

Industry Partnerships Programme



The Australian Wine Grape Industry Taking Stock and Setting Directions Final Report, December 2006

Prepared by

RESEARCH WITHOUT BOUNDS



Kiri-ganai research

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

ABOUT KIRI-GANAI RESEARCH

Kiri-ganai Research Pty Ltd is a Canberra based consultancy company that undertakes consultancy and analytical studies concerned with industry performance, natural resource management and sustainable agriculture. Our strength is in turning knowledge gained from markets, business operations, science, research and policy into ideas, options, strategies and business plans for industries and businesses.

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- The authors of many reports reviewed by the Project Team whose information, knowledge and insights are acknowledged and greatly respected in building a complete picture of the Australian wine grape industry.

Structure of this report

This report is set out in two parts:

Part A is the summary of the project, the project findings and conclusions, and the results of Setting Directions for the future of the Australian wine grape industry. These address the desirable outcomes for the industry, namely: global competitiveness, profitability, sustainability, resilience and self-reliance.

Part B provides supporting information to Part A and is a situational analysis of the industry's resources, external environment and enabling environment. Part B aligns with the Industry Partnerships Programme's industry assessment framework.

In this report, the **resources** of the Australian wine grape industry are considered to be those attributes which provide its productive and marketing capacity. This includes the industry's natural resources (soils and topography, water availability and

climate); it's wine grape growing enterprises and wine grape markets (ie, the buyers of grapes by enterprise type and buying arrangements).

The **external environment** in which the industry operates includes the global market place, the national economy and Australian society. Conditions and events in the external environment influence the fortunes of the Australian wine grape industry. They are factors over which the industry has little or no control, but are considerations against which industry strategies and investment plans must be tested and validated if they are to achieve success.

The **enabling environment** for the wine grape industry includes the elements of its operational environment which it is able to influence directly or indirectly. The industry is able to do this through its own efforts or in partnership with stakeholders including the Australian Government and relevant state governments. The enabling environment includes the private sector component which is the Australian wine industry value chain; the industry's organisations and services; and the role of government at local, state and national levels.

Disclaimer

Care has been taken to ensure that the information contained in this report is reliable and that the conclusions reflect considerable professional judgment. Kiriganai Research Pty Ltd, however, does not guarantee that the report is without flaw or is wholly appropriate for all purposes and, therefore, disclaims all liability for any loss or other consequence which may arise from reliance on any information contained herein.

Contribution of Australia's grape growers to the wine success story

While much is written about the world leading expertise of Australian winemakers and the quality of their wines, much less is known about the extraordinary contribution of Australia's 8000 wine grape growers to the success of the wine industry. Twenty one per cent of Australia's vineyard estate is owned by wine companies, with the remaining 79% of Australian vineyards held by private wine grape growing enterprises – often family run businesses of two or three generations.

Australian vineyards directly employ more than 15,000 people, and many thousands more in the service and supply industries. Many regional economies are built on and remain largely reliant on wine grape production, and while many wine regions have highly concentrated vineyard plantings, vineyards are widely dispersed and have become a common feature of much of the landscape of southern Australia.

Australian wine grape growers are highly skilled, world leaders in viticultural technology and natural resource management, and have expertly adapted their production techniques to suit the individual climatic, soil and topographic conditions that exist across 155,000 hectares of vineyards in 65 wine regions - in warm, temperate and cool climate growing zones.

The extraordinary range of vineyard sites and grape varieties, together with the skills and ingenuity of Australian growers in producing consistently high quality grapes for wines made for the full spectrum of consumer preference, has been the most important factor in allowing Australian winemakers to develop wine markets across the world – propelling Australia to fourth largest wine exporter in the world in little more than a decade.

It is an accepted fact that the quality of wine is defined in the vineyard, so the real foundation stones of the Australian wine industry – through the growing of quality wine grapes to meet the varied specifications of winemakers and the preferences of consumers – are the nation's vineyards and wine grape growers.

The future success of the Australian wine industry is intrinsically bound up with the ability of Australia's wine grape growers to continue to innovate to supply grapes for Australia's 'value for money' wines cost competitively, and to maintain economic and environmental sustainability in an increasingly globalised and internationally competitive wine market.

"...we [the viticulturalists] have control of a lot of the flavour components, when you look at how we grow the grapes, expose them to the light, the leaf-plucking, the yield levels – all these things are really regulated in the vineyard right from pruning on." Prue Henschke (quote from an article titled, 'The grape and the good', by Susan Skelly in the The Bulletin, 10 October 2006).

Wine Grape Growers' Australia Inc. December 2006

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PART A: SUMMARY REPORT

1. *Project background*

A project under the Industry Partnerships Programme

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 IPP 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 a Taking Stock and Setting Directions project to address the serious difficulties being faced by growers due to the large oversupply of wine grapes in 2006 and the very low prices being received. In addition, IPP projects allow the industry take a comprehensive and longer term view of its performance and future prospects assessed against desirable outcomes.

The purpose of the Taking Stock and Setting Directions Project was to undertake an analysis of the industry's current performance and situation, identify likely challenges and opportunities, and to set strategies for its future profitability and sustainability.

The objectives of the project were to:

1. Undertake an analysis of the wine grape industry's current situation and performance.
2. Identify likely challenges and opportunities for the wine grape industry over the next 5 -10 years.
3. Determine the capacity of the wine grape industry to respond to current and future challenges and opportunities.
4. Identify key areas that the wine grape industry could build on to increase their profitability, sustainability, competitiveness, resilience and self-reliance (including a process to assist the wine grape industry to determine appropriate responses to these key areas).
5. Assist the wine grape industry to develop its own strategies on issues the industry has identified as high for priority.

Industry oversight of the project

The Australian Wine Grape Industry Partnerships Project engaged the consulting company, Kiri-ganai Research Pty Ltd to work with the industry and the Australian Government Department of Agriculture, Fisheries and Forestry to undertake the Taking Stock and Setting Directions project.

The resulting report has been built from the experience, knowledge and ideas of the industry's wine grape growers, industry organisations, service providers and government.

In this study, the team's analysts visited a variety of Geographical Indication (GI) regions in most states; talked to many wine grape growers, winemakers and industry service providers; considered the nature of the industry's value chain and markets;

and analysed industry data and information on its performance and contribution to the Australian economy.

Importantly, the project was oversighted by a Project Management Committee comprising representative and expert stakeholders. The members of the Committee included:

- 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.

2. A situational analysis of the wine grape growing industry

Attributes of wine grapes as an agricultural product

Wine grapes are a highly perishable agricultural 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 have meant that, traditionally, most wineries were located in relatively close proximity to the vineyards that supplied 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.

The growth of the Australian wine grape and wine industry

While Australia is now regarded as a New World producer that has come to prominence in world trade in wine during the 1990s, the grape and wine industry extends back to the first European settlement. Osmond and Anderson (1998) demonstrate five major 'boom' periods since 1850, with the recent growth of the industry as the fifth boom.

A major turning point in the industry's development was when table wine production exceeded that of fortified wine in the late 1960s. This led to rapid expansion in the number of vineyards and wineries in the 1970s. There was growth again in the 1980s after a period of depressed prices and incomes in the late 1970s. Australian consumption peaked in 1988 and there was a significant switch from bulk and cask wines to higher priced bottled wine.

The fifth boom came in the mid 1990s with the industry's establishment of Strategy 2025 which was based on an assessment of the strengths of the Australian wine industry and consumer trends in the world shifting to consumption of varietal wines associated with 'mediterranean' style meals, increased dining out and higher disposable incomes.

The Australian industry achieved a rapid expansion of wine exports and growth in the domestic wine market. This was associated with an unprecedented trebling of the national vineyard area between 1990 and 2004 and successive record levels of grape and wine production.

Similar changes were taking place in other New World wine producing countries, although not at the same rate of increase and absolute change. Most of the increases in New World production were in the same grape varieties (cabernet sauvignon, merlot and shiraz for red wines and chardonnay, sauvignon blanc and colombard for white wines). World wine production moved considerably ahead of consumption in 1998 and again in 2002.

The result of the recent expansion is that the Australian industry is much larger than at any time in its history and has prominence in global markets. Exports have exceeded domestic sales and have been concentrated in the UK and USA markets with most growth being for bulk and popular premium wines.

The current market downturn

The publication of *The Marketing Decade: setting the Australian wine marketing agenda 2000-2010* foresaw emerging problems with oversupply as world-wide plantings came on stream. The publication noted that over the decade there was no guarantee that all available fruit would be processed, but that it was important to understand the potential magnitude of the supply increase so that the implications could be examined and appropriate strategies implemented.

The oversupply occurred sooner than foreshadowed in the 'Marketing Decade', appearing to have commenced in 2000-01 when wine production exceeded sales and an 'economic' level of stocks leading to excess wine inventories. There were no industry-wide strategies in place to deal with this emerging situation.

Despite the high level of stocks, wineries' grape intake levels remained high, but in 2005 and 2006 as wine stocks grew further, they moved to reduce grape

purchases. This occurred via wineries either not renewing grape supply contracts or amending existing contracts, particularly through yield and production caps.

Growers were forced to discard unsold grapes and reported 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 declined since the early 2000s. For the 2006 vintage, contracted grapes were consistently below \$400 per tonne in warm climate regions. Prices were 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 was sold on the spot market. In 2006, very low prices of \$100 per tonne or less were received by growers in both warm and cooler climate areas.

With low prices prevailing in most regions and increases in the cost of production, the viability of many grape growing enterprises has been under severe pressure. Many specialist growers, without significant off-farm income, are now 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.

The drought and frosts are likely to significantly reduce grape production in 2007 and possibly in 2008. Depending on the extent of reduced production, initial indications are that wine inventories may be able to be brought back to economically sustainable levels in 2008-09 which is much earlier than the previous predictions of 2010-11.

At the time of writing this report, some large and mid-size wineries have stated that they will be looking to write new grape contracts to replace expected lost grape production in 2007 and 2008. If significant demand develops as a result of prospective lost production, there may be some upward movement in prices for growers with varieties in demand and more likelihood that available grapes will be harvested in 2007.

However even if an earlier than expected overall rebalancing of wine grape demand and supply eventuated, considerable change will be required in the Australian wine grape industry in adjusting to changes in the world wine market, a consolidating industry value chain, lower grape prices, slower growth in wine sales and rising costs of production.

3. Project findings and conclusions

In this report, analysis of the industry's situation and performance is set against an assessment framework (below) that allows a comprehensive and longer term view of the Australian wine grape industry. The immediate issues of the 2006 grape oversupply, low grape prices and grower viability are assessed against desired industry outcomes along with the longer term industry issues.

The desired outcomes for the Australian wine grape industry which now operates in a global wine industry are competitiveness, profitability, sustainability, resilience and self reliance.

Figure 1: Industry Partnership Programme (IPP) – industry assessment framework		
IPP Framework		Taking Stock and Setting Directions
Drivers	Resources	The industry's profile and performance is based on its physical, financial, human and social capital.
	External environment	Global and Australian attributes, events and trends that impact on the industry, but are outside its capacity to change.
	Enabling environment	Market, organisational and policy attributes that are within the influence of the industry or government to change.
Outcomes	<ul style="list-style-type: none"> ➤ Global competitiveness ➤ Profitability ➤ Sustainability ➤ Resilience ➤ Self-reliance 	Taking Stock and Setting Directions for the industry against competitiveness, sustainability, profitability, resilience and self-reliance outcomes.

- **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.
- **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.
- **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.
- **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.
- **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.

The following paragraphs summarise the key findings and conclusions of the project referenced to the desired industry outcomes.

Competitiveness

Australia has had spectacular success in exporting wines to the world in the past two decades with compound growth in the volume of its exports of 24% per annum. In 2004, Australia was ranked as the third largest exporter with over 10% of total world exports by value. While Australia exports wine to many countries, we rely heavily on the large UK and USA markets for wine sales.

Current trends in export sales show that there is now clear evidence that the export growth success of the past decade is losing momentum. The average price per litre 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 volume growth in recent times has been in bulk wine as winemakers sell off their surplus stocks at low prices.

Australia has dominated the 'popular premium' market segment. 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 are amenable to global sourcing from the lowest cost producers. Growers and winemakers perceive difficulties for wine made from Australian grapes in maintaining long term competitiveness in the bulk wine market segment in the face of competition from lower cost producers, particularly from South America.

There is little growth in the export market for premium, super premium and specialty wines which comprise around 20% of Australia's export sales, although Australia is already well represented in these market segments as a proportion of its share of world exports. These wines are seen by consumers as lifestyle goods and subject to discretionary expenditure. Much of the growth in vineyard 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 wine grape oversupply in the temperate and cool climate regions that grow grapes for premium, super premium and specialty wine styles.

Rapid changes in the world wine value chain are taking place. The world market is becoming increasingly integrated with consolidation at both wine maker and retail level. The high level of concentration in Australia's wine production has been a factor in our export success in that the large companies have the economic scale and resources to successfully compete in a consolidating world wine value chain. On the other hand, Australia's large number of small wineries export small volumes to a large number of countries and provide market diversity and flexibility in being able to innovate in meeting consumer preferences.

In the medium term, renewed growth in exports to the levels of growth experienced over the past decade will be difficult. The wine trade is presently taking place in an environment where world wine production is significantly higher than consumption, wine prices are under pressure from excess wine inventories and retailer discounting, and this is flowing through to lower grape prices.

Key issues for the industry in maintaining the industry's global competitiveness are:

- **Maintaining export success** through developing and implementing wine marketing strategies that result in sales in each of the wine market segments which will support profitable grape growing and winemaking sectors. This will require increased market and consumer research and the development of specific marketing strategies for each market segment within an overall industry marketing vision and plan.

- **Benchmarking** all sectors of the wine industry value chain, including grape growing enterprises, against international competitors and using this information in the ongoing quest to maintain and extend competitive advantages. Benchmarking for growers needs to consider cost structures of grape growing in relation to the wines produced from those grapes. It needs to be supported by developing the industry's extension capacity to ensure growers have the business skills to monitor and apply benchmarking results.
- Researching and adopting new grape growing **business models** for competing in consolidating value chains (ie, in winemaking, distribution and retailing) and for achieving enterprise profitability. This needs consider the effectiveness of present grape marketing and selling arrangements to fewer and larger winemakers. It should also include the possibility of dealing with intermediary or specialist winemakers that supply wine on specification to the large wine companies.

Profitability

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

Wine grape prices saw substantial increases during most of the 1990s, with the weighted average indicator price (based on prices in the warm inland irrigated regions) rising to \$1,400 per tonne for reds and around \$850 per tonne for whites. Average prices have declined significantly over the present decade.

Many growers consulted in this project reported current prices to be well below the cost of production. ABARE survey results for indicator regions (the Riverina and McLaren Vale) showed declining farm business profits in 2003-04 and 2004-05. The average rate of return on capital and management for the Riverina was 2.4% in 2004-05 and 3.2% in McLaren Vale. Since then, the average grape price fell by 12% in the Riverina and 16% in McLaren Vale.

