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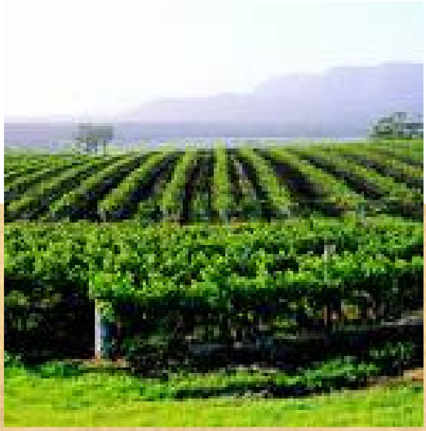
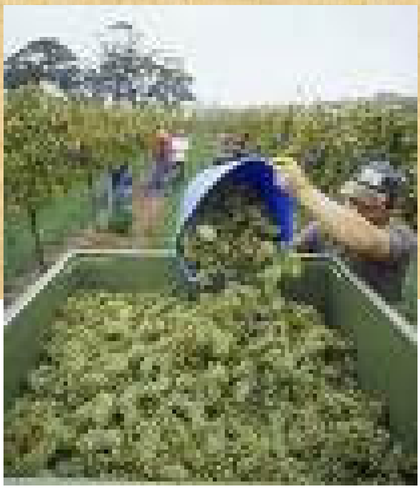


Australian Wine Grape Industry Partnership Project



Setting Directions
Draft Workshop Discussion Paper
1 November 2006

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Kiri-ganai research

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THE AUSTRALIAN WINE GRAPE INDUSTRY TAKING STOCK AND SETTING DIRECTIONS PROJECT, 2006

Project team

The project is being led by Kiri-ganai Research Pty Ltd under the direction of Dr Richard Price, Managing Director. Ken Moore and Richard are the team's analysts, with Ken being the principal author of this report. Mike Williams facilitated the industry's Taking Stock Workshop in August 2006 and will be the facilitator of the Setting Directions Workshop on 9 November 2006.

Acknowledgements

- The many wine grape growers, wine producers and other industry stakeholders who gave their valuable time, insights and knowledge during meetings with the consultants and in the industry workshop.

- The Project Management Committee comprising Alan Newton, Chairman, Wine Grape Growers Australia Inc (WGGA); Mark McKenzie, Executive Director, WGGA; Michael Matthews, Chairman, Victorian Wine Industry Association; Mike Stone, Chief Executive Officer, Murray Valley Winegrowers Inc.; Brian Simpson, Chief Executive Officer, Riverina Wine Grapes Marketing Board; Roseanne Healy, Chair, Riverland Winegrape Growers' Association Inc.; Kerry Smart, WA member of WGGA executive council; Guy Adams, Chairman, South Australia Viticultural Council; Bob Taplin, Barossa Winegrape Growers' Council; Bill Schumann, Wine Policy, Department of Agriculture, Fisheries and Forestry (DAFF); and Fiona Hill, Industry Partnerships Programme, DAFF.

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1. The Taking Stock and Setting Directions Project

In July 2006, the Australian Government Department of Agriculture, Fisheries and Forestry and Wine Grape Growers Australia Inc. initiated a Taking Stock and Setting Directions Project under the Government's Industry Partnerships Programme (IPP). The Programme is part of the Agriculture Advancing Australia package which helps primary industries to become more competitive, profitable, sustainable, resilient and self-reliant.

IPP support was provided by the Government for the wine grape industry to undertake the project to address the serious difficulties being faced by growers due to the large oversupply of wine grapes and the very low prices being received. The support also enables the industry to take a comprehensive and longer term view of its performance and future prospects assessed against desirable outcomes.

The project comprises three stages: Taking Stock of the industry's situation and performance, Setting Directions for the future, and the preparation of a comprehensive project report. The project's final report will be presented to the Government and the industry in December 2006.

2. Setting directions for the future of the Australian wine grape industry

This paper is for discussion at the Setting Directions Workshop in Adelaide on 9 November 2006.

It is based on a Taking Stock process conducted between July and October 2006 which involved a situational analysis of the wine grape industry and its operating environment.

A Taking Stock report was prepared following consultations with 165 people including growers and their representatives, board members and staff of national wine grape and wine industry institutions, winemakers, retailers, service providers and staff of Australian Government and some state government agencies. The report was also based on a review of industry information and an industry workshop held 24 August 2006.

A summary of the key findings of the Taking Stock report is provided in Appendix 1 of this paper and was distributed to participants of the forthcoming Setting Directions workshop. Appendix 2 provides a SWOT analysis (strengths, weaknesses, opportunities, threats).

The current Setting Directions phase of the project is to identify the industry's priority issues, to agree on proposed strategies and outline actions that the wine grape industry can take to increase its competitiveness, sustainability, profitability, resilience and self-reliance.

The Taking Stock and a SWOT analysis identified a set of priority issues for the industry in Setting Directions for the future. The following diagram shows the relationship between desired industry outcomes, the priority issues and possible strategies. The numbers assigned to the priorities and strategies do not indicate the priority order.

