European Commission

Study on the competitiveness of European wines

EXECUTIVE SUMMARY

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AIM OF THE STUDY

The aim of the study is to build on the current position of European wines in the world market to derive conclusions on how to further advance the policy objective of improving their competitiveness. The study analyses the development of EU wines competitiveness and identifies the key factors in the most important consumer markets where EU wines enter in direct competition with third country wines.

The study focuses on still wines and distinguishes between two business areas: bottled wine and bulk wine. The analysis also distinguishes wines by price/quality segments and wines with Geographical Indication and without, including varietal wines.

Seven case study markets are examined in detail: China (including Hong Kong), Japan, Russia, USA, Denmark, Germany and the United Kingdom. The main EU competitors considered in the study are New World Countries (NWC): Argentina, Australia, Chile, New Zealand, South Africa and USA.

The study period is up to the horizon 2025. In order to assess past and current development of the competitiveness of European wines, data from 2000 onwards are analysed.

DATA SOURCES, METHODS AND TOOLS

The study uses both quantitative and qualitative methods.

A detailed literature review examined the scientific literature on competitiveness and international trade in the wine market comprising wine sector main characteristics at global level, wine production and industry structure. EU wine policy and policies implemented by NWC were also studied. In addition, the literature review allowed to collect information on main characteristics of the case study consumer markets.

Statistical analysis used data from a variety of sources: Comtrade and Comext trade statistics; production data (national statistics, FAO, OIV, etc.); IWSR market data and web checks in the case study countries.

In-depth interviews and a questionnaire to key market players were used to gather data, including informed opinions about the factors of competitiveness in each of the seven case study countries.

The MicMac mathematical method[1] was applied to assess direct and indirect cause-effect relationships among the identified factors of competitiveness and their order of importance, therefore establishing which are the key factors able to generate competitive advantage. Key factors are differentiated depending on whether they relate to suppliers' structure and behaviours or to the product.

LIMITS OF THE DATA

Wine production statistics do not allow to distinguish domestic production of still wines from the total domestic wine production, nor the part of domestic production made from home-grown grapes and that obtained from wine and/or grape must imported in bulk.

The selected source of market data on wine consumption (IWSR) only includes packaged wines. Domestic consumption however includes wine and/or grape must imported in bulk for blending with wine made from domestic grapes. Furthermore, data are available for volumes, but not values.

Information gathered through interviews suffers from the limitation of representing the opinions of the interviewed individuals. In the in-depth interviews only few stakeholders provided information about uses and destination of wine imported in bulk. This incomplete information represents a limit for the analysis.

STUDY THEMES

The analysis develops around three Themes. Theme 1 aims at assessing past and present development of the competitiveness of EU wines. The analysis centres on:

- The global competitiveness of EU wines in the world market and in the most important export markets;
- The competitiveness of EU wines with respect to domestic consumption in the case study markets;
- The context variables that influence the competitive position of EU wines, adopting the Porter's Diamond approach based on six groups of determining factors.

[1] Michel Godet (2006). Creating Futures - Scenario Planning as a Strategic Management Tool, Paris, Economica.

Theme 2 focuses on the key factors of competitiveness, namely

- The identification of factors of competitiveness and assessment of their importance;
- The response of EU wines to factors of competitiveness compared to NWC wines and to domestic wines.

Building on the analysis of the first two themes, Theme 3 aims at deriving conclusions on how to further improve EU wines competitiveness to the horizon 2025, specifically based on:

- The expected trends of certain variables of the Porter's Diamond, namely, Factor and Demand conditions;
- The likely changes in the competition dynamics characterising the most important country markets;
- The expected changes in the hierarchy of the identified key factors of competitiveness;
- The possible adaptation strategies developed by economic actors to changes occurred in the competitive arena and in the hierarchy of key factors of competitiveness.

MAIN RESULTS

THEME 1: Development of the competitiveness of EU wines

A first part of the analysis based on trade data shows that between 2000 and 2012/2013 EU wines improved their overall competitive position in the world market in value terms, while maintaining it in volume terms, despite an overall loss of market shares (in value and volume). This overall result, however, is generated by opposite trends: enhanced competitive performance of bottled wines (both values and volumes) versus worsened performance of bulk wine exports.

The analysis also shows that from 2007 onwards, a strategy change takes place with gradual substitution of bottled wine with bulk wine exports by some NWC: Australia, USA, South Africa and New Zealand.