At the beginning of this project, industry predictions were for an extended period of excess wine stocks and little prospect of recovery in wine grape prices in the medium term (even up to 2011). As noted above, the situation has changed dramatically for the coming 2007 vintage and possibly the 2008 vintage. However, even with demand and supply rebalancing in the short term, the world oversupply and international competition for wine market share will continue to put pressure on wine and grape prices.

In addition with a return to normal seasonal conditions, Australia's present vineyards have the capacity to produce in the order of 2 million tonnes of grapes which would again exceed likely demand for wine grapes. In such circumstances, it is unlikely that grape prices will return to the levels of the late 1990s, at least, during the remainder of the current decade.

Key issues for the industry in re-establishing profitability are:

- Establishing effective **industry strategic planning and information services** to assist wine grape demand and supply rebalancing, and grower decision making.
- Improving **mutual understanding of respective businesses in the value chain** including understanding of costs of production and wine grape and wine pricing. 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. 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.

- Achieving appropriate **economies of scale and cost reduction** in grape production and marketing. Economies of scale in wine grape production can be achieved through property consolidation, joint vineyard management arrangements, contracting vineyard operations over a number of properties, and greater outsourcing of functions. Growers may also need to explore the potential for collaborative marketing arrangements that are compatible with Trade Practices Act requirements.

Sustainability

Economic viability

The very high grape prices that prevailed in the late 1990s and early 2000s attracted a lot of investment and expansion of the national vineyard estate. Between 1993 and 2004 vineyard expansion was also partly facilitated by a taxation arrangement that allowed accelerated depreciation for grapevine establishment costs. A disproportionate amount of this investment was directed at the production of higher-cost temperate and cool climate fruit when compared to trends in world wine market demand.

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.

Australian Bureau of Statistics estimates that there are 8,350 Australian vineyards. Many of these are small-scale as a result of the previous high grape prices attracting many specialist growers to the industry. Approximately, 50% of vineyards in warm regions and 60% in cooler climate regions are less than 10 ha.

Significant economies of scale are available in wine grape production. ABARE has shown that the top performing vineyards in both McLaren Vale and the Riverina have a larger area under vines than the average of all vineyards in the respective regions. In McLaren Vale, the bearing area for top performing vineyards is 82% larger than the average and in the Riverina, it is 113% larger.

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. Small vineyard size presents difficulties in achieving economies of scale in production and marketing, and accessing capital for investing in vineyard upgrading and new technology.

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. The problem of small block size and associated fixed irrigation infrastructure in warm inland regions, as noted in the 1985 'Inquiry Into the Grape and Wine Industries', continues some twenty years later. Infrastructure and adjustment strategies will be required to overcome this problem.

A key factor in grower viability is the grape price that the winemaker can afford to pay at various wine price points. In order to pay \$450 per tonne, KPMG estimated that the winemaker needed to produce wine that retails at \$6.99 a bottle. To pay \$650 per tonne, the wine retail price needed to be \$7.99.

Economic viability is also influenced by the enterprise arrangements that exist in wine grape production. Many different models exist. These include specialist growers who sell all their grapes to wineries; wine companies that grow their own grapes and contract from other sources to meet requirements; and small growers who grow their own grapes for processing in their wineries or who contract winemaking.

Australia's wineries source a significant proportion of their grape intake from their own vineyards (21% in 2004-05). Many growers expressed concern about large wine companies divesting vineyards and winemaking facilities and sourcing more wine from contract winemakers and the bulk wine market. At this stage, only one major winery has publicly announced a company policy along these lines.

Australia's growers rely heavily on the large wine producers to buy the majority of their production. The top six wine producers crush 73% of the Australian wine grape intake.

Of Australia's 2,000 wineries, the majority (70%) crush less than 100 tonnes of grapes and these wineries provide diversity in the demand for grapes for small growers.

Anecdotal information suggests that some vineyards, mainly in cooler climate or peri-urban areas, are lifestyle ventures for high income or high net worth urban owners. A lot of these businesses are reported to be operating at a loss in the current market situation and being subsidised by other sources of income and capital.

Other specialist growers are relying on off-farm employment (self or spouse) to meet vineyard and living costs. This employment includes vineyard contracting for other growers.

Another group of growers operate their vineyards as a hobby or 'sea change' and frequently earn income from a cellar door, café, B&B accommodation or tourist attractions. Some 75% of winemakers have cellar doors and make an important contribution to Australia's wine and food tourism industry in regional areas.

The view of many growers consulted, supported by some studies, is that those who rely on wine grape income are experiencing serious financial difficulties and are unlikely to be economically viable at present price levels. This includes mid-size and large growers.

Natural resource management (NRM)

The sustainability of the Australian wine grape industry is also dependent on its natural resource management. The wine and grape growing sectors are active participants in environmental programs directed at maintaining a 'clean-green' reputation in world markets.

Climate variability is having a major impact on irrigation water availability and cost. The continuation of drought conditions across southern Australia is substantially reducing inflows to the major river systems and water authorities have already made significant reductions in water allocations (including high security water) for the 2006-07 season. This is increasing pressures on water prices.

Australian Bureau of Statistics data shows that water efficient drip and micro spray irrigation accounts for 76% of the total irrigated vineyard area. However, the data also shows some 36,000 hectares of vineyards (including table and dried fruit properties) are watered by overhead spray and furrow or flood irrigation. Upgrading this to more efficient irrigation methods is constrained by unsuitable or outdated irrigation infrastructure.

Climate change is predicted to have a major impact on Australian wine regions over the long term due to rising temperatures and reduced rainfall. This will change the varieties that will be grown in some regions.

Sustainability

The key issues for the industry in ensuring industry sustainability are:

- Planning for and undertaking major **structural adjustment** in the wine grape growing industry with appropriate support for growers. 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. Means of achieving appropriate economies of scale as highlighted above will need to be addressed in industry strategies.
- Establishing a culture of **continuous improvement and innovation** in wine grape production and marketing in order to meet the pace of change in world wine markets and value chains. This will need to be backed by market-driven R&D that focusses on market intelligence, trends in consumer wine preferences and purchasing, and grape varieties and attributes that will produce wines that meet consumer demand.
- Monitoring the impact of climate variability on irrigation **water availability and cost**. Irrigation infrastructure needs to be upgraded in some warm inland regions of New South Wales and Victoria with consequent changes to more efficient irrigation methods.
- Continuing to implement best practice **natural resource management** to strengthen the industry's environmental standing in the Australian community and export markets.
- Monitoring **climate change** and formulating response strategies that will provide guidance to future industry investment.

Resilience

The Australian wine and wine grape industry has a history of cycles of 'boom' and 'bust'. 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 significant change than in previous industry downturns. The Australian industry is now much larger, is much more reliant on 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 and resurgent Old World producers and consumer-driven markets where fashion, convenience and lifestyle influence consumption.

Demand/supply coordination in grape growing is 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.

With the consolidation that is occurring in Australia's largest wine companies and industry difficulties due to grape and wine over-supply, many in the industry consider that the previous high level of collaboration has deteriorated in recent times.

The exchange of information between growers and winemakers has traditionally been important for growers in making decisions for investing in their vineyards. There are indications that growers may have been over-reliant on winery information for decisions on new plantings and that a broader range of production and market information is needed to cover all aspects of the investment (including for its economic life).

The likelihood of a major reduction in grape production in 2007 and possibly 2008 due to seasonal conditions also highlights the need for accurate and up-to-date information for production forecasting and monitoring purposes. Concerns were expressed about the accuracy of coverage for ABS data on vineyards, grape production, and wine inventories, and that further work is required on price data to make it more useful for industry benchmarking and business planning.

Although detailed and wide ranging data is collected on the industry, there has been less analysis and dissemination of the available information to assist growers and winemakers in their business decision making. This is changing with improved information services from the Australian Wine and Brandy Corporation.

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.

Strategy 2025 released in 1996 included a strategy for the 'viable expansion of vineyards'. The Strategy called for an annual average planting rate of 1,500 hectares (45,000 ha) to achieve the sales target of \$4.5 billion. Actual growth overshot this target by 100% with an increase of almost 90,000 ha by 2005 for wine sales of \$5.5 billion.

Another 2025 strategy was to introduce risk management that identified and formulated contingencies for industry-wide risks. The grape growing sector presently does not have a national strategic plan or a risk management strategy. Strategies to manage the emerging demand/supply imbalance that were called for by 'The Marketing Decade' in 2000 did not eventuate. The complex interactions of the grape and wine production cycles, overlain by climate variability, need to be better understood.

The key issues for the industry in strengthening its resilience are:

- Strengthening **information collection, analysis and reporting** to support grower decision making, and for industry demand and supply forecasting and monitoring.
- Developing effective **planning and strategy setting processes** for the grape growing sector linked to sales targets and marketing strategies for wine.
- Ensuring ongoing investment in the industry's **human, capital and financial capacity**. The future competitiveness and prosperity of the industry will depend on adequate on-going investment in wine 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.
- Establishing and maintaining **collaborative relationships** through the wine industry value chain in order to successfully compete in a rapidly changing world wine market. Mutual respect and understanding of roles in the value chain is critical for industry resilience in future with high level collaboration

required between wine grape growers, winemakers, retailers and the wine industry as a whole with consumers.

Self reliance

Australia's wine grape 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.

Industry self reliance requires the development of Wine Grape Growers' Australia Inc. (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 resources necessary to make a real difference to the sustainability of the Australian wine grape growing sector.

There are a large number of organisations that represent growers and/or winemakers at the regional (GI) level and state levels. 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.

WGGA is presently funded largely by the major inland regions. In order for WGGA to be able to provide effective industry leadership, WGGA requires more financial and intellectual input from a wider range of regional organisations and wine grape 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.

Grape grower/winemaker relationship management is also 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 grower/wine maker relationships.

A code of conduct for relationships between growers and winemakers is being developed by Wine Grape Growers Australia and the Winemakers' Federation of Australia. Such a code requires maximum sign-up for it to be effective and it will have a positive effect on grower-winery relationships if it covers the majority of fruit harvested in Australia.

Potential exists for WGGA to build strategic alliances and collaborative partnerships in the value chain, with governments and with the national industry institutions. This may increase the resources available to WGGA to add value to its strategies and more effectively represent the wine grape growing sector.

WGGA needs to work to strengthen its relationships with the Australian Government, state governments and local government in industry policy development, planning and program delivery.

It is important that the industry maintains investment in its leadership capabilities and establishes succession plans for key decision making positions. This includes appropriate involvement of younger generations and women.

The key issues for the industry in developing self reliance are:

- Consolidating Wine Grape Growers Australia as a strong and effective **national organisation** of grape growers;
- Coordinating the **industry structure** at regional, state and national levels and resolving funding and resourcing constraints.
- Investing in the development of **industry leadership**; and
- Improving **policy development capacity** and strengthening relationships with government.

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

While the Australian wine grape industry, like many agricultural industries, faces many challenges and opportunities in future, there are strong indications that it will continue to be successful.

- Australia now has the vineyard area and capacity to meet further growth in wine sales;
- Australian wine grape growers are world leaders in vineyard management and viticultural practices; and
- The wine grape sector comprises a diversity of business types and sizes that can respond quickly and with innovation to the requirements of wine market segments domestically and overseas.

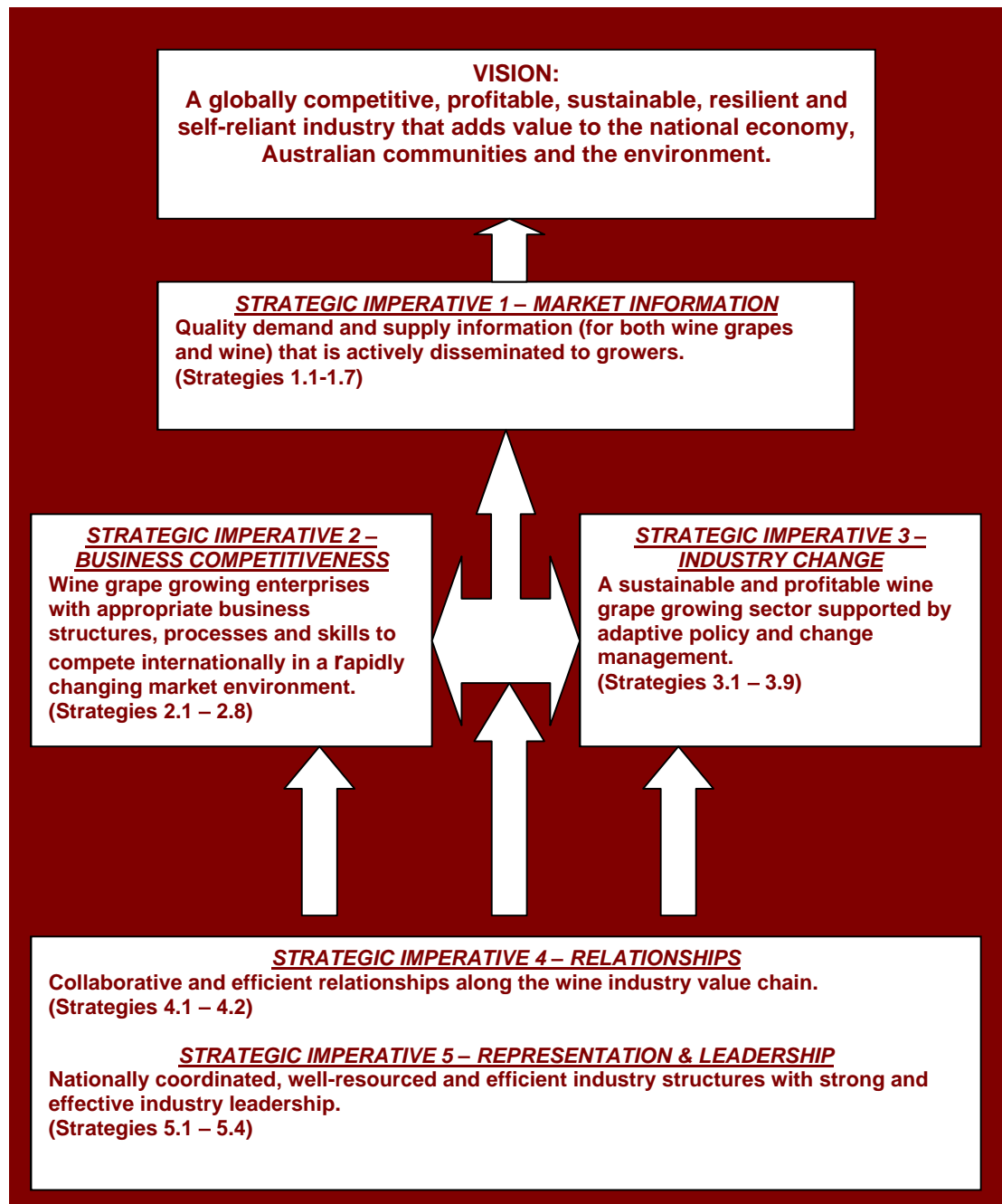
The Australian Wine Grape Industry Partnerships Project, Taking Stock and Setting Directions, has provided the opportunity for the industry to work with independent industry analysts and to identify the strategic imperatives, strategies and actions it must address now for a sustainable future.