Setting Directions for the Australian Wine Grape Industry's Future

OUTCOME – GLOBAL COMPETITIVENESS

- Priority Issue 1 – Wine marketing strategies for increased sales
- Priority Issue 2 – Industry benchmarking against world's best practice

(Possible Strategies S1 – S6)

OUTCOME - PROFITABILITY

- Priority Issue 3 – New grape grower business models for increased profitability
- Priority Issue 4 – Improved mutual knowledge of value chain businesses
- Priority Issue 5 – Economies of scale and cost reduction

(Possible Strategies S7-14)

OUTCOME - SUSTAINABILITY

- Priority Issue 6 – Industry structural adjustment
- Priority Issue 7 – Innovation and continuous improvement
- Priority Issue 8 – Water resource access and efficiency
- Priority Issue 9 – World's best practice in natural resource management
- Priority Issue 10 – Managing for climate variability and change

(Strategies S15 – S29)

OUTCOMES – RESILIENCE & SELF-RELIANCE

Resilience

- Priority Issue 11 – Upgraded information collection, analysis and reporting
- Priority Issue 12 – Effective industry strategic planning processes
- Priority Issue 13 – Human, capital and financial capacity development

(Strategies S30 – S37)

Self reliance

- Priority Issue 14 – Coordination, resourcing and capacity development of industry structures at regional, state and national levels
- Priority Issue 15 – Development of industry leadership and the future generation

(Strategies S38 – S44)

OUTCOME 1: GLOBAL COMPETITIVENESS – the ability of the industry to compete and win market share in export and domestic markets. Wine is the traded product in world markets, but its competitiveness depends significantly on the quality (both perceived and actual) and efficiency of grape production.

PRIORITY ISSUE 1 – The development and implementation of marketing strategies that result in wine sales which will support profitable grape growing and winemaking sectors.

Taking Stock Pivotal Conclusions relevant to this priority issue

- The Wine Directions Strategy will be critical in identifying market opportunities for the Australian wine industry.
- Maintaining the Australian wine and wine grape industry at its present scale will require effective marketing strategies to defend existing markets and target new opportunties in the various market segments.
- The lack of growth in export sales of premium wines requires increased market and consumer research as a basis for developing future wine marketing strategies.
- Differences in patterns of consumer preferences and purchasing in the various market segments requires specific marketing strategies for each segment within an overall wine industry marketing vision and plan.
- The grape growing sector will need to monitor trends in grape sourcing by major companies in changing global market circumstances and analyse and report on the implications for Autstralian growers.
- Responsibity for developing and implementing 'Brand Australia' marketing strategies and regional branding of wines will rest with the wine industry as a whole.

Priority Issue 1 Possible Strategies for Consideration and Prioritisation

S1 Highlight the unique contribution of Australian grape growers to the wine industry and its global competitiveness.

S2 Contribute to industry marketing strategies, including the Wine Directions Strategy.

S3 Back wine marketing strategies with a wine grape industry strategic plan that ensures grapes are supplied in a profitable and sustainable way for the production of wines sold in each of the market segments.

S4 Monitor trends in grape and bulk wine sourcing by wine companies and developing new grower busines models to remain competitive and profitable.

S5 Contribute to marketing strategies that build Brand Australia and regional brands.

PRIORITY ISSUE 2 – Benchmarking all sectors of the wine industry value chain, including grape growing enterprises, against international competitors.

Taking Stock Pivotal Conclusions relevant to this priority issue

- In an increasingly competitive world wine market, the Australian wine value chain will need to benchmark itself against international competitors and to use this information in the ongoing quest to maintain and extend competitive advantages.

- Australian wine grape growers will need a better understanding of their own physical and financial performance and the perfomance of their major international competitors.
- Benchmarking needs to consider cost structures of grape growing by targeted end use (ie, for each market segment such as the popular premium price point).
- Benchmarking initiatives need to be supported by developing the industry's extension capacity. This is necessary to ensure growers have the business skills to monitor and apply benchmarking results, particularly where fewer growers will have secure grape supply contracts.

Priority Issue 2 Possible Strategies for Consideration and Prioritisation

S6 Implementing systems for benchmarking Australian viticulture to world's best practice in conjunction with whole of value chain benchmarking.

OUTCOME 2: PROFITABILITY – the ability of the industry to generate profits for wine grape growers and value chain businesses that justify the continuation of resources being used in the industry.

PRIORITY ISSUE 3 – Adopting new grape growing business models for competing in consolidating value chains and achieving enterprise profitability.

Taking Stock Pivotal Conclusions relevant to this priority issue

- With the world trend to consolidation of wine making, distribution and retailing, Australian growers need to examine the effectiveness of present grape marketing (including contractual or selling arrangements) to fewer and larger winemakers. This includes the possibility of dealing with intermediary or specialist winemakers that supply wine on specification to the large wine companies.
- Changes in domestic grape markets will also require the development of new business and marketing skills to win grape sales and make a profit over the long term.

Priority Issue 3 Possible Strategies for Consideration and Prioritisation

S7 Reviewing requirements for new business skills development for growers.

S8 Transitioning grower business models for competitive and profitable grape production, marketing and supply.

S9 Providing action learning, case studies and extension support for grower adoption of appropriate business models.

PRIORITY ISSUE 4 – Building collaborative relationships through the value chain and improving mutual understanding of respective businesses, costs of production, pricing, profit margins and return on assets.

Taking Stock Pivotal Conclusions relevant to this priority issue

- Further research is required on the relationship between wine prices, wine grape prices and costs of production in various regions, particularly to clarify the costs involved in grape production through to wine sales. This should include analysis of the proportionate shares of wine production and selling costs and revenue, and the profit margins that accrue at each stage of the value chain.
- Improved mutual understanding of the respective businesses of grape growing, wine making, distribution and retailing (including prices, costs and profit margins) would provide a strong basis for improved relationships in the value chain.