The analysis of the global competitiveness of EU wines with respect to domestic consumption shows that the position of EU wines deteriorated considerably. With the exception of Russia (where the wine embargo imposed to Moldova between 2005-2007 generated a sizeable advantage for EU wines), in all other countries the competitive position of EU wines worsened, only slightly in China, USA, Germany and Japan (the first two show a small increase in market share) and more significantly in Denmark, Hong Kong and the UK.

In terms of price/quality competitive position of EU wines on world markets, the ratio EU price/NWC price is >1 for bottled wine and <1 for bulk wine in nearly all years (2000-2012), suggesting that EU bottled wines are of better quality than the competitors' and, vice versa, wines exported in bulk are of lower quality.

European bottled wines are more frequently positioned in the higher price segments (Ultra Premium and Top Range) in third-country markets, whereas they are positioned in the lower price ranges in Germany and in the Medium Range in Denmark and UK. Wine producing Member States adopt different positioning strategies, with France consistently recording the highest prices (bottles and bulk) and Spain recording among the lowest, further decreasing for bottled wine exports in the years following the wine CMO reform.

With regard to the online retail channel, which is reported to be growing in most case study countries, French and Italian wines are best represented across all examined case study markets. EU wines are best represented in the Top Range segment, whereas non-EU wines are better represented in the Super and Ultra Premium ranges.

Based on the Porter's Diamond framework, the second part of analysis examines the most important context variables determining the competitive position of European wines.

<u>Factor conditions in producer countries</u>. Expected growth of wine consumption in the analysed country markets, decline of vineyard areas and wine production in the EU vis-à-vis increase for all competitors is likely to lead to further decrease of EU wine market shares. On the other hand, restructuring and conversion of vineyards (within the reformed wine CMO), stimulates recovery of EU wines competitiveness. Low wine export propensity makes the EU less aggressive on export markets compared to its main competitors (in particular, Chile, New Zealand, Australia, South Africa and Argentina). However, a more balanced distribution of EU exports on a larger number of markets makes the EU less dependent from few vital markets.

Demand conditions in consumer markets. Population trends in the examined country markets suggest that all competitors should potentially benefit from the same market growth opportunities. However, significant growth of GDP per capita in countries where EU wines are leader should encourage increase in their consumption. GDP growth should also encourage consumption in the Ultra Premium and Top Range segments, where EU wines are better represented.

Firm strategy, structure and rivalry (bottled wines). All factors related to firm strategies in key consumer markets suggest that EU wines are less competitive than competitors: lower shares of European brands in the case study markets; leading European companies (i.e. French) are not in the top four market leaders in most countries, except in Germany, Denmark and Hong Kong; European businesses have a share of non-EU wines in their product portfolios much larger than the share of EU wines in non-European companies portfolios.

Related and supporting industries. Increased use of new technology for bulk wine transportation (i.e. Flexitank) by certain NWC represents a competitive disadvantage for EU wine. However, this is partly due to self-imposed constraints by PDO/PGI wine production protocols to bottling outside the production area.

Government. EU wines appear to have an advantage over competitors generated by larger investments in promotion programmes (i.e. bottled wines) under the Promotion measure of the wine CMO. Bilateral trade agreements that lower or abolish tariffs can generate considerable competitive advantage to country-systems. Some countries (Chile, in particular) have developed agreements with many partners. Compared to these countries, the EU finds itself in a position of competitive disadvantage.

Chance. The years considered in the analysis are characterised by unfavourable evolution of exchange rates for the Euro, translating into competitive disadvantage for European wines relative to most competitors.

THEME 2: Identification of the key factors of competitiveness

Theme 2 focuses on identifying and analysing the key factors of competitiveness within the system, in other words, factors linked to product characteristics, as well as to the behaviour of wine suppliers.

The analysis allowed to identify 41 factors of competitiveness for packaged wines and rank them in order of importance. Analysis was carried out in the case study markets (China, Japan, Russia, USA, Denmark, Germany, UK) distinguishing between market segments (Entry Level, Medium Range and Top Range).