This has been achieved through the processes of industry consultations, meetings of the Project Management Committee to reflect on and approve material produced by the consultants; and importantly, two industry workshops held in August and November 2006, in Melbourne and Adelaide respectively. These workshops allowed direct industry input and feedback on the findings, conclusions and recommended strategies and actions.

Strategic imperatives

This project has identified the following five strategic imperatives as those that must be addressed by the industry in future in order to achieve the industry's vision.

Figure 2: Strategic imperatives for the Australian winegrape industry



STRATEGIC IMPERATIVE 1: MARKET INFORMATION

Outcome:

Quality demand and supply information (for both wine grapes and wine) that is actively disseminated to growers.

Rationale:

Rapidly changing market and business conditions requires improvements in collecting and analysing data, and communicating industry trends to wine grape growers and other value chain participants. The current downturn in the industry has highlighted the need for ongoing monitoring and assessment of grape demand and supply at the national and regional levels and addressing mismatches through industry strategies.

The exchange of information between growers and winemakers has traditionally been important for growers in making decisions for investing in their vineyards. There are indications that growers may have been over-reliant on winery information for decisions on new plantings and that a broader range of production and market information is needed to cover all aspects of the investment (including for its economic life).

During the project, growers and winemakers identified a particular need to monitor investment trends in vineyards and plantings and to address issues of concern. In view of the rapid expansion of the national vineyard estate over the past decade, many in the industry pointed to the need to 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.

STRATEGIES

Information

- 1.1 Refining industry data collection and filling gaps relating to wine and grape demand and supply variables at both a national and regional level;
- 1.2 Upgrading industry information interpretation and dissemination to growers, other value chain sectors, government and the media.
- 1.3 Analysing and communication information about industry trends and characteristics of industry cycles.
- 1.4 Monitoring and reviewing new investment in vineyards to determine impact on the wine grape demand-supply balance.

Marketing

- 1.5 Highlighting the unique contribution of Australian grape growers to the wine industry and its global competitiveness.
- 1.6 Contributing wine grape sector information to industry marketing strategies through the Wine Directions Strategy, particularly those that build 'Brand Australia' and regional brands.

Strategic planning

- 1.7 Implementing ongoing and integrated industry strategic planning, performance monitoring and evaluation processes.

KEY ACTIONS

1. Identify gaps and refinements in data collections and pursue implementation through the AWBC Statistics and Knowledge Development Advisory Committees, and the Working Group on Industry Information.
2. Develop an information dissemination and communication strategy for growers and other value chain sectors.
3. Collaborate with the Wine Directions Strategy Task Force and the AWBC on wine marketing strategies.
4. Work with the AWBC, WFA, GWRDC and DAFF on the proposed market intelligence system.
5. Prepare a wine grape industry strategic plan.
6. Prepare a submission to the Horticulture Australia study of the impact of Managed Investment Schemes.

STRATEGIC IMPERATIVE 2: BUSINESS COMPETITIVENESS

Outcome:

Wine grape growing enterprises with appropriate business structures, processes and skills to compete internationally in a rapidly changing market environment.

Rationale:

The future profitability of Australian wine grape growing enterprises will rest on the capacity of its participants to apply new ways of doing business that meets the requirements of changing markets. During the project, wine grape growers and winemakers identified industry benchmarking, developing new forms of business models, investigating economies of scale and cost reduction strategies and ensuring responsive and market-driven R&D as key factors in improving business competitiveness.

STRATEGIES

Benchmarking

- 2.1 Reviewing requirements for new business skills development for wine grape growers and implementing skills development programs as required.
- 2.2 Implementing a system for benchmarking Australian viticulture to world's best practice in conjunction with related initiatives across the value chain.
- 2.3 Providing information and encouraging investment in upgrading Australian vineyards and technology in line with benchmarking results.

Grower business models

- 2.4 Researching profitable grower business models for grape production, marketing and supply that are based on global market trends.
- 2.5 Providing action learning, case studies and extension support for grower adoption of appropriate business models, utilising support under the Agriculture Advancing Australia package and other government programs.

Economies of scale and cost reduction

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

Research and development

- 2.7 Developing and implementing a WGGA policy on R&D and innovation that covers the whole value chain, entrenches a culture of continuous improvement, and facilitates ongoing adoption of R&D in response to market demand.
- 2.8 Establishing a wine grape grower priorities review group (PRG) to involve growers at all levels and regions in the development and communication of priorities for R&D.

KEY ACTIONS

1. WGGA to implement a three-stage project to:
 - (a) prepare a first-stage model (Ready Reckoner) that will provide indicative grape prices payable for a range of wine retail market segments or price points;
 - (b) prepare a second-stage model (a detailed financial modelling tool) to accommodate individual grower situations and regions;
 - (c) develop a training package and timetable to roll out to the industry that explains the financial modelling tool and provides advice and extension support for setting business objectives, business planning and succession planning.
2. Liaise with ABARE on improving vineyard financial performance assessments by establishing a system of indicator regions.
3. Develop a whole of value chain benchmarking framework, in association with WFA.
4. Research grower benchmarking and business models internationally and in other industries, and consult with growers on practical requirements at the enterprise level.
5. Develop a benchmarking system illustrated by case studies and action learning packages, and implement and associated communication and extension support for growers.
6. Address issues arising from vineyard managed investment schemes with Government and address industry concerns with MIS companies.
7. Prepare a WGGA policy on R&D and innovation that aligns R&D plans and investment to the vision and strategic imperatives of a wine grape industry strategic plan;
8. Establish a wine grape grower Priorities Review Group to determine and communicate wine grape R&D priorities;
9. Liaise with GWRDC on WGGA's R&D policy and priorities;
10. Identify and establish collaborative activities with other research funders on issues of common interest.

STRATEGIC IMPERATIVE 3: INDUSTRY CHANGE

Outcome:

A sustainable and profitable wine grape growing sector supported by adaptive policy and change management.

Rationale:

There is a high proportion of specialist wine grape growers in all regions that lack the economies of scale or wine grape markets needed for long-term viability at a lower level of grape prices. Small vineyard size presents difficulties in achieving economies of scale in production and marketing, and accessing capital for investing in vineyard upgrading and new technology.

The problem of small block size and associated fixed irrigation infrastructure in warm inland regions continues after many decades. Significant investment in infrastructure and adjustment strategies will be required to overcome this problem.

In addition, the planting boom of the last decade has seen overinvestment in the higher cost cool and temperate climate production zones targeting grapes for the premium, super premium and specialty market segments. The result has been that 40% of Australia's vineyards are in higher production cost zones but the market only requires 20% to 30% of plantings to support these higher price market segments. While efforts to grow the markets for higher priced wines may reduce the oversupply of high cost grapes, the extent of the overplanting in these zones represents a significant structural imbalance within the industry, and adjustment strategies will also be required to align supply and demand within the wine grape sector.

The view of many growers consulted during this project is that those who rely on wine grape income are experiencing serious financial difficulties and are unlikely to be economically viable at present price levels. This includes mid-size and large growers.

Planning for and undertaking major structural adjustment in the wine grape industry with appropriate support for growers will be required for future industry sustainability and profitability.

STRATEGIES

Change management

- 3.1 Investigating, developing and implementing industry driven strategies for long term structural change.
- 3.2 Supporting growers to fully comprehend and utilise existing Government assistance programs including Australian Government Drought Assistance, the Agriculture Advancing Australia package and other appropriate government support programs.

Human resource and infrastructure capacity

- 3.3 Monitoring human resource capacity in Australian viticulture and developing measures to attract people to the industry.
- 3.4 Collaborating with infrastructure funders and providers to ensure the provision of modern distribution infrastructure for delivery of grape supplies to wineries.

Water management

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

- 3.6 Collaborating with governments, water authorities and infrastructure companies on irrigation infrastructure investment.
- 3.7 Providing information and extension support for the application of best practice irrigation practices across the industry.

Natural resource management

- 3.8 Developing world's best practice natural resource management (NRM) standards for Australian viticulture and examining opportunities arising from Government natural resource management programs.
- 3.9 Researching potential impacts of climate change on wine grape production and regions, and developing climate change response strategies.

KEY ACTIONS

1. Implementation by WGGA of a three-stage project that:
 - (a) Reviews the access of wine grape growers to, and their use of, established Government programs including Australian Government Drought Assistance (including Exceptional Circumstances support), the Agriculture Advancing Australia (AAA) package (including Farm Management Deposits, FarmBis, Rural Financial Counselling Service, Farm Help) and broader Government policies on industry structural adjustment.
 - (b) Prepares a submission to the Minister for Agriculture, Fisheries and Forestry on the review in (a) above and the outcomes of the Taking Stock and Setting Directions Project.
2. Work with governments and industry organisations to develop policies and initiatives for increasing the availability and productivity of human resources in viticulture.
3. Liaise with governments, financial institutions and infrastructure companies on infrastructure upgrading and provision.
4. Prepare an industry water management strategy and liaise with Australian and state government water agencies on irrigation infrastructure requirements.
5. Establish a comprehensive information base on climate change and variability for wine grape growers.

STRATEGIC IMPERATIVE 4: RELATIONSHIPS

Outcome:

Collaborative and efficient relationships along the wine industry value chain.

Rationale:

Mutual respect and understanding of roles in the wine industry value chain is critical for industry resilience in future with high level collaboration required between wine grape growers, winemakers, retailers and the wine industry as a whole with consumers.

With the consolidation that is occurring in Australia's largest wine companies and industry difficulties due to grape and wine over-supply, many in the industry consider that the previous high level of collaboration has deteriorated in recent times.

Industry strategies need to include monitoring of value chain relationships to ensure the collaboration necessary to successfully compete in a rapidly changing world wine market.

STRATEGIES

- 4.1 Establishing networks with all sectors of the wine industry value chain that exchange information, cooperate and collaborate on competitiveness and profitability issues.
- 4.2 Developing relationships with national, state and local governments in order to promote the interests of the wine grape industry and the development of evidence-based policy relating to the industry.

KEY ACTIONS

1. On the basis of the value chain collaboration achieved through the Taking Stock and Setting Directions Project, the Wine Industry Relations Committee and Wine Directions, move to establish an Australian Wine Alliance whose charter would be whole of industry policy and strategies, and information exchange.
2. Implement the Australian Wine Industry Code of Conduct.
3. Establish and maintain ongoing liaison with major wine companies on grape sourcing arrangements and inform growers of key trends.
4. Establish ongoing issues forums involving key players across the value chain, to inform the ongoing development of industry strategies.
5. Provide ongoing evidence-based reports on industry performance and issues to governments.
6. Identify information and case studies that highlight industry successes and communicate these to the industry, media and other sectors of the economy, including the financial sector.

STRATEGIC IMPERATIVE 5: REPRESENTATION & LEADERSHIP

Outcome:

Nationally coordinated, well-resourced and efficient industry structures with strong and effective industry leadership.

Rationale:

Across all agricultural industries, representative organisations face increasing demand for industry services, policy development, and the establishment of close working relationships throughout the value chain.

Industry self reliance requires the development of Wine Grape Growers' Australia Inc. 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.

STRATEGIES

- 5.1 Building a national structure for wine grape grower representation that economically links regional and state efforts with the national level work of WGGA.
- 5.2 Addressing funding and resourcing issues at national, state and regional levels.
- 5.3 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 sector.
- 5.4 Providing leadership for the wine grape sector in managing ongoing industry adjustment and change.

KEY ACTIONS

1. Review the WGGA business plan in the light of this Taking Stock and Setting Directions project;
2. Clarify the linkages between industry organisations at regional, state and national level;
3. Review all available options for funding of wine grape grower organisations in consultation with the industry and governments.
4. Investigate the opportunities for project and partner funding and negotiate arrangements.
5. Identify key areas for leadership development (including succession planning), and implement leadership development programs as required.
6. Promote the involvement of younger people and women in industry organisations and leadership development initiatives.

PART B: SITUATIONAL ANALYSIS OF THE INDUSTRY'S RESOURCES, EXTERNAL ENVIRONMENT AND ENABLING ENVIRONMENT

CHAPTER 1. BACKGROUND TO THE AUSTRALIAN WINE GRAPE INDUSTRY

1.1 Origins and development of the Australian industry

Even though Australia is now regarded as a New World producer that has come to prominence in world trade in wine during the 1990s, the wine and grape industry has a long and interesting history. This background to the development of the industry is based on an account by Walsh (1979).

The industry's origins

The first grape vines were bought by Governor Phillip from Rio de Janeiro and the Cape of Good Hope in 1788. Three years later, there were three acres in the Governor's garden in Parramatta. The first private vine grower was Phillip Schaeffer who established a one acre vineyard at Rydalmere. These early grapes were for table fruit and initially grew successfully, but were soon affected by disease.

In 1800, two French prisoners of war were sent to Australia with instructions from Governor King to promote viticulture and wine making. Initial attempts with plantings in Parramatta at producing wine were largely unsuccessful again due to disease (anthracnose).

Gregory Blaxland was the pioneer experimentalist of the wine industry and trialled viticulture and wine making over a 25 year period to 1831. He was the first to export wine from Australia and to win an overseas award in 1822. James Busby was the first to promote the industry and teach viticulture. After a tour of France, Spain and Germany he planted 365 different varieties in the Hunter Valley in 1832, but left the industry for New Zealand in 1833.

Establishment of vineyards and problems in the 1800s

Viticultural activity in the Hunter Valley increased during the 1830s under growers such as Kelman, Wyndham, King, Jamison, Suttor, Carmichael and the Macarthurs. With new settlements around the Australian coast, vineyards were established in Western Australia, Victoria and South Australia. In 1829, Richmond Houghton and others planted vines in the Swan Valley. J.B. Hack and others planted the first vines in South Australia around Adelaide and William Ryrie established the first commercial vineyard in Victoria in 1838 at Yering Station near Lilydale.

The industry expanded rapidly during the 1840s and several of Australia's famous vineyards in New South Wales and South Australia had their origins in that decade. John Reynell established vineyards in Reynalla, George Anstey in Highercombe, and Christopher Rawson Penfold in Magill. Other plantings were made in Clarendon, the Clare Valley and German settlers pioneered the Barossa Valley where Johann Gramp planted the first vines at Jacob's Creek in 1847. Samuel Hoffman planted at Tanunda in 1848 and Samuel Smith planted Yalumba in 1849.

In the 1850s, Paul de Castella planted Yering in the Yarra Valley and in the 1860s, Hubert de Castella and Baron de Pury planted St Hubert's and Yeringberg. New areas were opened up in Victoria with Lindsay Brown planting the first vines in the Rutherglen district. Many other famous vineyards and industry leaders emerged during this period in Victoria and South Australia.

In the early years of the development of the industry, growth of the domestic market was limited by abstinence and temperance movements, although excessive drinking

was an issue. Access to export markets and recognition of Australian wine was also facing difficulties.

Until the 1850s, Australian wine was effectively shut out of the British market. Australian exports increased when the British Government abolished the preferential duty on Cape wines and Australians such as Patrick Auld set up firms in London to market the country's wines. Australia also participated in many large scale international exhibitions in the second half of the nineteenth century to stimulate trade and Australian wines won trophies. In 1889, St Hubert's won one of the fourteen Grand Prix awards for overseas wines at the Paris Exposition, although there was much suspicion, prejudice and discrimination against the 'colonial product'.