Priority Issue 4 Possible Strategies for Consideration and Prioritisation

S10 Investigating grape growing and wine production costs, the relationship between grape and wine prices, and profits or rate of return on assets and management to growers and winemakers.

S11 Exchanging appropriate business information between value chain sectors from grape growing through to retail sales.

S12 Building collaborative relationships in the wine industry value chain that address profitability and competitiveness issues.

PRIORITY ISSUE 5 – Achieving appropriate economies of scale and cost reduction in grape production and marketing.

Taking Stock Pivotal Conclusions relevant to this priority issue

- Industry and enterprise level strategies for achieving economies of scale and cost reduction are critical to the future profitability of wine grape growing.
- Significant economies of scale are available in wine grape production through property consolidation, joint vineyard management arrangements and contracting vineyard operations over a number of properties.
- Individual growers may need to explore the potential for collaborative marketing arrangements compatible with Trade Practices Act requirements.

Priority Issue 5 Possible Strategies for Consideration and Prioritisation

S13 Researching and disseminating information on economies of scale and cost reduction strategies for wine grape production and marketing.

S14 Promoting best practice models and providing extension support that addresses key scale and cost reduction issues.

OUTCOME 3: SUSTAINABILITY – the capacity of the industry to be economically viable in the long term and to invest in the maintenance of the industry's natural resources for future productive use.

PRIORITY ISSUE 6 – Planning for and undertaking major structural adjustment in the wine grape growing industry with appropriate support for growers.

Taking Stock Pivotal Conclusions relevant to this priority issue

- In the medium to long term (ie, the next 5-10 years), the Australian wine grape sector will need to adjust to grape price levels that are likely to be much lower than those reached in the late 1990s and early 2000s when the expansion of the vineyard area took place.
- Significant change may be required in grape growing enterprises, vineyard size, the varieties planted in some regions, and in clonal material used in some instances.
- The number of growers reporting loss of grape supply contracts, financial difficulties and uncertainty about future options, indicates that growers will need assistance in examining their businesses and their future prospects of earning profits.
- There is a high proportion of specialist growers in all regions that lack the economies of scale needed for long-term viability at a lower level of grape prices. A better understanding is required of how small-scale and specialist growers are likely to react to adjustment pressures.
- A lot of growers that lack scale are concentrated in some of the warm inland regions with fixed or unsuitable irrigation infrastructure that mitigates against build-up of property scale. Infrastructure and adjustment strategies will be required to overcome this problem.
- The apparent imbalance between the proportion of wine grape supply from high-cost cool climate regions and international wine market trends will need to be monitored and addressed in industry strategies.
- There are concerns amongst growers about the impact of speculative plantings without genuine grape contracts and new plantings displacing production by established growers that need to be addressed by the industry.
- Concerns relating specifically to managed investment schemes including the provision of realistic market information and prospects in product disclosure statements, perceived excessive quotations of vineyard development costs and inequity in taxation treatment between schemes and established growers need to be addressed with the MIS sector and Government.

Priority Issue 6 Possible Strategies for Consideration and Prioritisation

S15 Investigating, developing and implementing strategies for structural adjustment in collaboration with government and industry organisations.

S16 Developing appropriate support and incentive packages in collaboration with government and industry organisations.

S17 Providing extension and counselling support to growers on their businesses and financial prospects.

S18 Monitoring and assessing grape supply from regions and addressing demand/supply mismatches in industry strategies.

S19 Monitoring investment in vineyards and plantings.

S20 Addressing issues concerning new plantings through planning and value chain collaboration.

PRIORITY ISSUE 7 – Entrenching a culture of innovation and continuous improvement in wine grape production and marketing.

Taking Stock Pivotal Conclusions relevant to this priority issue

- The pace of change in world wine markets and value chains will require a culture and strategies for continuous improvement in grape growing that needs to be backed by R&D that achieves innovation in production and marketing.

Priority Issue 7 Possible Strategies for Consideration and Prioritisation

S21 Establishing an effective whole of value chain R&D system that builds a culture and practice of innovation and continuous improvement.

PRIORITY ISSUE 8 – Maintaining access to, and improving efficiency of, water resources.

Taking Stock Pivotal Conclusions relevant to this priority issue

- The impact of climate variability on irrigation water availability and cost is a priority issue and needs to be monitored.
- Irrigation infrastructure needs to be upgraded in some warm climate regions of NSW and Victoria (eg, piping under pressure and accurate water metering).
- There is scope for the industry to further reduce its use of water and increase water productivity by growers converting most vineyards to drip and micro spray.

Priority Issue 8 Possible Strategies for Consideration and Prioritisation

S22 Monitoring and disseminating information to growers on the impacts of climate variability on irrigation water availability and costs.

S23 Collaborating with governments, water authorities and companies on irrigation infrastructure investment.

S24 Providing information and extension support for best practice irrigation in viticulture.

PRIORITY ISSUE 9 – Continuing to implement and demonstrate world's best practice in natural resource management.

Taking Stock Pivotal Conclusions relevant to this priority issue

- Extension of the Australian Wine Industry Stewardship initiative to cover most of the national grape crush will strengthen the industry's standing in the Australian community and export markets.