Overall, factors related to supplier behaviour result to be more important than product factors, in particular, “Ability to select importers/distributors/buyers” and “Reactive adaptation of the product to customers' demand”. Among product factors, “Price” and “Product quality”, together with other factors again related to price and quality, emerge as most important. Not surprisingly, quality is a critical factor in particular for Top Range and also Medium Range wines, whereas price is crucial at Entry Level (important also in Medium Range). As Medium Range wines are overall defined by their price/quality ratio, “Correct price/quality positioning” becomes decisive for competitiveness in this segment (whereas in the other two segments it appears as important, but not crucial). Other critical factors related to price and quality are “Price stability” and “Quality consistency over time”, especially for Entry Level, but also for Medium Range wines.

No specific critical factors were identified with respect to product labelling. However, “Indication of grape variety” emerges as important in all segments, whereas “Origin of the product/*terroir*” is only important for Top and Medium Range wines. Nevertheless, the concept of “Origin” refers to the country (e.g. France) or region (e.g. Tuscany) of production, whereas Origin as linked to geographical indication (PDO/PGI) does not result to be a particularly important factor of competitiveness.

Two factors were identified as most critical for bulk wines. The first product factor is “Price”. The second, linked to the structure of suppliers, is “Size of supply volumes” (i.e. the operating size of suppliers). Overall, the other factors play a less important role. Among these, “Price stability” and “Correct price/quality positioning” are most often mentioned (thus, all factors are in some way related to price).

The factors of competitiveness identified for packaged wines were further analysed to identify cause-effect relationships and distinguish the (few) key factors that have an influence (direct or indirect) on other factors (which, therefore, are identified as dependent factors). The MicMac method was applied for the analysis[2].

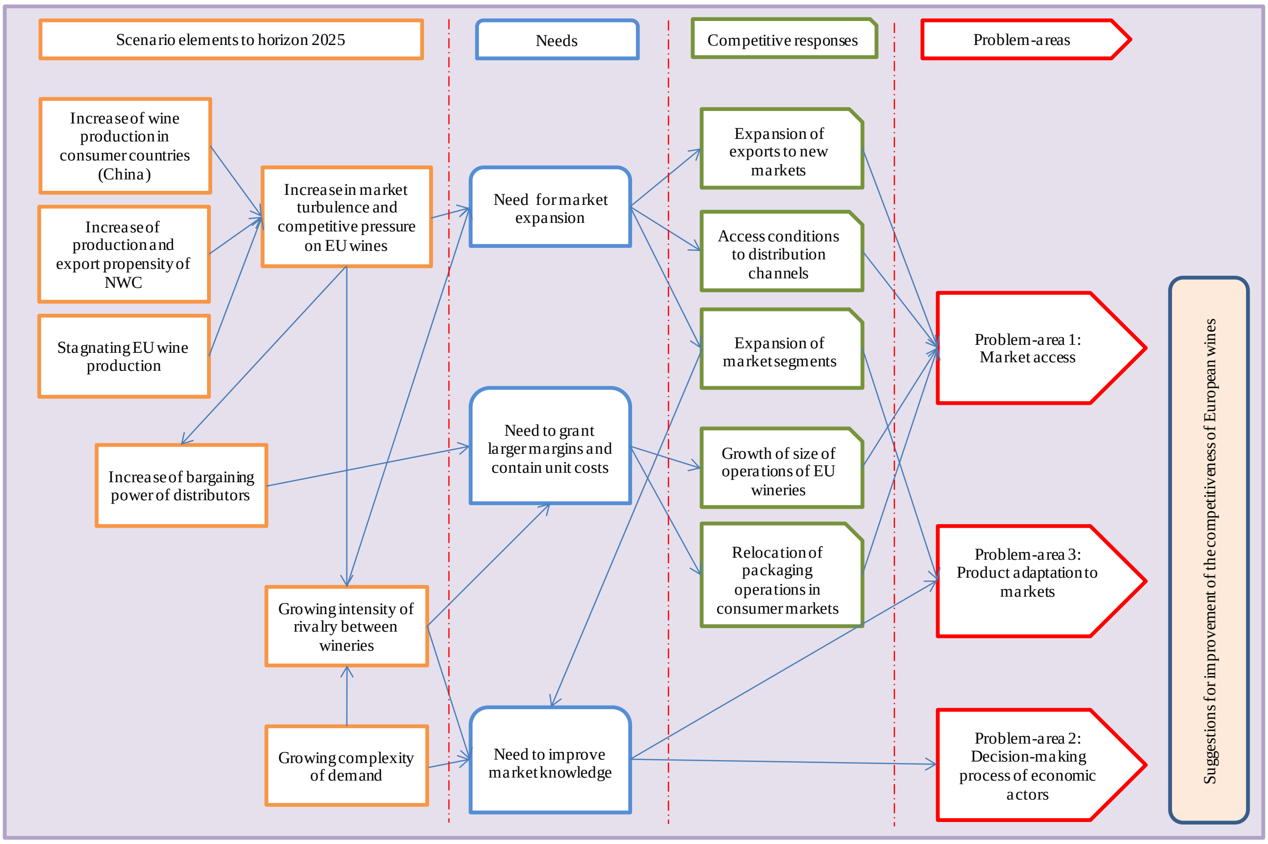
[2] The Micmac Forecasting method (Matrice d’Impacts Croisés-Multiplication Appliquée à un Classement) was created by M. Godet. The MicMac software allows to establish a hierarchy among the factors and to assess strength and direction of their relationships.