Phylloxera appeared in 1877 near Geelong and destroyed many vineyards during the last two decades of the nineteenth century. North American phylloxera resistant root stocks were introduced in this period.

Expansion in the 1900s

During the early years of the twentieth century many of the old-established firms spread their operations interstate. In 1912, McWilliams which was founded at Corowa expanded into the Murrumbidgee Irrigation Area (MIA) and was followed by Penfold and Seppelts. McWilliams also established in the Hunter Valley in the 1930s, again followed by Penfolds. Lindemanns established vineyards and wineries in Corowa and later Coonawarra in South Australia and Karadoc in Victoria.

There was a rapid expansion of the industry after the First World War with soldier settlements in the Murray Valley, MIA and the Hunter Valley. Yields were high in these areas, over-production resulted and grape prices collapsed. Many viticulturists could not compete and many of Victoria's famous vineyards of that period declined and were replaced by beef and dairy farms (eg, the Yarra Valley).

In 1929, orderly marketing for overseas sales was introduced with the establishment of the Wine Overseas Marketing Board and from 1936, the Australian Wine Board, financed by a levy on all grapes used for the production of wine, brandy and spirit for fortified wine. From 1925 to 1939, Australia supplied around 20% of Britain's wine imports.

The Second World War greatly affected the export trade and Australia's exports to Britain virtually ceased after 1941 due to a British embargo and lack of shipping space. After the war, exports resumed, but on a smaller scale. The Wine Board opened the Australian Wine Centre in Soho, London in 1960, but growth in exports was relatively small and slow until the 1990s.

The marketing of wine changed after the War from bulk sales in wholesale and retail outlets to bottles under companies' brands. This led to more competition amongst vignerons and improvements in quality. With greater European settlement and the prosperity of the 1950s, wine consumption in Australia increased. The discovery and appreciation of modern Australian table wines dates from the 1960s stimulated by the promotion activities of the Australian Wine Bureau and wine companies. Many wine articles, books and wine and food societies appeared in this period.

Transformation of the industry from the 1960s

Table wine production exceeded fortified wines for the first time in 1968-69 and per capital consumption increased from around five litres in the early 1960s to 14 litres

in the mid 1970s. During the 1960s, the production of pearl (perle) wines was established by Gramp and Sons of Orlando with cold and pressure controlled fermentation of wine. Barossa Pearl, a sweet sparkling wine, appealed to women consumers and had a major impact on the Australian market and eventually led to greater consumption of still table wines.

During the 1960s and 1970s, there was rapid growth in the number of vineyards and wineries in all states including Tasmania and a revival of viticulture in areas which had badly affected by phylloxera such as the Yarra Valley and Geelong. In the first half of the 1970s, the area of vineyards increased by 10% and the production of wine grapes by 20%. Depressed economic activity resulted in bleak assessments of the industry's future and concern about the impact of taxation and excise.

The industry's situation was summed up in an article in the Australian Quarterly (Shergold, September 1978) as follows:

“Within the present recessionary climate there exists an unfortunate conjunction of economic forces – increased supply costs, demand fluctuations, surplus production, price-discounting – which together with alterations to the tax structure have left the wine industry floundering in a sea of ifs and buts.”

The article considered that small growers and winemakers who sold to larger wineries were vulnerable and that the large wineries were protected from liquidity problems through take-overs from multi-national and local corporate giants.

1.2 The modern industry and rapid growth in the 1990s

As we now know, the industry revived and grew rapidly during the 1980s. However, as noted by Strategy 2025, there was minimal focus on developing new wines in the domestic market during the 1980s. It was suggested that the industry needed to be more innovative and to concentrate on expanding export markets as a reaction to weak domestic demand and unprofitable discounting practices in Australia during the late 1980s.

Domestic wine consumption peaked in 1988, but domestic sales of Australian wine continued to expand in value rather than volume reflecting a switch from cask or bulk wine consumption to higher-priced bottled wine. Imported wine sales were low (less than 5%) due to the variety, quality and value of Australian wine.

It was noted that significant opportunities existed for increasing domestic wine consumption as a result of population growth in prime wine consuming age groups, growth in the dining out market, increasing popularity of the Mediterranean diet, tourism growth and the quest for more individualised beverage experiences.

Strategy 2025 provided the vision and strategies for the rapid expansion of wine exports and growth in the domestic market over the second half of the 1990s. This was associated with an unprecedented expansion of the national vineyard area and the production of wine grapes.

The result of the expansion is that the Australian industry is much larger than at any time in its history and has prominence in global markets. Exports continue to grow in volume, although unit values of exports are declining. Overproduction of wine grapes and wine has been associated with the rapid growth and prices for grapes are rapidly declining with wine prices being subject to discounting. This situation is replicated in most wine producing and exporting countries.

Osmond and Anderson (1998) in analysing trends and cycles in the Australian wine industry from 1850 to 2000, considered the recent growth of the industry as the fifth boom. The five booms and their defining characteristics are:

1. Mid 1850s: growth in domestic demand from the gold rush period and the wealth that was created;
2. 1880s: growth in domestic and export demand with exports being dominated by generic bulk wine which was mainly dry red;
3. 1918-1930: large increase in plantings associated with an export boom after World War I and supported by a subsidy for exported wine;
4. 1960s: rapid growth in domestic demand with Australian consumption increasing three-fold;
5. 1995-2001: rapid growth in exports of table wines associated with an unprecedented expansion of vineyard areas in all regions, but particularly in cooler climate regions. A large number of small grape growers and winemakers were attracted to the industry due to record high prices and significant tax benefits for high income professionals.

1.3 Re-emergence of past problems

A report of the *Inquiry into the Grape and Wine Industries* (McKay, 1985) on a downturn in prices and incomes, noted that the economic situation of the wine grape industry had been made more difficult by large surpluses in the dried vine fruits sector. The Committee observed a range of problems which are apparent in the current downturn. These included:

- Small block sizes in all regions that mitigates against “a programme of orderly vineyard rehabilitation, redevelopment or replacement of unwanted varieties”;
- The rigidities of some irrigation areas with their structure of small blocks and associated fixed irrigation infrastructure resulting from ‘closer settlement schemes’;
- The low income situation of a significant number of grape growers, particularly in the Sunraysia and Riverland regions, who were unlikely to become economically viable and needed both adjustment and welfare assistance; and
- The lack of internal financial resources for many growers to put aside poorly performing areas of their vineyards and to redevelop these areas.

It is apparent that these problems which characterised this previous downturn have re-appeared in the present circumstances.

1.4 Emergence of new problems

The *Marketing Decade: Setting the Australian Wine Marketing Agenda 2000>>2010* (Winemakers’ Federation of Australia & Australian Wine and Brandy Corporation, 2000) while very optimistic for the future of the wine and grape sectors, foreshadowed likely oversupply problems.

The document stated that:

“Another important shift has taken place in the marketplace relating to the supply-demand balance equation. In recent years, demand for premium wines (especially red wines) has exceeded supply. Supply

is now rapidly catching up and as world wide plantings come on stream over the next five years, a surplus will emerge.”

It was also noted that:

“In the 1990s, a period of supply shortfall, all vineyard production was processed and sold mostly as branded wine. Over the next decade, there is no guarantee that all available fruit will be processed. Nevertheless, it is important to understand the potential magnitude of the supply increase so that implications can be adequately examined and appropriate strategies implemented.”

The marketing strategy predicted that wine production/ availability will increase from 765 ML to 1,152 ML between 2000 and 2010 on the assumption that vineyard yields would decline in response to demands for higher quality wine production. This did not eventuate and the prediction came to fruition for unfortified beverage wines by 2001-02 (gross total wine production, 1,220 ML).

The growth in wine production was driven by the rapid growth in Australia’s vineyard area. Strategy 2025 foreshadowed the need for an additional 45,000 hectares (ha) of new vineyards for a total bearing area of 105,000 ha, but the actual increase in the bearing area between 1996 and 2006 was 89,000 hectares (almost double what was foreshadowed).

Consultations: What we heard

“Funny, we’ve less than 200 years of winemaking history, but with the commoditisation line we’re taking, we’re losing what history we’ve got.” (Winemaker)

AUSTRALIAN WINE GRAPE INDUSTRY TAKING STOCK

INDUSTRY ASSESSMENT FRAMEWORK COMPONENT:

INDUSTRY RESOURCES

CHAPTER 2. AUSTRALIAN WINE GRAPE PRODUCTION AND MARKETS

The chapter covers the attributes of Australian wine grape production and marketing. It relates to the resources component of the industry assessment framework used in Taking Stock and Setting Directions projects.

Topics covered include:

- Australia' grape growing regions;
- The industry's natural resources – soils and topography, water availability and climate;
- Australia's wine grape growers – numbers, types of enterprises and trends;
- Features of the national vineyard estate and trends;
- Wine grape production – volumes, yields, varieties and trends;
- Wine grape markets – buyers of grapes by enterprise type, selling arrangements, intakes by wineries, wine production, wine sales and stocks;
- Wine grape and wine prices – relationship between grape and wine prices, production costs and trends; and

2.1 Australian wine regions

Wine grapes are grown in southern Australia in all states. The most northerly growing regions are Hastings River in New South Wales and the Granite Belt and South Burnett wine regions in Queensland.

Wine regions are officially described in a Geographical Indication (GI) system which is a legal description of an Australian wine zone, region or sub-region. The main purpose of the GI system is to protect the use of a regional name under international law, limiting its use to describe wines produced from wine grapes grown within that GI.

The use of Geographical Indications in Australia commenced in 1993 when the Australian Wine and Brandy Corporation Act (1980) was amended to comply with European Community Agreements on Trade in Wine and the Agreement on Trade-Related Aspects of Intellectual Property Rights. This resulted from Australia's increasing wine exports to EC countries during the late 1980s and early 1990s.

GI's are determined by a Committee of the Australian Wine and Brandy Corporation on submission from an authorised applicant, namely:

- a wine grape grower;
- a wine maker;
- an Association representing wine grape growers and/or winemakers; or
- a declared grape grower or wine maker organisation.

The criteria which the GIC must consider when making a determination include:

- history (general, grape growing and wine production);
- geology;

- climate;
- harvest dates;
- drainage;
- water availability;
- elevation; and
- traditional use of the area and name.

Australia's present wine regions by Geographical Indications Zones are as follows:

South Australia

- Barossa – Barossa Valley, Eden Valley;
- Far North – Southern Flinders Ranges;
- Fleurieu – Currency Creek, Kangaroo Island, Langhorne Creek, McLaren Vale, Southern Fleurieu;
- Limestone Coast – Coonawarra, Mount Benson, Padthaway, Wrattenbully;
- Lower Murray – Riverland;
- Mount Lofty Ranges – Adelaide Hills, Adelaide Plains, Clare Valley;
- The Peninsulas.

New South Wales

- Big Rivers – Murray Darling (NSW areas), Perricoota, Riverina, Swan Hill (NSW areas);
- Central Ranges – Cowra, Mudgee, Orange;
- Hunter Valley – Hunter;
- Northern Rivers – Hastings River;
- Northern Slopes;
- South Coast – Shoalhaven Coast, Southern Highlands;
- Southern New South Wales – Canberra District, Gundagai, Hilltops, Tumbarumba;
- Western Plains.

Victoria

- Central Victoria – Bendigo, Goulburn Valley, Heathcote, Strathbogie Ranges, Upper Goulburn;
- Gippsland;
- North East Victoria – Alpine Valleys, Beechworth, Glenrowan, Rutherglen;
- North West Victoria – Murray Darling, Swan Hill (Victorian areas);
- Port Phillip – Geelong, Macedon Ranges, Mornington Peninsula, Sunbury, Yarra Valley;
- Western Victoria – Grampians, Henty, Pyrenees.

Western Australia

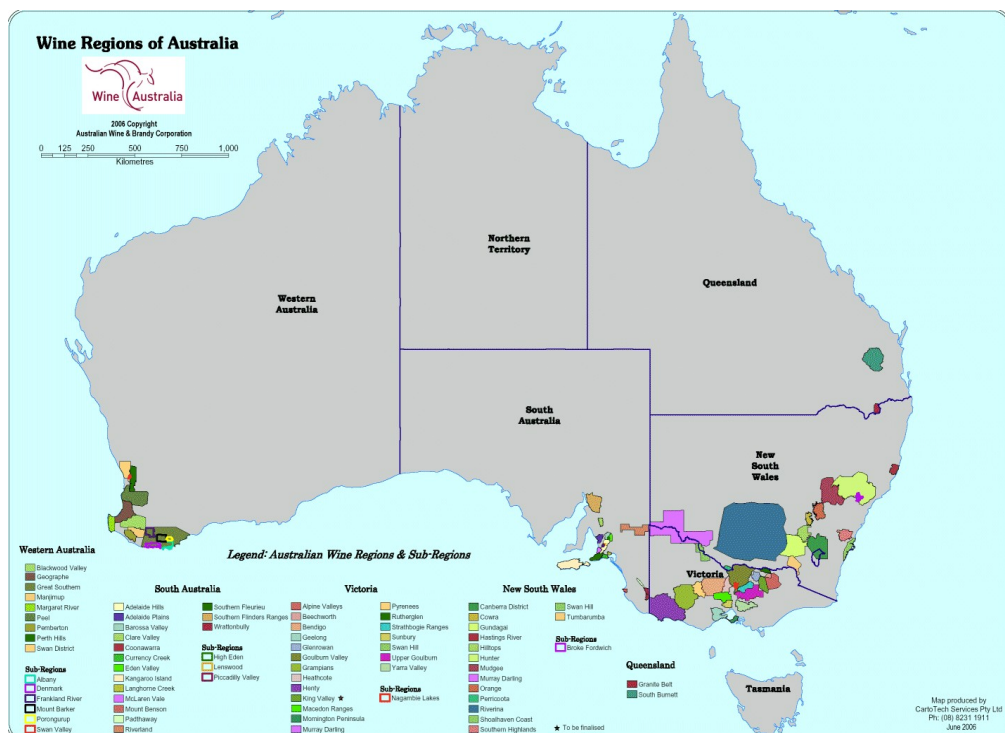
- Central Western Australia;
- Eastern Plains, Inland and North of Western Australia;
- Greater Perth – Peel, Perth Hills, Swan District;
- South West Australia – Blackwood Valley, Geographe, Great Southern, Manjimup, Margaret River, Pemberton;
- West Australian South East Coastal.

Queensland (no Zones)

- Granite Belt;
- South Burnett.

Tasmania (no Zones or Regions)

Figure 3: Australia's current wine regions, 2006.



Source: Australian Wine and Brandy Corporation, 2006

Warm inland and cool climate regions

Australia produces wine grapes in a diverse range of regions. General industry terminology has categorised Australian wine grape production into warm inland regions (comprising the Riverland (SA), Murray Darling (NSW and Victoria) and the Riverina (NSW), and cool climate (effectively the remaining regions). However, there is much dispute in the industry over this categorisation and a strong belief that it is too coarse.