Priority Issue 9 Possible Strategies for Consideration and Prioritisation

S25 Developing world's best practice natural resource management (NRM) standards for Australian viticulture.

S26 Examining opportunities arising from Government Environmental Management Systems and NRM programs, including the forthcoming new round of the Natural Heritage Trust.

S27 Collaborating and participating in Australian Wine Industry Stewardship.

PRIORITY ISSUE 10 – Monitoring and managing industry responses to climate variability and climate change.

Taking Stock Pivotal Conclusions relevant to this priority issue

- Industry strategies and investment plans need to take possible future climatic changes into account. The industry should closely monitor climate variability as a foundation for developing strategies for the industry to respond to climate change.

Priority Issue 10 Possible Strategies for Consideration and Prioritisation

S28 Researching potential impacts of climate change on wine grape production and regions.

S29 Developing climate change response strategies.

OUTCOME 4: RESILIENCE – the capacity of the industry to bounce back from adverse shocks and its flexibility to deal with future shocks, either physical, economic, policy decisions, or changes in the external environment such as exchange rate appreciation.

PRIORITY ISSUE 11 - Strengthening Information collection, analysis and reporting to support grower decision making and industry policies and planning.

Taking Stock Pivotal Conclusions relevant to this priority issue

- Maintaining and improving industry information services is important in both understanding key trends and providing growers with information that enables sound decision making.
- Industry projections for future grape production levels are subject to uncertainty about grape market changes, seasonal growing conditions and the impact of grower and winemaker actions to reduce production.
- There is a need for improved information on the mix of wine inventories, grape quantities left in vineyards, types of grape growing enterprises and grape selling arrangements.
- Other improvements to industry information include the need to validate or 'ground truth' vineyard production data and assess new plantings coming into commercial production.

- More accurate price batch data for the analysis of wine grape market segments is also required.
- Strengthening of market information and sharing the information in the wine industry value chain is a means of building stronger relationships.

Priority Issue 11 Possible Strategies for Consideration and Prioritisation

S30 Refining industry data and improving information collection and dissemination relating to wine grape demand and supply variables.

S31 Upgrading industry information interpretation and dissemination to growers, other value chain sectors, government and the media.

PRIORITY ISSUE 12 - Developing effective planning and strategy setting processes for the grape growing sector linked to marketing strategies and sales targets for wine.

Taking Stock Pivotal Conclusions relevant to this priority issue

- Successfully negotiating future industry change will require improved strategic planning for the wine grape growing sector that is complementary to wine production and marketing strategies.

Priority Issue 12 Possible Strategies for Consideration and Prioritisation

S32 Implementing ongoing strategic planning, and performance monitoring and evaluation processes.

S33 Monitoring and assessing grape supply from regions and addressing demand/supply mismatches in industry strategies.

S34 Analysing and communicating information about industry trends and characteristics of industry cycles.

PRIORITY ISSUE 13 - Ensuring ongoing investment in the industry's human, capital and financial capacity.

Taking Stock Pivotal Conclusions relevant to this priority issue

- The future competitiveness and prosperity of the industry will depend on adequate on-going investment in wine grape growing and marketing skills, attracting people to the industry, upgrading Australian vineyards and technology, provision of modern distribution infrastructure and accessing funds from financial markets.
- Increasing support for greater involvement of younger people and women in the industry will strengthen and balance the industry's human resource and leadership base.

Priority Issue 13 Possible Strategies for Consideration and Prioritisation

S35 Enhancing human resource capacity in Australian viticulture and attracting people to the industry.

S36 Increasing investment in upgrading Australian vineyards and technology in line with benchmarking results.

S37 Collaborating with infrastructure funders and providers to ensure the provision of modern distribution infrastructure for grape supplies to wineries.

OUTCOME 5: SELF RELIANCE - the capacity of the industry's institutions and leaders to plan for the future, to provide leadership during periods of prosperity and downturn, to respond quickly and effectively to issues, and to build relationships within the industry value chain and with governments, the community and other sectors of the economy.

PRIORITY ISSUE 14 – Coordinating and building the industry's structure at regional, state and national levels; resolving funding and resourcing constraints; and strengthening policy development, change management and relationship management capacity.

Taking Stock Pivotal Conclusions relevant to this priority issue

- Industry self reliance requires the development of WGGA as a strong national organisation supported by efficient and effective state and regional organisations to represent wine grape growers and provide value in the services demanded.
- As the peak body for one of Australia's largest agricultural industries, WGGA will need significant funding from its members if it is to develop the administrative, intelligence gathering, data analysis, market research and advocacy necessary to make a real difference to the sustainability of the Australian wine grape growing sector.
- A short term imperative for WGGA, state level and regional organisations is achieve a coordinated structure at regional, state and national levels and to resolve funding and resourcing constraints, particularly during the current industry difficulties.
- In order for WGGA to be able to provide effective leadership for state and regional organisations and growers generally, WGGA requires more financial and intellectual input from a wider range of regional organisations and growers.
- A key role needs to be in providing leadership to growers and their respective regional and state organisations in understanding, embracing and managing the change that will be a feature of the industry in future.
- WGGA needs to work to strengthen its relationships with the Australian Government, state governments and local government in industry policy development and planning.
- Potential exists for WGGA to build strategic alliances and collaborative partnerships in the value chain, with national industry institutions and other industries. This may increase the resources available to WGGA to add value to its strategies and more effectively represent the wine grape growing sector.