The following main results emerge from this analysis:

- Most key <u>influencing factors</u> are linked to behaviour (related, in particular, to bargaining power and access to distribution channels), specifically: "Ability to manage relationships with importers / distributors", "Intensity of PR activities with importers, buyers, etc.", "Size of the supplier".
- Similarly, many key <u>dependent factors</u> are related to behaviour, for instance "Appropriate advertising, promotion and communication", "Correct product positioning", "Providing consistent price/quality". The most important product-related dependent factors across all three segments are few: "Price", "Brand / Image of the product" and "Status symbol content".
- Moving from Entry Level to Top Range, some of the behaviour factors are replaced by product factors. In particular: "PDO-PGI popularity", "Origin of the product/*terroir*", and "Product quality".

THEME 3: How to improve the competitiveness of EU wines

Theme 3 derives conclusions on how to improve the competitiveness of European wines, based on the authors' analysis of the previous themes. The following diagram summarises the main results of the study and shows the main needs and problem-areas that were identified.



The following three problem-areas were identified:

Market access

The (widely shared) expectation of increase in the turbulence on the international wine market leads to the first issue, that of market access. All types of initiatives (policy, strategic and operational) aimed at facilitating market access generate competitive advantage. Market access entails different levels.

The first strategic level is the extension of the "market-portfolio". Expansion to new markets or to non-traditional markets (e.g. Republic of Korea, Algeria, Philippines, Mexico) would have a three-fold purpose:

- To reduce the risks associated with sudden economic/political changes and resulting from implementation of strategies by competitors on their traditional markets, particularly in mature markets;
- To counter the expansion strategies of some NWC (primarily, Chile and Australia), notably in new markets;

- To ensure presence (with the highest possible relative market share) in markets where wine is at the introduction or development stage of its life-cycle. High market shares and strong growth prospects (though no huge volumes would be expected) are likely to generate increasing returns on investments.

The implementation of an expansion strategy implies the availability of adequate financial resources for the necessary investments.

> Therefore, it would be desirable:
>
> - to encourage more EU businesses to use the funds of the Promotion measure of the wine CMO for penetration of non-traditional markets such as the Republic of Korea, Algeria, Philippines and Mexico (for example, through a modulation of the rate of co-financing or other incentives);
> - to give priority to the use of RDP measures (EAFRD) and the investment measures of the wine CMO (EAGF) for structural and organisational adaptation of export-oriented wineries, through adequate definition of the selection criteria (scores) for businesses to access funding.

However, a policy of expansion probably involves changing two, partly cultural, aspects. The first concerns the rather "inward" vision of European production, by which wine exports remain marginal relative to the internal market. The second is due to the constraints posed to production potential, which, in principle, clash with the objective of increasing penetration of European wines on third-country markets.

The second level is political-institutional and concerns the signing of bilateral preferential trade agreements with third consumer countries, also (but not only) with a view to expanding the market portfolio. In the hypothesis of exchange rates between the Euro and other currencies remaining at current levels, and in view of increasing market turbulence, the competitive position of EU wines could worsen. Therefore:

> It would be desirable to speed up / start up bilateral agreements between the EU and partner countries concerning (also) wine. The partners should not only be the traditional ones with which agreements still are not in place (e.g. China, Russia) or negotiations are currently ongoing (e.g. Japan, USA), but also other non-traditional markets (e.g. Philippines). In this sense, it would be desirable for a stronger link between institutional and economic partners, in order to achieve coherence between public and private initiatives (in essence, creation of a system).