An alternative suggestion put forward by Wine Grape Growers Australia is to describe three areas – warm (comprising the warm inland and riverland regions),

temperate (comprising the majority of other regions in South Australia, Victoria and New South Wales, Western Australia and Queensland), and cool climate comprising the most southerly or high altitude areas of South Australia, Victoria, New South Wales and Tasmania. A cool climate for wine grape growing is generally regarded as mean January temperature of less than 20 degrees Celsius.

Grapes from different regions, particularly temperate and warm regions) are increasingly being blended in wines traditionally made from grapes of warm climate regions. This has been encouraged by the very low prices being received on the spot market for grapes from temperate regions. It is likely that this will continue to be a feature (and some argue it is a 'virtue') of Australian wine production while grapes from temperate regions remain in oversupply.

2.2 Natural resources

The location of wine grape growing depends on the suitability of soils, typography, water availability and climate.

Soils and topography

Suitable soils for viticulture are those that provide a suitable root environment. These are well drained and aerated soils with good organic matter content, an adequate supply of nutrients, no physical barriers to root growth and a pH which is neither too acidic nor too alkaline. 'Ideal' soil comprises adequate topsoil depth (eg greater than 350mm) overlaying a well drained sub-soil with good water holding capacity through the profile. Very light (eg, sand), very heavy (eg, dense clays), waterlogged or deep fertile soils are generally unsuitable for grape growing due to either poor or over-vigorous growth.

While there are many areas in southern Australia with very suitable soils for grape growing, many of the soils of cooler climate areas are shallow, poorly drained or have acidic pH.

Water availability and irrigation

Water availability is critical to grape growing either through adequate rainfall during the growing season or through irrigation. In most grape growing areas of Australia, irrigation is necessary to supplement rainfall. The largest proportion of grapes are grown in Australia's main irrigation areas including the Lower Murray (Riverland), Big Rivers (Murray Darling - NSW, Perricoota, and Riverina and North West Victoria zones (Murray Darling – Victoria, and Swan Hill).

Australia's wine grape regions lie in areas that are experiencing protracted dry conditions. Most of southern Australia has experienced these conditions since late 1996, and eastern Australia has experienced them since 2002.

2006 has been a year of record low rainfall which has had a major impact on inflows to rivers and on soil moisture levels. Inflows to the River Murray in the past five years have been the lowest since records began in 1891 and have been extremely low in 2006.

Water allocations for irrigation are currently under extreme pressure in most areas. At the time of writing this report, high security allocations intended for permanent plantings including vineyards were approximately 50% of entitlements in the NSW Murray Valley, but remained at 95% in the Victorian Murray Valley. General security allocations for other irrigation remained at zero. For the Murrumbidgee, high security allocations had been reduced to 85% with general security allocations down to 18%. In South Australia, water allocations for irrigators have been reduced from 80% to 60% as the drought continues in the Murray-Darling Basin.

The major reductions in allocations have brought to prominence the issues of water availability, water prices and irrigation efficiency. These will become increasingly important for wine grape growing if dry conditions continue.

The ABS reports that there were 7,020 vineyards that irrigated a total area of 149,960 hectares in 2005. This was 84.1% of the total number of vineyards in Australia (8,347) and 90% of the total area of vineyards.

Consultations: What we heard
“WFA should be speaking out about the lack of balanced debate on water and the environment. Water will be the issue of the future.” (Winemaker)

Table 1: Irrigation of vineyards by States (1)

	NSW	Vic	SA	Other states	Australia
No. vineyards	1,589	2,478	2,987	1,293	8,347
Irrigated vineyards	1,361	2,068	2,615	976	7,020
Proportion (%)	85.7	83.5	87.5	75.5	84.1
Area of irrigated vineyards (ha)	36,005	35,215 ⁽²⁾	64,816	13,925	149,960
Water used (ML)	159,577	179,519	197,738	26,308	563,142
Usage ML/Ha	4.43	5.10	3.05	1.89	3.76
Usage ML/tonne	0.34	0.56	0.23	0.28	0.31

(1) Includes vineyards for drying and table grapes which use more water.

(2) As an example, approximately 13,000 ha are for table and drying grapes with some 23,000 ha for wine grapes.

Source: ABS Catalogue No. 1329.0 Australian wine and grape industry, 2005

Surface water from either state owned or private irrigation schemes was the most common source of water used by vineyards in Australia (83,757 hectares) drawing from this source. South Australia (29,035 hectares), New South Wales (26,123) and Victoria (25,156) collectively have 95.9% of the vineyard land sourcing water from state owned or private irrigation schemes. Nationally, the next most important water source for vineyards was underground water supply (31,694 hectares), followed by other surface water (26,945 hectares).

South Australia irrigated the largest area (64,816 hectares) accounting for 43.2% of the total, New South Wales (36,005 hectares) and Victoria (35,215 hectares) collectively had 47.5% of the area of grapevines irrigated nationally.

Australian vineyards used 563,142 megalitres (ML) of water with South Australia accounting for 35% of total water used, Victoria for 32%, New South Wales for 28%, and the other states for 5%. Victoria has the highest usage rate at 5.1ML/Ha or 0.56ML/tonne of grapes produced, followed by NSW at 4.43 and 0.34, South Australia at 3.05 ML/Ha and 0.23ML/tonne, with the other states at 1.89ML/Ha and

0.31ML/tonne. Part of the higher use in NSW and Victoria is due to a higher proportion of grapes for drying and the table, which use more water, being in the total grape mix.

The most common form of irrigation is the efficient drip or micro spray method with 113,858 hectares, or 76% of the total area irrigated this way. South Australia and the smaller states lead in using this method. The relatively inefficient methods of overhead spray and furrow or flood (surface) irrigation remain prominent in Victoria and New South Wales. Industry representatives have attributed this to outdated and poor irrigation infrastructure which prevents growers effectively using more efficient irrigation technology and management practices.

Table 2: Irrigation methods used by States

Irrigation method	NSW	Victoria	SA	Other	Australia
Drip or micro spray					
No. vineyards	885	1,026	1,949	924	4,784
Area	25,819	20,649	53,859	13,531	113,858
% state irrigated area	71.7	58.6	83.1	97.2	75.9
Spray					
No. vineyards	223	751	761	43	1,778
Area	3,150	10,395	9,814	316	23,674
% state irrigated area	8.7	29.5	15.1	2.3	15.8
Irrigation method	NSW	Victoria	SA	Other	Australia
Furrow or flood					
No. vineyards	371	543	150	10	1,074
Area	6,918	3,852	790	27	11,586
% state irrigated area	19.2	10.9	1.2	0.2	7.7
Other					
No. vineyards	6	13	23	8	50
Area	33	104	111	18	267
% state irrigated area	0.1	0.3	0.2	0.1	0.2

Source: ABS Catalogue No. 1329.0 Australian wine and grape industry, 2005

Climate

Climate is the primary determinant of the suitability of wine grape varieties and wine type. The most important aspects of climate are spring and summer temperatures, short term temperature variability, sunshine hours, rainfall, frost and hail incidence, and wind strength. These factors determine vineyard productivity and profitability, grape quality and wine type (fortified, table or sparkling). Some unfavourable climatic factors can be offset by vineyard management, but this increases production costs.

Grape growing generally occurs in the Mediterranean-type climates of southern Australia with predominant winter and spring rainfall, dry temperate to warm summers with mean average January temperatures at least above 17 degrees, low incidence of spring and autumn frosts, low hail frequency in summer and moderate winds.

Impact of drought and frost

As noted above, Australia has experienced frequent and severe drought in the first years of this new century. The 2003 wine grape harvest was reduced by around 195,000 tonnes due to drought. The current 2006 drought is one of the worst in living memory and it will significantly affect the 2007 harvest and possibly flow through to the 2008 harvest if secondary buds have been hampered.

In addition, very low soil moisture and the lack of cloud cover increased the risk of spring frost and this occurred in the south east of South Australia, in the central and northern regions of Victoria and in Tasmania. There were also pockets of frost damage in the Barossa Valley, McLaren Vale, Clare Valley and the Riverina.

Future impacts of climate change

CSIRO and the Australian Greenhouse Office have released likely impacts of climate change on Australian regions including those in which grapes are grown. It is predicted that most of Australia may warm 0.4 to 2.0 degrees Celsius by 2030 and 1.0 to 6.0 degrees by 2070.

Consequential impacts are considered to be:

- more evaporation, more hot days and fewer cold days;
- rainfall decreasing in the south and east (mainly in winter and spring);
- some inland and eastern coastal areas experiencing wetter summers;
- some inland areas becoming wetter in autumn;
- extreme rainfall and tropical cyclones becoming more intense and having impact over a more extensive area.

Smart (2006) notes that wine grape growing is one of the most climate-sensitive agricultural industries and as there is only a small average temperature difference between Australia's present wine regions, even small changes are important. He points out that the likelihood of very high temperature events is increasing and this can be very damaging to vines and their fruit.

Smart lists the key implications of climate change for the wine industry as:

- the loss of reputation for some regions that presently produce excellent varietal wines if they become warmer;

- the existing hot inland regions such as the Riverland, Sunraysia and Riverina may become too hot to produce commercially acceptable wines; and
- pest and disease patterns may change and worsen.

Leanne Webb has examined the impact of climate change in wine grape production in a PhD which is to be published in 2007. Webb's thesis examined:

- the potential impact of climate change on grapevine phenology;
- the impact of projected climate change scenarios on the yield and quality of grape production in each wine region;
- potential mitigation strategies;
- the availability of land and water resources to enable the implementation of proposed adaptive strategies.

Webb, et al (2006) concluded that climate change potentially poses a very serious threat to the Australian grape industry which they suggest already operates on the warm side of the climate range for wine grape species.

Table 3 shows possible changes in temperature, rainfall and the moisture balance (rainfall minus evaporation) in current grape growing areas.

Table 3: Possible climate change on Australian wine grape growing regions

	Now	2030	2070
South western Australia - indicative impacts (Perth)			
Annual av. max. temp.	23.3	24.3 +or- 0.7	26.3+or- 2.2
Dec – Feb above 35C	15	19+or-3	29+-10
Av. annual rainfall mm	869	800+or- 105	660+or- 310
An. moisture balance	-882		
Southern South Australia – indicative impacts (Adelaide)			
Annual av. max. temp.	21.4	22.4+or- 0.7	24.4+or- 2.2
Dec – Feb above 35C	10	13.5+or- 2.5	21+or-7
Av. annual rainfall mm	454	435+or- 35	400+or- 110
An. moisture balance	-1,407	- 1,470+or- 40	- 1,600+or- 125
Tasmania - indicative impacts (Launceston)			
Annual av. max. temp.	16.9	17.8+or- 0.6	19.5+or- 1.8
Jun–Aug days below 0C	21	14+or-4	7+or-7
Av. annual rainfall mm	684	684+or- 25	684+or- 80
An. moisture balance	-630	-675+or- 30	
Victoria – indicative impacts (Melbourne)			
Annual av. max. temp.	19.8	20.8+or- 0.7	22.8+or- 2.2
Dec – Feb above 35C	8	10.5+or- 1.5	15+or-5
Av. annual rainfall mm	657	630+or- 50	580+or- 155
An. moisture balance	-584	-665+or- 50	-825+or- 155
Eastern NSW – indicative impacts (Sydney)			
Annual av. max. temp.	22.1	23.3+or- 0.8	25.6+or- 2.5
Dec – Feb above 35C	2	3+or-1	7+or-4
Av. annual rainfall mm	1,102	1,070+or- 70	970+or- 265
An. moisture balance	-686	-765+or- 45	-930+or- 155

Source: CSIRO and Australian Greenhouse Office, Future climate change in Australia, 2001

Natural resource management

The Australian wine grape industry is an active participant in environmental programs directed at maintaining a 'clean-green' reputation in world markets. The industry operates an Australian Wine Industry Stewardship (AWIS) initiative which links export market environmental assurances with regional priorities identified by natural resource management (NRM) boards and catchment management

authorities. Due to these linkages, the perpetuity of regional NRM arrangements is crucial to the ongoing validity of the AWIS.

AWIS market research has found that wine export market priority issues are greenhouse gas and climate change, biodiversity, water, waste and 'green' procurement. A review of the 34 regional NRM plans relevant to wine grape growing regions across Australia has revealed regional actions and targets that address several of these priority issues.

From this, a short list of 11 questions has been identified to show whether a grape grower is making a contribution to these actions and targets. The questions are included as an insert in spray diaries, and the information is used to demonstrate environmental performance in the wine supply chain.

The spray diary insert was trialled by five wine companies and 468 growers in the 2005/2006 growing season. In recognition of the success of the trial and ongoing work in refining the process, adoption of Australian Wine Industry Stewardship for the 2006/2007 growing season has already exceeded 55% of Australia's national grape crush, with more companies expected to come on board.

The Winemakers' Federation of Australia has made use of 'Pathways to EMS' funding to develop the AWIS, and 'Sustainable Industries' funding to provide coordination of both AWIS and the industry Eco-Efficiency Agreement.

Funding from both sources will cease in 2007, and the industry has committed to resourcing the AWIS coordination role beyond this time. Regional presentations were held around Australia throughout July and August to provide opportunity for companies, especially Australia's 1,700 small and boutique operations, to obtain more information about AWIS.

2.3 The national vineyard estate

The Australian Bureau of Statistics (ABS, 2005) reported that there are 8,347 establishments with vineyards in Australia in 2005 with 36% in South Australia, 30% in Victoria, 19% in New South Wales and the remainder in the other states.

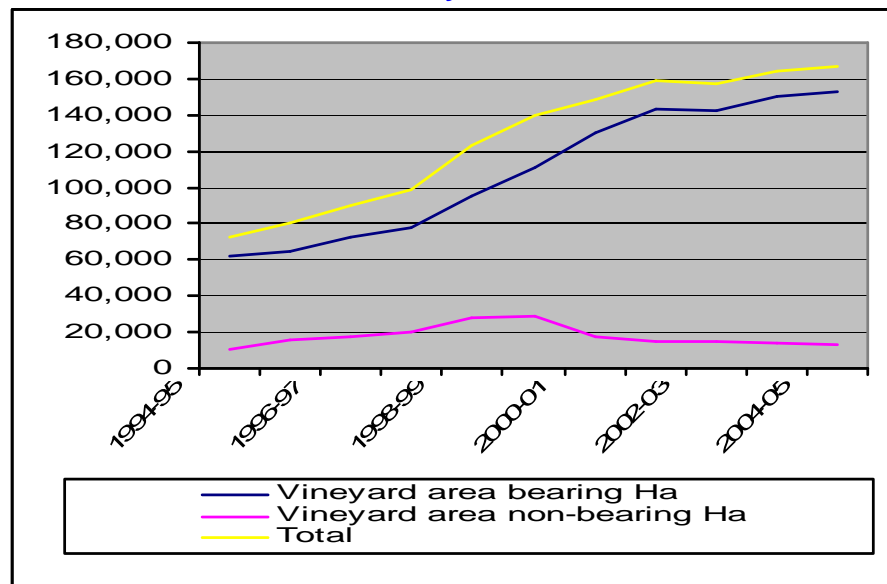
The national vineyard estate was estimated as 166,665 hectares in 2005 (includes drying and table grapes). The bearing area was 153,204 hectares, (a rise of 1.8% from the previous year) and the non-bearing area was 13,462 hectares. AWBC estimates the bearing area was 154,000 hectares for the 2006 harvest.