- Regional and state level organisations could play a key role with WGGA in supporting the professional development of growers, particularly in strengthening grower business models, as part of overall efforts to assist them in adjusting to the ongoing changes that lie ahead.
- In line with the need for improved industry information services, WGGA could be a 'reseller' of information that has been analysed and packaged to meet specific grower interests.

Priority Issue 14 Possible Strategies for Consideration and Prioritisation

S38 Reviewing the effectiveness of the industry's structure at national, state and regional level.

S39 Addressing funding and resourcing issues at national, state and regional levels.

S40 Providing leadership for the wine grape sector in managing industry adjustment and change.

S41 Developing relationships with national, state and local governments in order to promote the interests of the wine grape industry.

S42 Developing strategic alliances with industry stakeholders and others outside the industry to provide additional resources to underpin a strong industry support capacity that benefits the wine grape industry.

S43 Improving industry communication and professional development for grower businesses.

PRIORITY ISSUE 15 – Investing in the development of industry leadership and the future generation.

Taking Stock Pivotal Conclusions relevant to this priority issue

- It is important that the industry maintains investment in its leadership capabilities and establishes succession plans for key decision making positions.

Priority Issue 15 Possible Strategies for Consideration and Prioritisation

S44 Supporting future leaders and upgrading leadership development and succession planning.

APPENDIX 1: A situational analysis of the wine grape growing sector

Contribution of grape growers to Australia's wine success story

Australia has had spectacular success in the past decade in exporting wines to the world. Our competitiveness in international markets has resulted from the value created by all sectors of the industry for the increasing numbers of consumers who purchase Australian wines.

Australia's growers deliver value to the wine industry through the quality of grapes produced. The way in which the four basic elements of water, sugar, acidity and tannin are combined in the harvested grapes is the critical influence in the style of wine that results. All of these elements are influenced by the soil of the vineyard, the climate and seasonal weather conditions, the type of grape variety grown and the growers' vineyard management. Outstanding growers capture the distinctiveness of the Australian terroir in the grapes they produce and this attribute has made Australian wine attractive to consumers.

Australian growers also add value to the wine industry through the diversity of grape varieties grown; the consistency in grape quality that is achieved and the efficiency of their vineyards, thereby enabling 'value for money' wines to be produced.

Growers manage their viticultural practices, time of harvesting and delivery to the winery to meet the stringent requirements of winemakers relating to grape purity, maturity and condition. These are essential factors in producing wines that will be preferred by consumers.

They also meet industry commitments to care for the environment through their natural resource management, compliance with environmental guidelines and regulations and participation in industry and government programs.

Australian growers have shown a willingness to invest in and adopt innovative and new technologies so that they remain globally competitive and at the forefront of efficient and quality production techniques.

For these reasons, wine grape growers have played a key role in Australia's export success and in the value created for world and domestic consumers of Australian wine.

In recent years, conditions in the world wine market and in Australia have resulted in a significant turnaround in the economic circumstances of growers due to large grape oversupply and low prices.

In response to increasing wine sales over the past decade (particularly exports), there was a rapid rise in national wine grape production in the decade 1996 to 2006 driven by an increase in the bearing vineyard area of

137% from 65,000 ha to 154,000 ha. This is almost 50,000 ha more than the 40,000 ha stated as required to meet the wine sales target of Strategy 2025.

Trends in export sales also show that there is now clear evidence that the export success of the past decade is reversing. The average price per litre of exports is falling and this caused the value of exports to decline in the year to 30 September 2006 for the first time since 1991.

The current downturn

The profitability and future sustainability of the Australian wine grape sector is being seriously affected by the large over-supply of grapes. The oversupply appears to have commenced in 2000-01 when wine production exceeded sales and an 'economic' level of stocks leading to excess wine inventories.

Wineries grape intake levels have remained high over this period, but in 2005 and 2006 as wine stocks grew further, wineries have moved to reduce grape purchases. This has been occurring via wineries either not renewing grape supply contracts or amending existing contracts, particularly through yield and production caps.

Growers have been forced to discard unsold grapes and are reporting increased vine mothballing, grubbing or abandonment. The wine grape sector estimates that up to 200,000 tonnes were left unharvested or discarded in the 2006 harvest.

Grape prices have generally been declining since the early 2000s. For the 2006 vintage, contracted grapes were consistently below $400 per tonne in warm climate regions. Prices are higher in temperate and cool climate regions, but the cost of production is significantly higher than for warm inland regions.

Since 2003, an increasing amount of uncontracted fruit has been sold on the spot market. In 2006, very low prices of $100 per tonne or less were being received by growers in both warm and cooler climate areas.

With low prices now prevailing in most regions and increases in the cost of production, the viability of many grape growing enterprises is under severe pressure. Many specialist growers, without significant off-farm income, are facing financial difficulties. In some areas, the number of wine grape growers seeking assistance through rural counselling services has rapidly increased.

Grower incomes in 2007 are likely to be further affected by the very dry and warm conditions across wine regions during most of 2006 and severe spring frosts in some regions. If grape production is significantly reduced in 2007 due to these seasonal conditions, it may assist grape prices in 2008, but it is too early in the season to accurately predict actual production.

