due to that country's preferential tariff treatment. Amongst other factors such as an appreciating currency, this has prompted an increasing number of producers to reassess their positioning at the low end of the market where they have experienced most success in the past. The depreciation of the South African rand observed in the latter half of 2011 will have provided some relief, as the process of transitioning to higher price points is likely to come at the expense of significant time and market share.

In the US market, where South Africa has an import tariff advantage over Chile, South Africa has struggled to establish a sufficiently strong brand with consumers to gain momentum in that market. In part, this is likely due to the fact that South Africa's product mix is heavily skewed towards white wines, particularly Chenin Blanc, that has yet to resonate with US consumers.

Summary and conclusions

From a process of globalisation, to democratisation and quasi-commoditisation, bulk wine is flowing around the world in unprecedented volumes. Fuelled by surplus stocks that accumulated over the course of the past decade, bulk wine flows have altered the conventional supply chain model and competitive dynamics for popular premium wines in the world's major wine import markets.

A process of structural and seasonal supply rationalisation in more recent times would suggest that the tide of global stock levels has been steadily receding. While this development certainly presents a constraint to future growth in global bulk wine trade, more restrained growth is nevertheless predicted over the coming three to five years as many of the market forces that have stimulated bulk trade in the past are likely to remain in place in the foreseeable future.

Price and volume pressures in major import markets are likely to be sustained in the difficult and unpredictable economic climate that prevails in many major developed wine markets. The ongoing migration to the off-premise channel and growing influence of the major grocery retail chains could well convince more wine companies to seek supply cost savings by bottling in-market. For others, the high investment costs associated with market development and brand-building could result in a decision to simply supply in bulk. For some major producing regions, added margin pressures stemming from rising costs in a tightening grape market and/or a relatively high exchange rate may provide added motivation.

Demand from the expanding middle classes in emerging markets has provided added support to growth in the bulk wine trade in recent years. The importation of foreign bulk wine to augment domestic production or to satisfy growing demand for foreign wines is expected to continue to develop in coming years. Import tariffs and regulations currently have a defining influence over bulk trade into many emerging markets and will continue to impact import volumes and relative competitiveness for some time to come.

In the popular premium segment in particular, some producer countries appear better placed than others to sustainably service the demand for low-cost varietal wine in coming years. Countries such as Chile have been identified as having sufficient sources of competitive advantage to remain a viable supplier to this market segment, while others such as Australia find that their position is highly dependent on the value of their currency.

Those who cannot sufficiently compete on a commodity product level, be it due to a high currency or a high-cost structure, must drive innovation and brand-building efforts to drive value growth through product differentiation. Put simply, consumers need to be given a compelling reason to pay more in the present environment.

Producer countries operating with well-organised and well-funded industry groups in place have the opportunity to explore marketing initiatives to influence consumer opinions over time. These may be industry-wide initiatives, but more targeted programmes by large branded wine companies or subsets of producers with complementary markets and brand positioning are also having an impact. Consumer-focused product innovations such as reduced-alcohol wines, new varietals and new packaging formats are just some strategies that are already being explored to change the status quo.