The growth in the national vineyard estate over the decade since 1996 has been unprecedented and has increased the vineyard area by 137%. The rapid growth in the late 1990s is attributed to the rapid growth in export sales, high grape prices, positive expectations on the part of wineries and vineyards about future growth and accelerated depreciation for new plantings. A disproportionate amount of the new investment in vineyards was directed at the production of higher-cost cooler climate fruit when compared with trends in the world wine market demand.

With declining grape prices and the difficulty of obtaining grape supply contracts or selling wine grapes, the growth rate in the vineyard estate has decreased substantially since 2001-02.

Consultations: What we heard
"We need a national register of vineyards to get a proper assessment of what is in the ground. That, and an accurate assessment of what is in stock and its age." (Wine-grape grower)

Figure 4: Growth in the national vineyard estate in hectares, 1995-2005



Source: ABS Catalogue No. 1329.0 Australian wine and grape industry, 2005

Vineyards by State

South Australia has the largest area and accounts for 43% of the total followed by New South Wales (23.6%), Victoria (23.3%), Western Australia (7.8%), Queensland (1.5%) and Tasmania (0.8%). Table 4 shows that for all states except Tasmania (77%), bearing vineyards represent 90% or more of the total state vineyard area.

Table 4: State vineyards, 2005

State	Bearing Ha	Total including not bearing Ha	Bearing/non bearing %	State vineyards as % of total
SA	66,979	71,413	94	42.8
NSW	35,777	39,278	91	23.6
Victoria	35,049	38,764	90	23.3
WA	11,747	12,971	91	7.8
Queensland	2,307	2,556	90	1.5
Tasmania	981	1,269	77	0.8
Australia	153,204	166,665	92	

Source: The Australian and New Zealand Wine Industry Directory, 2006 from ABS Catalogue No. 1329.0

Vineyards by variety

White grape varieties account for 41% of the national vineyard estate. Chardonnay is the predominant white variety accounting for 44% of the total area of whites. It is the second largest variety in area covering 18% of the national estate. White varieties which had significant increases in area in 2005 were Pinot Gris, Viognier, Muscat a Petit Grains Blanc, Sauvignon Blanc and Chardonnay. Doradillo, Trebbiano, Marsanne and Sultana had significant reductions in area.

Red grape varieties account for 59% of the national vineyard estate. Shiraz is the predominant red variety accounting for 41% of the total area of reds. It is the predominant variety in area covering 24% of the national estate. Varieties which showed significant increases in area in 2005 were Tempranillo and Durif, with a 3.4% increase in the area of Shiraz. There were significant declines in the area of Meunier, Nebbiolo, Barbera, Ruby Cabernet, Touriga, Malbec, Cabernet Franc, and Petit Verdot. Cabernet Sauvignon, which is the second largest red variety and third largest variety overall, declined in area by 2.4%.

Table 5: Vineyard areas by selected grape varieties, 2004 and 2005

White varieties	2004 ha	2005 ha	% change
Chardonnay	28,008	30,507	8.9
Sultana	8,570	7,286	-15.0
Semillon	6,278	6,282	0.1
Riesling	4,255	4,326	1.7
Sauvignon Blanc	3,425	4,152	21.2
Colombard	2,819	2,704	-4.1
Muscat Gordo Blanco	2,400	2,416	0.7
Verdelho	1,618	1,603	0.9
Viognier	683	927	35.7
Traminer	759	743	-2.1
Pinot Gris	329	708	115.2
Chenin Blanc	761	688	-9.6
Trebbiano	457	341	-25.4
Muscat a Petit Grains Blanc	190	231	21.6
Marsanne	230	193	-16.1
Muscadelle	159	167	5.0
Doradillo	168	123	-26.8
Others	4,782	5,235	9.5
Total white	65,891	68,323	4.2
Shiraz	39,182	40,508	3.4
Cabernet Sauvignon	29,313	28,621	-2.4
Merlot	10,804	10,816	0.1
Pinot Noir	4,424	4,231	-4.4
Grenache	2,292	2,097	-8.5
Ruby Cabernet	1,998	1,681	-15.9
Petit Verdot	1,623	1,439	-11.3
Mataro	1,040	963	-7.4
Cabernet Franc	742	633	-14.7
Sangiovese	511	488	-4.5
Malbec	504	440	-12.7
Durif	339	400	18.0
Tempranillo	257	312	21.4
Red varieties			
Muscat a Petit Grains Rouge/ Rose	308	298	-3.2
Tarrango	190	201	5.8
Barbera	199	163	-18.1
Meunier	158	126	-20.3
Nebbiolo	121	97	-19.8
Touriga	68	58	-14.7
Other	4,123	4,195	1.7
Total red	98,290	98,033	0.3

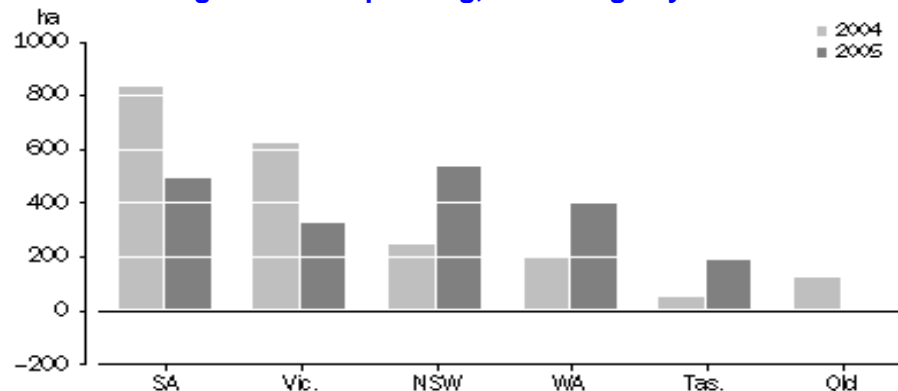
Source: The Australian and New Zealand Wine Industry Directory, 2006

Plantings and losses by State

ABS reports that in 2004-05 there was an increase in the planted area of 6,093 hectares (ABARE's estimate is slightly less at 5,912 hectares). The area lost due to vine grubbing is reported as 4,271 hectares. This gives a net increase in the area planted under vines of 1,823 hectares which is 10.0% less than the net increase recorded in 2003-04 (2,025 hectares).

For 2005, Figure 5 shows the largest net increase in New South Wales, followed by South Australia, Western Australia, Victoria and Tasmania.

Figure 5: Vine planting, net change by state



Source: ABS data available on request, Vineyards Survey, 2005

Source: ABS Catalogue No. 1329.0 – Australian Wine and Grape Industry, 2005

Plantings and losses by variety

In 2004-05, white grapes accounted for 61% of plantings with reds accounting for 39%. Chardonnay plantings were the largest, exceeding those of Shiraz, and the net change in Chardonnay accounted for 94% of the net change of 1,823 hectares overall. After Chardonnay and Shiraz, Sauvignon Blanc, Pinot Gris and Viognier showed the largest net increase. Cabernet Sauvignon showed the greatest loss dropping 512 hectares followed by Sultana with a net loss of 380 hectares.

Intended plantings for 2005-06, were 1,575 hectares for white varieties and 878 hectares for reds giving an overall level of intended plantings of 2,453 hectares. If these plantings are carried out and losses remain at the level of 2004-05, there will be a reduction in the size of the national vineyard estate. However in terms of future grape production, it is necessary to add the existing non-bearing areas, which for 2005, the ABS estimated at 13,462 hectares.

Table 6: Changes to total area during 2004-05, selected red and white varieties

White varieties	Planted Ha	Lost	Net change
Chardonnay	2,162	454	1,708
Sauvignon Blanc	472	73	399
Pinot Gris	228	67	161
Semillon	199	176	23
Riesling	125	107	17
Viognier	122	13	109
Muscat Gordo Blanco	84	105	-21
Sultana	59	439	-380
Other whites	267	501	232
Total whites	3,718	1,935	1,784
Red varieties	Planted Ha	Lost	Net change
Shiraz	1,523	481	1,041
Cabernet sauvignon	255	766	-512
Merlot	147	217	-70
Pinot Noir	115	149	-33
Grenache	48	85	-38
Mataro	24	60	-36
Durif	16	6	11
Petit Verdot	15	32	-17
Other reds	232	540	-318
Total reds	2,375	2,336	39
Total all grapes	6,093	4,271	1,823

Source: Source: ABS Catalogue No. 1329.0 – Australian Wine and Grape Industry, 2005

Wine grape grower businesses

Australian vineyards are operated under different business models including:

- Independent or specialist growers that sell grapes to wineries under contract and/or on the spot market. These vineyards are owned by long established family farm businesses, urban professionals who have purchased vineyards for a variety of reasons including lifestyle and tax minimisation, and investors in Managed Investment Schemes (MIS). The latter have a corporate structure that manages its vineyards on behalf of investors and sells wine under contract and/or the spot market. These businesses operate under Australian Tax Office product rulings and ASIC approval of their business prospectuses.
- Large wineries that grow their own grapes and contract other growers to meet the full portfolio of grape requirements. The largest 24 wine companies in Australia own or lease 20% of the national vineyard estate, and the largest six wine producers crush 73% of the Australian wine grape intake.
- Small and medium sized wineries that grow their own grapes for wine making either in their own wineries or by contract winemakers. In 2006, some 1,200 grape growers operated small wineries on-site and 490 contracted winemakers in off-site processing facilities. Of Australia's 2,000 wineries, the majority (70%) crush less than 100 tonnes of grapes.

As with specialist growers, these wineries may be owned by long established grape growing family businesses, professionals from other occupations seeking to invest surplus income or assets and MIS investors. They also include families seeking a

‘sea change’ by purchasing a small vineyard and establishing a cellar door, café, bed and breakfast accommodation or tourist attractions. Retired teachers have been prominent in this development.

Wine grapes are largely sold through supply contracts with winemakers, but with the over-supply of grapes and wineries preferring to reduce grape intakes due to high wine stocks, increased sales are taking place on the spot market at very low prices. There is little data available on the proportion of grape sales made through contracts and spot sales.

The high wine grape prices that prevailed in the late 1990s and early 2000s attracted a large number of specialist grape growers operating small vineyards. Table 7 shows that the majority of Australian vineyards in both warmer and cooler climate areas are less than 10 hectares:

Table 7: Proportion of vineyards by size, Australia 2005

Region	Less than 10 ha	10 – 24.9 ha	25 - 49.9 ha	50 ha and over
Cooler climate (% of growers)	60	22	10	8
Warmer climate (% of growers)	51	32	10	7

Source: Department of Agriculture, Fisheries and Forestry, 2006 based on unpublished Australian Bureau of Statistics data.

A key issue for the future profitability and sustainability of Australian vineyard businesses is the scale of operations and capacity to achieve economies of scale. Small scale vineyards have difficulty in meeting the cost of production and marketing pressures that a more competitive global market environment is placing on their grape growing businesses. They are limited by size in accessing sufficient capital to achieve the scale economies that corporate and some corporate and MIS vineyards are able to access.

Options to build scale, reduce costs and develop professional marketing strategies include:

- cooperative marketing structures to improve the bargaining position and marketing effectiveness;
- syndication of production from several farms under one management unit to achieve economies of scale and implement cost cutting strategies;
- property consolidation; and
- syndication of plant and equipment to reduce both fixed and variable costs of production.

The problem of small block size and associated fixed irrigation infrastructure in warm inland regions as noted in the 1985 ‘Inquiry Into the Grape and Wine Industries’ continues some twenty years later and represents long term market failure.

The future profitability of the Australian wine grape industry will depend on its capacity to adjust and adopt business models that build scale and professional marketing capability to successfully do business with consolidating wineries.

Impact of Managed Investment Schemes

The industry has expressed concern about the establishment of new vineyards by Managed Investment Schemes (MIS), particularly where grape buyers have not been established or where contracts are not specific about whether the grapes can be sold.

The number of product rulings issues by the Australian Taxation Office for viticulture and wine production since 1999 is as follows:

- 1999 – 26
- 2000 – 20
- 2001 – 17
- 2002 – 32
- 2003 – 9
- 2004 – 10
- 2005 – 20
- 2006 – 15

Not all of these rulings are for new schemes and not all projects commenced.

The specific projects covered by the 2006 rulings are:

- Palandri Winegrape Project 2005-2006;
- Heathcote Ridge Vineyard Project;
- Great Southern 2006 Wine Grape Income Project;
- Barossa Vines Project 2006;
- National Viticultural Fund of Australia Project No. 5;
- Gunns Plantations Winegrape Project 2005 (Supplementary release); and
- Adelaide Hills Premium Vineyard Project.

The impact of MISs on new vineyard areas is of growing significance in terms of the overall national vineyard estate. Vineyard MIS plantings are estimated to be in the order of 15,000 hectares or approximately 9.8% of the national vineyard estate (RIRDC May 2005). There are issues that must be addressed by the wine grape industry, MIS sector, wine producers and Government. The industry state that their concerns include the nature and promotion of the schemes, including the potential of plantings without genuine grape contracts to negatively effect the wine grape supply /demand balance; the level of vineyard development costs quoted, the consequent tax deduction levels available to MIS investors, and the perceived inequity in taxation treatment between schemes and established growers; and the impact of substitution by wineries of grape supply contracts with established growers, in favour of contracts with MIS vineyards.

The impact of MIS plantings on the industry is of particular concern to family owned vineyard enterprises in the Inland regions of the Riverland (SA), Murray Valley (Victoria and NSW), and Riverina (NSW), who perceive MIS vineyards as displacing them in the grape supply market, and adding to the overheating of wine grape supply through an emphasis on short term tax minimisation for investors, rather than generating sustainable income through the viable sale of wine grapes.

It is important for both the wine grape and wine industry and the schemes themselves that MISs provide unambiguous information on markets for the grapes that are produced and vineyard production costs. For example, The Heathcote Ridge Vineyard Project managed by Blaxland Vineyards clearly states that “the Heathcote Ridge property will be planted in 2006 (60%) and 2007 (40%) and the first commercial crop will not be until 2009. A 10 year contract has been secured from Orlando Wines.”

Some projects do not clearly demonstrate that actual sales contracts have been achieved and industry advice is that, in some cases, the claimed contracts will actually expire before the vines come into full commercial production.

While MISs have brought new investment into the wine grape growing industry, in future it will be important to ensure that all new investment in the industry contributes to future profitability and sustainability, and does not lead to distortion of wine grape supply through speculative planting.

It is noted that Horticulture Australia has commissioned a review of the impact of MISs on the Australian horticultural industry. This will focus on horticultural industries with significant levels of MIS involvement. Potential impacts on MISs that will be covered in the study include oversupply, competition for scarce resources, price impacts and changes in supply chains. The report will be completed by 28 February 2007 and will be presented at HAL's industry forum in May 2007.