Until wine inventories are reduced to economically sustainable levels and grape production levels reduced, it is likely that more growers will face the prospect of less secure contracts and greater reliance on the spot market for grape sales. In addition, there is the prospect of growers having to bear the cost and risk of processing their own grapes into wine for sale at prices determined by the market for bulk wines at the time.

Features of wine grape production and marketing

Australia's wine grape industry is distinct amongst Australia's agricultural industries in that the output is not exported in unprocessed form. Wine grapes are a highly perishable product with a very short time available between picking and processing. There is also a very narrow window of optimum picking time to meet winemaker specifications. These requirements mean that most wineries are located in relatively close proximity to the vineyards that supply their grapes.

Wine grapes are differentiated by variety and region. With the advent of refrigerated transport, wineries now source grapes and blend wine from many regions. This has changed relationships between winemakers and growers with wineries becoming less reliant on local growers.

The demand of winemakers for grapes is determined by the level of wine sales and wine inventories. The relationship between demand and supply is influenced by grape and wine production cycles.

The grape cycle results from the lag between planting a vineyard and receiving a commercial grape yield which can be from 2 to 4 years, plus the maturation time for wine produced from the new supply. Thus, it can be up to 6 years from the time of planting before the new supply reaches the consumer.

As an agricultural product the supply of wine grapes is affected by seasonal conditions. While this has been ameliorated by improvements in grape growing technology and management`, grape supply continues to be affected by the weather conditions over the growing cycle. Production is negatively affected by drought, floods, frosts and hailstorms and positively influenced when favourable rainfall and temperatures come together as ideal seasonal conditions.

The existence of the grape cycle and seasonal variations creates difficulties in demand-supply coordination for the industry and its ability to quickly respond to changes in consumer preferences and trends in wine purchases.

Key Taking Stock findings

In this project, the immediate issues of grape oversupply, low grape prices and grower viability are assessed against desired industry outcomes along with longer term industry issues.

Global competitiveness

Australia is now a significant player in the world wine market with overseas sales accounting for 10% of the value of world wine exports which makes Australia the third ranked exporting producer. Our prominence has resulted in Australia's vineyards, wine production and marketing strategies being closely observed by other wine producing countries.

Australia has dominated the 'popular premium' market segment particularly in the United Kingdom and USA. This segment comprises brands in the A$7-11 a bottle price range.

Presently, almost 80% of Australia's exports are bulk and popular premium wines. These market segments have provided the export opportunity and available market for Australian wines produced from grapes largely grown in the warm inland regions.

Popular premium wines are increasingly a 'fast moving consumer good' purchased by consumers in supermarkets. These wines compete on price and value for money in consumer budgets. As such, they are amenable to global sourcing by international beverage companies from the lowest cost producers.

Australia also successfully sells branded wines to the world premium, super premium and specialty market segments. These wines are seen by consumers as lifestyle goods and subject to discretionary expenditure and requiring sophisticated marketing strategies.

The volume growth of Australian exports in recent times has been in bulk wine as winemakers sell off their surplus stocks at very low prices. Some in the wine industry argue that this is impacting on Australia's image as a supplier of quality wine and that it will ultimately affect our ability to increase sales of premium wines.

There has been little growth in the export market for premium, super premium and specialty wines which comprise around 20% of Australia's export sales. Much of the previous growth in plantings was to produce grapes for these wines and the current area now comprises around 40% of the national vineyard estate. This has resulted in oversupply in regions that grow these types of grapes.

The Australian wine industry now faces challenges in maintaining the previous export success in the face of competition from other successful exporters. This will take place against a world market background in which wine and grapes will continue to be in over-supply for the foreseeable future. Competitive and price pressures on grape growers are likely to be maintained as retailers and wineries discount wines to win market share.

Profitability

The increase in grape production that has resulted from the rapid expansion in the national vineyard estate has led to the large grape oversupply and serious impact on prices and grower profitability. With wine sales falling below production, wine stocks have increased to excessive levels and caused wineries to move to reduce grape intakes and prices.

Industry predictions are for an extended period of excess wine stocks and little prospect of recovery in wine grape prices in the medium term (even up to 2010).

In the present market circumstances, some adjustment now appears to be taking place in grape production levels with winemakers reducing contracts and growers decreasing the quantities harvested. The latter is occuring through growers increasing vineyard grubbing, mothballing unprofitable areas and discarding grapes that they cannot sell.

There is also the prospect that the 2007 vintage could be significantly reduced by very dry and warm conditions in most regions and severe frosts in some regions.

However, even with demand and supply rebalancing in the medium term, the world oversupply and international competition for wine market share will continue to put pressure on wine and grape prices. It is unlikely that grape prices will return to the levels of the late 1990s, at least, during the remainder of the current decade.

Sustainability

The sustainability of the Australian wine grape industry relates to both its long term economic viability and capacity to invest in the conservation of its natural resources for future productive use.

In terms of its future economic viability, international competition in wine markets will continue to drive innovation and adjustment in all sectors of the Australian wine industry value chain and this will require 'whole of chain' action to build competitive advantages for the industry.

Australia has a large number of small-scale vineyards many of which may not be able to achieve long term economic viability. A lot of growers that lack appropriate scale for the types of grapes being produced are concentrated in the warm inland regions. Outdated fixed or unsuitable irrigation infrastructure in some regions is one factor that potentially mitigates against build-up of property scale in these areas.