The third level is access to distribution channels, and therefore it regards key influence factors of competitiveness for which action may be to some extent stimulated by the public authority[3]. We have identified "Intensity of Public Relation (PR) activities with importers, buyers, etc." and "Size of the supplier". Considered together, these two key factors of competitiveness influence (directly or indirectly) other important factors, specifically, "Appropriate advertising, promotion and communication activities directed to consumers", "Correct price/quality positioning" and "Price".

With regard to "Intensity of PR activities with importers, buyers, etc.", in principle PRs may be included among activities allowed under the Promotion measure of the wine CMO, which then becomes functional to create the conditions for a more effective response to this factor of competitiveness.

> However, it would be desirable to encourage, through appropriate adaptation of the selection criteria (scores), the submission of promotional plans that include incoming activities (i.e. organisation of customer visits at wineries), deemed as important, in particular, in Russia, Japan, USA and Germany.

Concerning the "Size of the supplier", the small size of European businesses represents a not easily overcome constraint in the short- to medium-term. In order to overcome barriers to market access and negative effects on other key factors, the possibility of solving the structural size problem through an organisational solution could be explored, so as to allow organised groups of small businesses to implement appropriate marketing strategies (in terms of effectiveness and efficiency of invested resources).

Therefore:

[3] Here we do not consider, among the key factors for market access (identified in Theme 2), those that depend only on the degree of responsiveness of firms, which we could only address by recommending adjustments in their individual behaviours.

It would be desirable to develop public initiatives to facilitate the establishment of aggregate business forms and an organised system of collaborative marketing, able to overcome the 'size' barrier, allowing at the same time to reach a critical mass in terms of number of products and a wider/deeper product portfolio as demanded by distributors/retailers (in particular, Off-trade). This would be desirable for all case study markets, but especially the UK and USA.

The fourth level regards wine businesses cost structure and the possibility to grant higher margins to distributors. This directly leads to the possibility (in some markets and only for wines positioned in the Super and Ultra premium segments) to transfer wine in flexitank and to relocate bottling operations in the consumption markets. The adoption of bulk transportation in flexitank could help EU companies to extend trade beyond nearby markets, thus develop strategies for expansion in new markets. However, this possibility would require overcoming certain constraints characterising PDO-PGI systems and also a change in the logistics and operations of EU suppliers in export countries, in order to relocate bottling activities. Therefore:

There is need to overcome the self-imposed constraints of many production protocols of European PDO-PGI wines (i.e. obligation to bottle wines within the production area), at least for wines not in the Top range.

Moreover, ways should be found to encourage technological adaptation, as well as organisation of logistics in countries of destination, required to relocate bottling operations. For this purpose, the possibility of extending the scope of the investment measures provided for in the wine CMO could be considered, acknowledging, however, that this would generate complex problems of implementation under current EU rules.

The decision-making process of economic actors

The analysis suggests that in the future wine demand will probably be more complex and sophisticated than at present in the various country-markets, and that increased market turbulence will lead to more intense rivalry between wine producers of different countries. The ability of European wine businesses to react and adapt to changes in the competitive environment foreseeable to the horizon 2025 also entails an improvement of the conditions that facilitate the decision-making process of the actors.

This is needed, in particular, to better respond to key factors of competitiveness related to positioning and communication (specifically, "Correct price/quality positioning" and "Appropriate advertising, promotion and communication activities directed to consumers" in each segment). In this respect, the improvement of the level of knowledge of market changes and of the competitive environment that can encourage "Reactive adaptation of the product to customers' demand" is a critical aspect. Therefore:

It would be appropriate to develop a market intelligence system able to convey to European businesses along the supply chain adequate information about changes occurring in the markets and in the behaviour of competitors.

However, wine businesses should develop the ability to translate this information into business decisions. This may be most effectively achieved through improvement of skills for effective use of business tools[4]:

It would be appropriate to encourage the implementation of training activities in export business targeted to the industry, for example within Measure 1 - Knowledge transfer and information actions of 2014-2020 RDPs, through the involvement of already existing local organisations (e.g. chambers of commerce, chambers of agriculture, etc.)

Product adaptation to markets

This problem-area leads directly to the issue of strategic decisions concerning the product on the different markets. In turn, this involves politically sensitive aspects, which can be explained as follows.