2.4 Wine grape production

Production trends over the past decade

The decade 1995 to 2005 showed a rapid increase in production of wine grapes between 1997 and 2002, drought-affected production in 2003 and then an increase in production again in 2004 followed by levelling off in 2005 (and in 2006 – estimate). The rapid rise in grape production, particularly between 1997 and 2002, was a response to increasing wine sales (especially exports) and an increase in the bearing vineyard area.

Figure 6: Grape production and intended use, a 10-year perspective



Source: Australian Wine and Grape Industry (cat. no. 1329.0).

The Australian Bureau of Statistics' winery survey is accepted as the final estimate of total Australian production each year. The ABS crush estimate is consistently higher than the production estimate from its viticulture census and reported in its publications such as Catalogue No. 1329.0, Australian Wine and Grape Industry.

For example, the ABS crush estimate for 2004-05 is 1,925,500 tonnes as against the viticulture census number of 1,818,426 tonnes (6% higher).

The national estimate is based on estimates of wine grapes crushed by wineries processing at least 50 tonnes per year and for 2004-05, this is reported as 1,925,500 tonnes. ABARE makes adjustments to this estimate and suggests national wine grape production for 2004-05 is 1,937,000 tonnes.

This Taking Stock report uses the ABARE production number of 1.94 million tonnes as the best estimate of 2004-05 wine grape production. Overall production was up by 2.2% with red wine grape production down by 2.1%, but offset by an increase in white grape production by 13.2%. The production of multi-purpose grapes declined by 21.1%.

Table 8: Wine grape production, Australia

Variety	2000-01	2001-02	2002-03	2003-04	2004-05
Red	795	911	804	1,093	1,071
White	498	576	519	683	773
Multi-purpose	129	120	88	119	94
Total	1,422	1,606	1,411	1,895	1,937

Source: Australian wine grape production – projections to 2007-08, ABARE report 06.4

The 2006 vintage

ABARE's projection of the 2006 vintage is 1.921 million tonnes. This is calculated by their formula where production in 2005-06 was based on the 2004-05 bearing area plus the area of new plantings that were expected to reach commercial bearing in 2005-06 less the area grubbed in 2004-05 for 2005-06 multiplied by the expected yield.

The Australian Wine and Brandy Corporation (April, 2006) reported the national crush at 1.9 million tonnes. They saw measures taken by growers to reduce red yields and caps placed on contracts by wineries causing the red grape crush to drop 5% to 1.02 million tonnes (54% of the national crush), although the white grape crush increased by 4% to 0.88 million tonnes (46%).

The AWBC reported regional variations with the crush up by 20% in the NSW Riverina and down by 5% in the Murray Valley and down 10% in the SA Riverland. The increase in the Riverina was attributed to winery expansion and the reductions in the Murray Valley and Riverland due to low prices and tonnage caps. Many cooler climate areas such as Langhorne Creek, McLaren Vale and Mudgee reported a reduced crush of 5%, 8% and 10% respectively.

Increased areas of grapes unharvested or discarded

Actual vineyard production for 2006 was higher than total production measured through the wine grape crush by wineries. As noted above, with growers losing wine grape contracts and prices declining, many growers left vines unharvested or discarded harvested fruit in 2006.

This represented excess production that could not find a market. In addition, growers reported that large quantities of grapes were sold in the spot market for very low prices that were well below costs of production. These grapes could be considered as excess production, but there are no reliable estimates of the quantity of grapes sold in this way.

With regard to unharvested vines, ABARE (2006) estimated that this applied to 4,882 hectares in 2004-05. This represents 58,700 tonnes or 3% of total production

for that year. ABARE reported that a higher percentage of red grapes were not harvested, particularly in Western Australia (10%) and the Hunter Valley region (9%).

The South Australian Phylloxera and Grape Industry Board estimated 100,000 tonnes left in the vineyard in South Australia following its 2006 survey of growers. The Murray Valley wine grape growers' survey found 50,000 tonnes were left in the vineyard in that region. This is based on a sample survey of about 70% of growers in the region.

On the basis of these surveys and other reports, Wine Grape Growers Australia (WGGA) estimates that at least 200,000 tonnes were left unsold in 2006.

Major wine companies with large vineyard holdings also reported leaving large areas unharvested in 2006 because markets were not available to take the volume of production (Jamie Odell, Fosters Group speaking at the Romeo Bragato Conference, Queenstown, New Zealand, September 2006).

Projection for the 2007 vintage

ABARE originally forecast a slightly reduced vintage in 2007 at 1.902 million tonnes based on normal seasonal conditions. However, the record dry conditions across southern Australia for much of 2006 and the severe spring frosts in some areas in South Australia, Victoria, New South Wales and Tasmania will substantially reduce the 2007 harvest.

Stanford [2006 (b)] has suggested "a 2007 harvest of about 1.56 million tonnes compared with a potential 1.94 million tonnes in an average season." The impact of the drought and frosts will also flow through to 2008.

Winemakers consulted during this project reported that they expected to reduce their crush tonnage in future. They indicated that this would be achieved through reducing the level of grape contract renewals on expiry, incentives for growers to reduce yields through price adjustments and by not agreeing to take grapes beyond a certain level of tonnage.

The predicted reduction in production may result in some of these measures not been undertaken and early indications are that wineries are now concerned about contracting sufficient fruit in 2007 and 2008. In addition, it may result in growers not going ahead with plans for 'mothballing', 'grubbing' or abandoning vineyards during 2006.

Some of the 13,700 hectares of non-bearing area (2004-05) coming into commercial production for the 2007 harvest will partly offset the expected reduction in grape production. However, seasonal conditions as described above point to a significantly reduced crush in 2007 of the order suggested by the Australian Wine and Brandy Corporation.

Wine grape production by variety

The ABS vineyard census (see Table 9) indicates that Chardonnay dominates white wine grape production (47% of total whites and 21% of total wine grape production). Shiraz dominates red production accounting for 41% of total reds and 23% of total wine grape production.

Table 9: Wine grape production for wine, drying and table uses, 2005

White Variety	Tonnes	% of total white	Yield (tonnes/ha)
Chardonnay	378,253	46.8	14.8
Semillon	96,654	12.0	16.3
Colombard	77,501	9.6	30.0
Muscat Gordo	48,412	6.0	23.4
Blanco			
Riesling	41,219	5.1	10.3
Sauvignon Blanc	38,347	4.7	11.9
Sultana	35,041	4.3	24.0
Verdelho	18,612	2.3	12.1
Chenin Blanc	12,477	1.5	18.7
Traminer	9,133	1.1	13.7
Viognier	5,475	0.7	8.2
Trebbiano	5,400	0.7	16.0
Pinot Gris	2,824	0.3	8.8
Muscat a Petit	2,702	0.3	14.1
Grains Blanc			
Crouchen	2,276	0.3	21.5
Marsanne	1,826	0.2	10.0
Doradillo	1,596	0.2	13.1
Muscadelle	1,397	0.2	8.5
Other whites	29,298	3.6	
Red Variety	Tonnes	% of total red	Yield (tonnes/ha)
Shiraz	415,300	41.1	11.1
Cabernet	283,876	28.1	10.2
Sauvignon			
Merlot	132,517	13.1	12.8
Pinot Noir	36,873	3.7	9.3
Ruby Cabernet	33,559	3.3	20.3
Grenache	25,347	2.5	12.6
Petit Verdot	25,011	2.5	17.8
Mataro	9,955	1.0	12.1
(Mourvedre)			
Sangiovese	6,531	0.6	13.9
Durif	5,200	0.5	14.0
Cabernet Franc	5,071	0.5	8.2
Malbec	3,613	0.4	8.7
Tarrango	2,891	0.3	16.0
Tempranillo	2,033	0.2	8.3
Muscat a Petit	1,684	0.2	6.2
Grains			
Rouge/Rose			
Barbera	1,408	0.1	9.7
Zinfadel	1,183	0.1	13.1
Meunier	1,122	0.1	9.2
Other reds	16,809	1.7	

Source: The Australian and New Zealand Wine Industry Directory, 2006

Wine grape yields

Wine grape yields vary greatly depending on variety and climate. Australian yields, as shown by the ABS viticulture census, are increasing with the total grape yield rising from 11.8 tonnes per hectare in 2001 to 13.2 tonnes per hectare in 2005. This has been due to both improvements in production methods and the increasing proportion of white varieties in total wine grape production. White varieties are generally higher yielding than reds.

Drought affects total yields, as shown by the 2003 vintage, when it dropped by 14% to 10.5 tonnes per hectare. Yields for the 2007 vintage are likely to be significantly affected by the impact of frost damage, very low rainfall and water allocations and reduced fruitfulness from smaller bunch sizes. The impact of these factors could also affect yields in 2008.

On a state by state basis, yields generally reflect the warm/temperate/cool climate mix:

- Yields are highest in Victoria rising from 13.6 tonnes/ha in 2001 to 15.7 in 2005;
- NSW yields are the next highest rising from 11.2 to 14.2 tonnes/ha over the same period;
- South Australian yields followed the traditional biennial fluctuation with yields of 12.3, 11.5, 10.3, 13.6 and 12.9 tonnes/ha respectively from 2001 to 2005;
- WA, Queensland and Tasmania, which produce cooler climate grapes, had average yields over the period of 7.2, 5.2 and 6.2 tonnes/ha respectively.

Stanford [2006 (a)] has analysed wine grape yields from 1991 to 2006. He outlines factors that raise yields, but generally return to average or trend rates:

- favourable seasons and those that favour white varieties;
- growers maintaining revenue per hectare; and
- younger vines being in the mix.

Factors which may hold yields at higher than trend levels include:

- younger vines being in the mix through high levels of plantings;
- precision vineyard management; and
- more whites being in the mix.

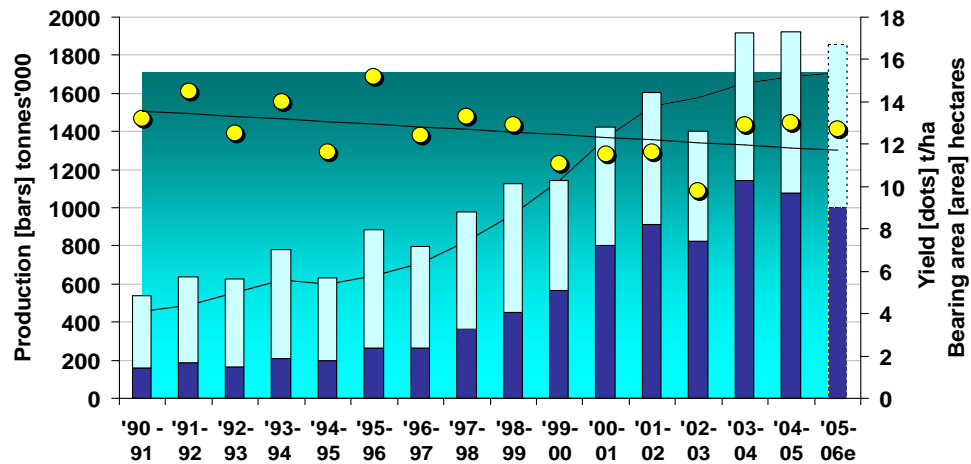
Factors that reduce harvested yields are:

- yield caps in contracts;
- grapes left on the vines or dropped.

However within this mix of factors, as shown in Figure 7 below, Stanford found that to 1997 yields followed the normal biennial fluctuation above and below trend. In 1998 and 1999 yields were above trend for both years, followed by four years below trend (2000-2003), and then rose above trend for the next three years (2004-2006). Stanford [2006 (b)] suggests a scenario of a 20% yield reduction in 2007 due to seasonal conditions as discussed above.

Figure 7: Australian wine grape yields, 1990-91 to 2005-06

Another big harvest in 2006, but not as big...



Source: Stanford, Australian Wine and Brandy Corporation, 2006

Wine grape production by Australian Geographic Indications (Zones), 2005

Table 10 categorises wine grape production in the warm, temperate and cool climate areas by GI Zones based on the ABS viticulture census. While the categorisation is comparative, there are some anomalies with some cool climate regions such as the Alpine Valleys in North East Victoria being categorised as temperate with the other regions (Beechworth, Glenrowan, Rutherglen). This categorisation shows that warm climate regions account for 64% of wine grapes produced, temperate regions for 27% and cool climate for 9%.

The GI Zones that produce the greatest proportion of grapes are warm climate: Lower Murray in South Australia (26%), Big Rivers in New South Wales (20%) and North West Victoria (17%). The main temperate producing areas are Fleurieu with 7% of total production, Barossa with 5.3%, Limestone Coast with 5.8% and South West Australia with 3.7%. The Central Ranges of NSW and the Mount Lofty Ranges are the main cool climate areas with 3.4% and 3.3% of production respectively.

Table 10: Production of wine grape production by GI Zones, 2005

GI zone	Warm	Temperate	Cool	% of wine grape production
Mount Lofty Range			59,927	3.3
Barossa		97,249		5.3
Fleurieu		127,269		7.0
Limestone Coast		103,124		5.8
Lower Murray	466,556			25.7
The Peninsulas		188		Neg.
Far North	1,725			0.1
Big Rivers	366,760			20.2
Western Plains	5,534			0.3
Central Ranges			61,977	3.4
Southern NSW			15,116	0.8
South Coast		893		Neg.
Northern Slopes		1,804		0.1
Northern Rivers	218			Neg.
Hunter Valley		23,672		1.3
North West Victoria	306,755			16.9
North East Victoria		30,701		1.9
Central Victoria		25,096		1.4
Western Victoria		7,174		0.4
Port Phillip			22,619	1.2
Gippsland		618		Neg.
Greater Perth	12,016			0.7
Central WA	437			Neg.
S.W. Australia		67,208		3.7
WA S.E. Coastal		226		Neg.
Eastern Plains, WA	62			Neg.
Queensland		6,689		0.4
Tasmania			6,136	0.3
% of total production	63.8	27.1	9.1	100.0

Source: ABS Catalogue No. 1329.0 Australian wine and grape industry, 2005

There is a structural imbalance in Australia's grape supply from warm and temperate climate areas in relation to the traditional markets. As shown in Table 10, temperate and cool climate grapes comprise 36% of total supply, but are generally grown for premium, super premium and specialty wines which only comprise 21% of Australian wine sales. The mismatch is, therefore, between grape supply growth (largely premium fruit) and wine demand growth (sub-premium price points – ie, bulk and popular premium wines).

As a result of the mismatch in grape supply and wine demand, uncontracted temperate or cool climate grapes, produced at a higher cost per tonne than warm climate grapes, was sold on the spot market at low prices and used in popular premium and clean-skin wines. Growers in warm climate regions see this development as a factor in their declining grape prices.

2.5 Wine grape markets

Wine grapes are not traded in world markets because they 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 wine maker

specifications. These requirements mean that wineries are located in relatively close proximity to the vineyards that supply their grapes. This relationship is changing as refrigerated transport allows fresh wine grapes and 'must' (crushed grape juice, skins and seeds) to be moved over long distances for processing. The low grape prices prevailing in some temperate or cool climate regions has facilitated the movement of these grapes to processing facilities located in warm climate regions.