There is also a large number of small scale producers in temperate and cool climate regions that may not be viable as specialist grape growing enterprises over the long term. However, significant adjustment in the vineyard area will be limited due to the number of vineyards owned by professionals from other occupations and investors who are able to sustain loss making ventures.

The large capital investment in vineyards and the lack of suitable alternative enterprises will also constrain rapid adjustment in the total vineyard area. In addition, growers with grape supply contracts for the next 2 to 3 years are unlikely to move out of wine grape production at this stage.

The poor financial returns accruing to specialist growers is reducing investment in achieving further economies of scale. Those growers with larger bearing areas tend to have stronger financial performance.

The importance of economies of scale is not as important where growers can establish strong product differentiation (eg, region of origin or production for icon labels) and have the management skills to profitably produce and market the differentiated product.

Results of studies, such as ABARE's analysis of sustainable enterprise size in horticulture, will be important for future strategies on structural adjustment.

With regard to natural resource management, the Australian Wine Industry Stewardship initiative provides a strong foundation for the industry to further improve and demonstrate its environmental and natural resource management performance.

The extent and degree of climate variability that is already apparent and the degree of climate change predicted by CSIRO and the Australian Greenhouse Office will have significant impact on Australian wine regions over the long term.

The impact will be in relation to water availability and cost, vineyard productivity and profitability, wine grape quality, and wine type and styles. This will have important consequences for the varieties that can continue to be grown in specific regions.

Resilience

The Australian wine and wine grape sectors have a history of cycles of 'boom' and 'bust'. However, both sectors have been resilient in successfully negotiating these cycles and emerging in a stronger position.

Each successive economic cycle has similarities and differences from the previous cycle. The most recent boom in the late 1990s and early 2000s is considered to have been the longest and strongest, and driven almost exclusively by wine sales' growth in export markets.

Many growers and winemakers believe that the present downturn reflects a 'seismic' shift in the industry that will involve more change to grape growing than in previous industry downturns. The Australian industry is now much larger, is much more dependent on growing wine exports and has more specialist grape growers including investor vineyards.

The world wine market has also changed markedly with rapid consolidation of winemaking and retailing, intense competition in export markets between New World producers and consumer-driven markets where fashion, convenience and lifestyle influence consumption. This will drive changes in grape growing, particularly in the scale of enterprises and business models for successfully supplying product to wineries.

Strategy 2025 released in 1996 included a strategy for the 'viable expansion of vineyards', but there was no specific strategic planning for guiding the growth that followed and then the subsequent over-supply and low grape prices.

Demand/supply coordination in grape growing is particularly difficult because consumers' wine preferences can change quickly. There is a significant time lag between the decision to plant a variety currently in demand and the resulting grape production which may be at a time when demand has changed.

In industry planning and strategy setting, it is important for the industry to have a close understanding of the grape and wine production cycles and to monitor key aspects of those cycles.

While the wine and grape sectors generally have good data on production, there are areas where the data, analysis and reporting could be improved for industry planning and investment decisions.

The exchange of information between growers and winemakers and other sectors of the value chain will help to build collaboration and to increase the competitiveness of the whole chain in competing with other countries.

Industry R&D has been critically important for providing information and innovations for growers and winemakers. This has traditionally concentrated on grape production and wine processing, although in recent years market and consumer research has increased.

Self reliance

There are a large number of organisations that represent growers and/or winemakers at the regional (GI) level and state levels. Some of these organisations have large memberships and are well resourced, but others face difficulties in attracting members, establishing secure funding and acquiring resources.

Support for state level organisations and a national grower body has increased as a result of the industry's difficulties. Growers generally want a unified voice to strengthen their position in dealing with the short-term transition of the industry and with a desired return to long-term stability and prosperity.

Grape grower/winemaker relationship management is a priority issue for state and national level industry organisations. Declining grape prices and a pricing system that still contains a large degree of subjective quality assessment is straining relationships.

Wine Grape Growers Australia Incorporated (WGGA) has been formed and can potentially fulfil grower demands for representation and industry services at the national level. WGGA is presently funded largely by the major inland regions and requires a broader funding base including other regions and growers. Similar funding and resourcing constraints need to be resolved at the state level and, in some cases, regional levels.

WGGA will also face increasing policy development demands and close working relationships with government as national, state and local government policies and community interests extend across most aspects of industry activity.

Generally there is strong grower and winemaker support for the major industry bodies, the Grape & Wine R&D Corporation (GWRDC) and the Australian Wine and Brandy Corporation (AWBC). This support extends to their functions and levy funding.

APPENDIX 2: Industry challenges – wine grape industry SWOT

The following table represents a consolidation of various factors and issues relating to the wine grape industry's strengths, weaknesses, opportunities and threats that have become apparent during the Taking Stock.