A first strategic aspect concerns the identification of the market segments that should be developed (e.g. global niche of excellence, premium wines, wines for the mass-market) and which labels are more effective for marketing to the consumer (in particular, on foreign markets). Specifically:

[4] Wine exports involve a wide range of actors: wholesalers, exporters, co-operatives but also farmers who are also wine makers, who may not necessarily have developed these skills.

a. Regarding European PDO/PGI wines, the analysis has highlighted low level of knowledge, but above all, lack of use of these labels by distributors/retailers for communication. One important reason is the generation of confusion: European GI wines appear on foreign markets with a multitude of acronyms depending on the language of the Member State (AOP, DOP, PGI, etc.). Confusion further increases due to the co-existence of new definitions (i.e. PDO/PGI) with the old ones (DOC-DOCG in Italy, AOC in France). It is, therefore, no coincidence that major retail chains (in third countries, but also in non wine producer Member States) do not place much value on these labels, choosing instead the country and region of production as a factor of communication to orientate consumers' purchase decisions.

   It is also important to remember that the market development strategies adopted by some of the most aggressive EU competitors (Australia, Chile) aim to add value to the geographical indication of their wines, in the sense desired by retail chains (i.e. indication of the production region). Therefore:

> With regard to PDO and PGI labels of wines positioned in the Top range and Ultra premium segments (intended for a more experienced consumer target), it would be appropriate to combine the acronyms used by different Member States in a single acronym to be used worldwide, associated with a mandatory logo (as developed for the organic sector). For these wines it would be appropriate to continue with information and promotion activities, as "PDO-PGI popularity" emerges from the analysis as a key factor of competitiveness for wines in the higher price/quality ranges.
>
> With regard to wines that enter the Commercial and Super premium segments, for which the "Origin of the product" is more important than PDO-PGI labels (consumers who may not be very experienced, but are sensitive to the history, culture and image of the country of origin), it would be appropriate to introduce into EU regulations the indication of the country/region of origin (for example, an umbrella brand covering wines of a Member State - e.g. Italy - or region - e.g. Tuscany).
>
> It would thus be appropriate to extend the financing of activities envisaged by the Promotion measure of the wine CMO to this type of wines.

b. The analysis shows that European varietal wines have not been successful. The incidence of these wines on total EU exports is marginal and exports did not pick up over time. It seems, therefore, that this is not a strategy for which European producers show much interest and that it is not favoured by the producing Member States. However, this lack of success may be partly due to the restrictions adopted in some Member States on eligible varieties, which may play against foreign market development in countries where the mention of grape variety is considered as a factor of competitiveness (e.g. USA and UK).

c. With regard to wines in the lower price/quality ranges, the analysis has shown the existence of foreign markets (e.g. Angola, Côte d'Ivoire) and EU markets (e.g. Germany) that demand large volumes of wine in these segments. While these wines do not enjoy an image of prestige, low margins applied to large volumes are economically attractive for European companies, in particular large cooperatives. Furthermore, the experience of other (industrial) sectors teaches us that a great production power (such as the EU) produces goods to cover all market segments, whereas focusing on specialist segments is a strategy typically adopted by small producer countries (such as, for example, New Zealand). Therefore:

> Taking into account the increasing complexity of segmentation expected in the future, it does not seem prudent to focus only on high quality wines (PDO-PGI), neglecting wines in the lower ranges for everyday consumption by lower-income families.

The adaptation of wine products to market demand also entails exploring the possibility to develop products for which there is demand potential (still not met) expressed by certain target segments, but a developed market does not yet exist. This could be, for example, the demand for wines with low or zero alcohol content by particular target groups who currently are excluded from wine consumption (drivers, consumers with health problems, pregnant women, etc.) However, as for all innovative products on the market, it would be necessary to have in place a definite regulatory framework. Therefore:

> Considering the demand potential for low or zero alcohol wines, it would be beneficial to ensure a clear legal framework for such products.

A third operational aspect concerns the adaptation of product presentation to meet local preferences ("Type and quality of the packaging" is a key factor of competitiveness growing in importance everywhere).

Suggestions for improvement could result from better market knowledge (e.g. through a market intelligence system), but also through intensification of “PR activities with importers, buyers, etc.”. However, implementation would depend on the ability of wine companies to develop and manage innovations demanded by the market. Therefore:

> It would be desirable to encourage the investments needed to develop and implement the innovations demanded by different markets. For this purpose, it may be beneficial to use RDP measures (EAFRD) and the investment measures of the wine CMO (EAGF), through appropriate definition of selection criteria (scores).

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