STRENGTHS	WEAKNESSES
• Highly skilled wine grape growers that adopt new technologies and are efficient in world terms. • Diversity of suitable climatic conditions and soil types in the wine regions of southern Australia to achieve a wide range of wine types and styles. • 'Clean and green' natural resource management. • Efficient user of water with high water productivity (high value of product per megalitre). • Diversity in vineyards in terms of size and grower business models that provides flexibility for different markets and changing market conditions. • Willingness of many growers and winemakers to experiment with different varieties in relation to regional characteristics. • Experienced family wine grape growing businesses with strong commitment to the future of the industry. • Corporate investment that has brought capital and scale to some vineyards. • Prominence for Australia as a major wine exporter with a record of outstanding growth. • Wine companies with the scale and global operations to be highly competitive in world wine markets. • Innovative small wineries in some regions (eg, the Barossa) that are achieving increased sales in the fine wine market segment. • The number and spread of small wineries that provide diversity to the industry and a willingness to experiment and innovate. • Strong national wine and wine grape R&D Program and funding. • Established industry organisations that provide research, information and marketing services. • A wide range of industry information sources and relatively comprehensive data. • Grower support for a strong national grower organisations to provide advocacy, information, policy and other services for the industry. • Regional grower and winemaker organisations that represent local interests and provide local services. • Committed growers willing to support their industry and marketing organisations. • Strength of overseas and domestic consumer preferences for Australian wines and willingness to seek new beverage experiences.	• Lack of profitability at present grape prices that is threatening the future viability of many growers. • Current depressed conditions limiting investment by long-term growers in vineyard innovation and cost reduction strategies. • Barriers to structural adjustment that are preventing the exit of unviable growers from the industry. • Lack of capital for small growers and wineries to fund new initiatives and market opportunities. • Over-dependence on wine sales to the UK and US in the 'popular premium' market segment. • Lack of growth in markets for premium (fine) wines resulting in an oversupply of grapes from cooler climate regions. • Some vineyards and varieties planted in the recent 'boom' that are not optimal for the specific climate and soil types of where they are located. • Time lags and costs associated with changes in varietal plantings. • Inadequate market research and intelligence on consumer preferences and new market opportunities. • Deficiencies in the communication of industry and market trends and implications for growers. • Few objective standards to measure grape quality parameters. • Poor understanding of the relationship between grape attributes and wine attributes. • Lack of mutual understanding of respective business costs and operations in the wine industry value chain. • Inflexibility of some grower business models in relation to changes taking place in the wine making, distribution and retailing sectors. • Perceived deterioration in the level of collaboration in the Australian wine industry value chain with claims of 'unethical' or poor business practices. • Deficiencies in the integration and coordination of industry information systems for providing 'real-time' data for industry decision making. • Tendency for over-reliance of growers on winemakers for information required for business decisions such as vineyard investment. • Decline in the number of students seeking education and training in viticulture, wine making and wine marketing. • Lack of resources for grower organisations to meet increasing demands for relationship management in the wine industry value chain, with government and the general community.

OPPORTUNITIES	THREATS
• Winning more market share in line with increasing world wine consumption. • Growing consumption of Australian wine in the large US market in line with increasing per capita wine consumption. • Capitalising on the potential of new markets in developing countries such as China and India. • Promoting Australian fine wines to affluent consumers world-wide who are seeking quality branded wines. • Innovative wine marketing to younger consumers who are seeking new beverage experiences and products. • Capitalising on the growth of the food service and hospitality sectors in Australia and overseas. • Promoting the attractions of Australian wine regions for food and wine tourism amongst Australian and overseas travellers. • Establishing strategic planning to provide leadership, change management and risk management for the challenges that lie ahead. • Using the industry's strong R&D resources and institutions to increase innovation in viticulture, winemaking, marketing and business management. • Building high level collaboration in the value chain for increasing competitiveness in the world wine market. • Developing wine grape grower relationships with the Australian Government through the Industry Partnerships Programme. • Using the support that presently exists amongst growers and governments to establish WGGA as a strong and respected national industry body. • Promoting the strengths of the industry to attract younger generations to occupations in the industry. • Demonstrating that grower and wine makers are leading the way in natural resource management. • Using the water reforms under the National Water Initiative Water Smart Australia program to highlight and address water infrastructure and management issues relating to the industry. • Participation in world efforts to achieve trade liberalisation that can bring increases in export opportunities. • Promoting the skills and successes of Australian grape growers in the Australian community.	• The history of industry downturns following boom periods where returns to grape growers and winemakers have been depressed for long periods of time. • Loss of world wine market share to wine producing countries with lower costs of production. • Failure to implement effective industry planning and strategy setting processes. • Failure to achieve effective industry adjustment and to position the industry for future export market competition. • Under-investment in upgrading Australian vineyards and wine making infrastructure. • With consolidation and increased scale of grape production, loss of diversity in grape varieties and attributes. • Australia's large wine companies sourcing bulk wine and grapes from other countries for their global brands. • Appreciating A$ continuing to reduce unit export values. • An escalation in the value of the $A or a major devaluation in the US$ making USA wines far more competitive in our European markets. • Failure of wine marketing and promotion of 'Brand Australia' and regional brands to win new consumers and markets. • Australia's apparent focus on the 'popular premium' market segment leading to a negative impact on its image in some markets (eg, Europe) as a premium wine producer. • Resistance of weeds and pests to herbicides and pesticides and new pests/diseases in vineyards. • Vineyard input cost escalation (ie, fertiliser, fuel, chemicals, labour). • High cost of compliance with a wide range of regulations. • Increased climate variability causing major fluctuations in the volume and quality of wine grape production. • Increasing temperatures and rainfall under climate change affecting suitability of many regions for wine grape growing. • Failure to attract younger generations into the industry. • Lack of progress in trade liberalisation limiting improvement in export market access. Failure to develop and resource industry organisations to provide increasing demand and requirements for advocacy, information, policy and other services.