Australia's wineries are the buyers of wine grapes. The 2006 edition of The Australian and New Zealand Wine Industry Directory lists 2,008 wine producers. This is a doubling of the number since 1998. The Directory reports that there was a net gain of 109 producers in 2005 with Western Australia showing the largest increase at 10.6%. Victoria has the largest number of wineries with 583 followed by South Australia with 502. However, South Australia has the greatest number of large wineries with 50% of the wineries that crush more than 5,000 tonnes.

The Directory reports that in 2006, 1,997 claimed to be making table wines, 574 are making fortified wine, 570 are making sparkling wine and 74 making organic wines. There are 1,119 wineries making wine on-site and 489 which use contract winemakers.

The importance of wine and food tourism to the Australian wine industry and, hence, grape growers is illustrated by 75% of wine producers having a cellar door. Queensland has the highest percentage with 91% of wineries having a cellar door and South Australia has the lowest percentage at 59%.

Australia's wine grape growers rely heavily on the large wine producers to buy the majority of their production. The top six wine producers crush 73% of the Australian wine intake. These are Fosters Wine Estates (includes Southcorp and Beringer Blass Wine Estates), Hardy Wine Company, McGuigan Simeon Wines, Pernot Ricard (formally Orlando Wyndham Group), Casella Wines and De Bortoli Wines.

Table 11: Wine grape intakes (tonnes) by Australia's largest wine companies, 2004-05

Foster's Wine Estates	410,327
Hardy Wine Company	363,550
McGuigan Simeon Wines	250,000
Pernot Ricard	156,216
Casella Wines	126,209
De Bortoli Wines	95,200
Evans & Tate	50,537
McWilliam's Wines	42,000
Kingston Estate Wines	34,000
The Yalumba Wine Company	34,000
Warburn Estate (Riverina Estate)	32,280
Wingara Wine Group	22,000
Andrew Pearce Wines	21,129
Peter Lehmann Wines	21,079
Tandou Wines	20,990
Angoves	19,119
Zilzie Wines	17,442
Brown Brothers Milawa	15,161

Source: The Australian and New Zealand Wine Industry Directory, 2006

At the other end of the scale, the majority (70%) of wine producers crush less than 100 tonnes of grapes, but they provide an important market, particularly for small grape growers. Victoria (77%), Queensland (96%) and Tasmania (95%) have the greatest proportions of small wine producers crushing less than 100 tonnes.

Table 12: Number of wine producers by tonnes crushed, by state

Tonnes	NSW	Vic	Qld	SA	WA	Tas	Total
Less than 10	56	96	24	43	28	30	277
10-99	236	352	63	82	183	36	952
100-499	77	84	14	120	66	7	368
500-999	16	13	1	29	13	2	74
1,000-4,999	19	23	2	33	17	2	96
5,000-9,999	5	5	0	16	2	0	28
10,000+	13	9	0	18	1	0	41

Source: The Australian and New Zealand Wine Industry Directory, 2006

Wineries source a significant proportion of the intake from their own vineyards. In 2004-05, this comprised 21% of their total intake. This proportion has been relatively stable over the period from 1996-97 to 2004-05 in moving between 20% and 26% of their intake. As expected, the intake is higher for premium varieties, lower for non-premium varieties and very low for multi-purpose varieties. However since the mid-1990s, it is evident that wineries have sourced more premium whites and reds from other vineyards, but have increased their supply of minor varieties from their own vineyards.

Table 13: Wine grapes sourced from winery owned vineyards as a proportion of the total crush (%)

Variety	2000-01	2001-02	2002-03	2003-04	2004-05
Premium white	30	23	23	26	22
Non-premium white	25	21	16	20	23
Premium red	27	21	21	25	22
Non-premium red	14	11	11	15	18
Multi-purpose	2	1	4	3	1
Minor	32	26	25	26	33
Total	26	20	20	24	21

Source: Australian wine grape production – projections to 2007-08, ABARE report 06.4

For the 2005 vintage, there were wine making facilities at 413 locations around Australia which crushed 50 tonnes or more. These facilities were owned by 366 winemaking businesses. In comparison, for the 2004 vintage there were winemaking facilities in 410 locations owned by 364 winemaking businesses.

These facilities provide opportunities for grape sales in all regions. Almost 30% of all locations were in South Australia and they accounted for 47% of the national wine grape crush, a small drop from the 48% recorded in 2003-04. New South Wales/Australian Capital Territory (NSW/ACT) had 22.8% of the total number of locations with 33.5% of the total wine crush, followed by Victoria (23.5% of all

locations and 14.8% of all grapes crushed) and Western Australia (18.9% of locations and 4.0% of the grape crush).

Wine grape intakes by wineries

ABARE has reported on expected and preferred intakes of wine grapes by wineries to 2007-08. Expected intakes are those that are planned by wineries and preferred intakes are the quantities wineries would prefer to take if the supply of grapes was not affected by seasonal conditions or contractual commitments.

ABARE's estimates are based on a survey of wineries under the National Wine Grape Utilisation Project. The data represents winery assessments of domestic and export demand; wine grape supply, prices and contractual arrangements; and capacity to process, store and market the output.

As stated in previous sections, the national wine grape crush is estimated as 1.921 million tonnes which is just 1.7% below the expected intake of 1.954 million tonnes. For 2006-07 and 2007-08, wineries expected intakes are 2.007 and 2.038 million tonnes respectively. If this occurred, it would be an increase of 4% over the 2005-06 crush.

The data shows a 6% increase in expected intake over the same period for premium white grapes (as defined by ABARE) and a 3% increase for premium reds. The expected intake for non-premium whites and reds is 2% above the 2005-06 crush.

Wineries preferred intakes as a percentage of expected intakes or actual intakes are shown in Table 14. This shows that the gap between preferred and expected intake reduces between 2004-05 and 2006-2007 and then the preferred intake exceeds expected intake in 2007-08. By variety, preferred intakes were higher than expected intakes for Shiraz, Merlot, Semillon and Riesling.

Table 14: Wineries preferred and expected intakes

Year		Expected intake	Preferred intake	% expected
2004-05	(actual intake)	1,937	1,711	88
2005-06		1,954	1,851	95
2006-07		2,007	1,938	97
2007-08		2,038	2,062	101

Source: Australian wine grape production – projections to 2007-08, ABARE report 06.4

ABARE also provided comparisons between preferred intakes and estimated production by warmer and cooler climate regions. This showed that wineries' preferred intake was generally lower than estimated production in cooler climate regions and higher than estimated production in warmer regions.

Overall, wineries maintained a high level of grape intake during the initial period of excess stocks and have reported that this was due to contractual commitments and expectations of wine sales. It has also been influenced by the very low grape prices on the spot market. However, the high grape intake levels have changed as excess wine stocks have grown. The data shows preferred intakes being less than expected in 2004-05, 2005-06 and 2006-07.

As noted previously in this report, winemakers took action in 2006 to reduce wine production levels through reducing the level of grape contract renewals on expiry, by providing incentives for growers to reduce yields through price adjustments, by limiting grape purchases from some growers to a certain level of tonnage and by suspending contracts in some instances.

Wine production, sales and inventories

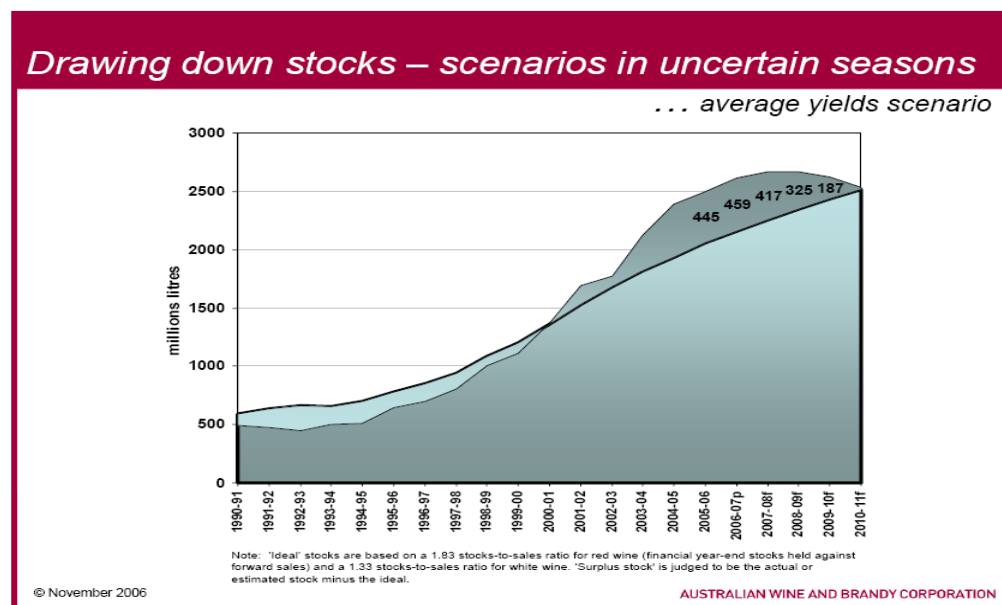
The crush levels over the past three years of around 1.9 million tonnes have produced 1.4 billion litres of wine. However, sales of wine (domestic plus export) for the 2004-2006 (financial years) have been between 1.0 and 1.2 billion litres. With production exceeding sales, wine stocks have risen and exceeded an 'ideal' ratio (stock-to-sales) in 2000-01.

Australian Bureau of Statistics (ABS) estimates of wine inventories for 2004-05 show an increase of 11.3% to a record high of 2,063 ML. However, the Australian Wine and Brandy Corporation (AWBC) believes that the ABS estimates understate the level of inventory held by wineries by 25-30%.

For most of 2006, the AWBC forecast that excess stocks will increase until 2008, before declining to the 'ideal' ratio in 2011. However in an updated analysis [Stanford, 2006 (b)] compared three scenarios based on a level of stocks excess to the ideal¹ of 460 million litres at the end of 2005-06. The first scenario of normal yields and an orderly draw-down of excess stocks could result in an 'ideal' ratio by 2011. The second scenario of a 20% reduction in yields in 2007 could result in the ideal being achieved in 2010. The third scenario of an additional low yielding season in 2008 could result in a draw-down of stocks to desirable levels by 2008-09. The first and third scenarios are shown in Figure 6.

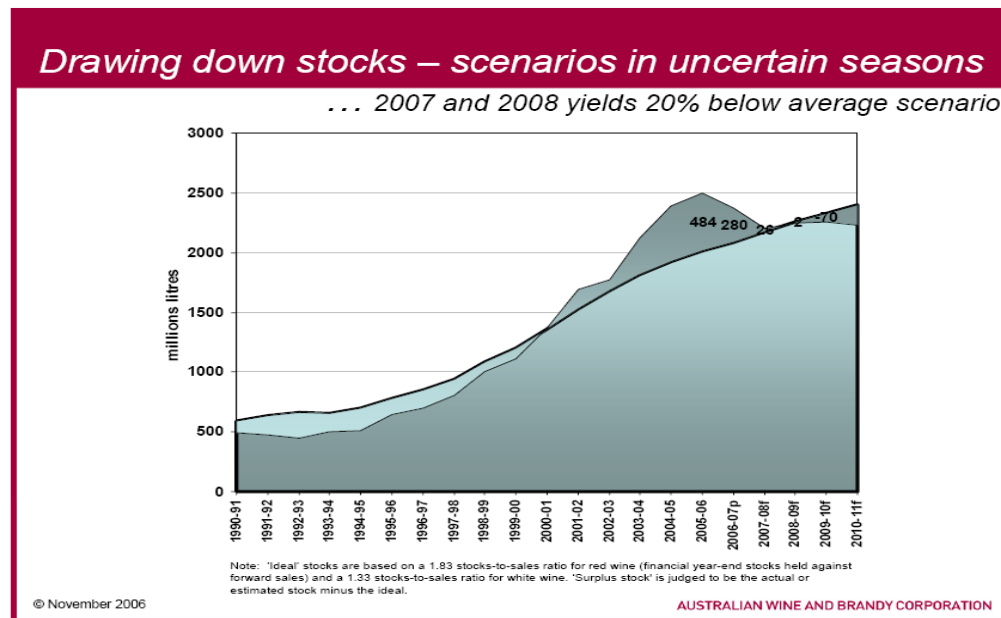
However as noted by Stanford, the current vineyard area has the capacity to meet projected demand over the next five years. As such, an early return to a normal yielding vintage in 2009 would again present supply problems without a better than expected increase in wine sales.

Figure 8: Wine production, sales and stocks, 1990-91 to 2009-10 (Average yield scenario)



¹ Ideal stocks are based on a 1.83 stocks-to-sales ratio for red wine (financial year-end stocks held against forward sales) and a 1.33 stocks-to-sales ratio for white wine. Surplus stock is judged to be the actual or estimated stock minus the ideal. [Stanford, 2006 (b)].

Figure 9: Wine production, sales and stocks, 1990-91 to 2009-10 (20% below ave yield scenario)



Source: Stanford, L., Australian Wine and Brandy Corporation, 2006

2.6 Wine grape and wine prices

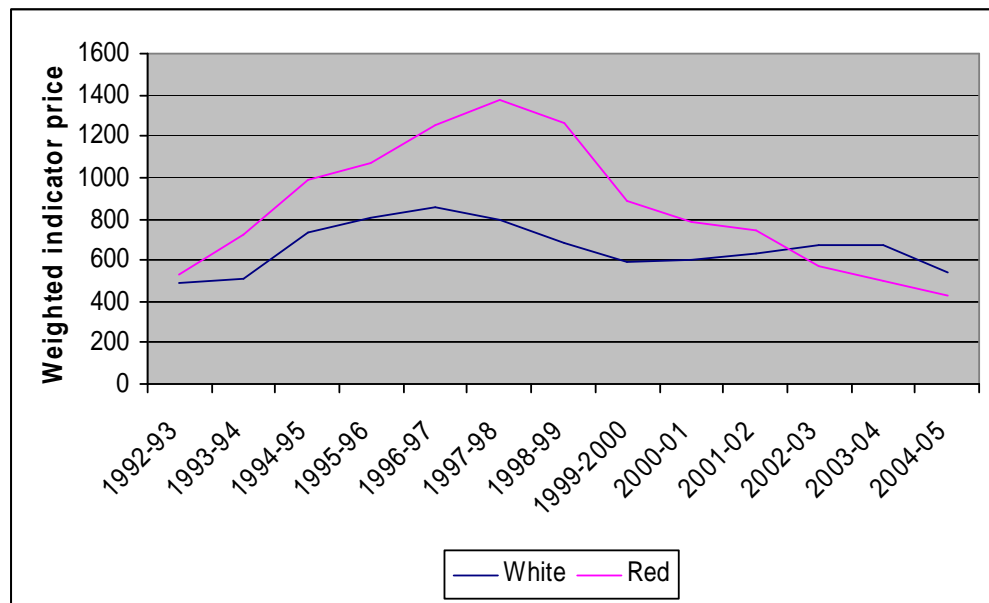
Wine grape prices have fallen significantly across most varieties reflecting the influence of excess inventories held by winemakers and expectations on future grape intakes and inventories.

The Australian weighted indicator wine grape price (AWI) based on prices for the three major inland irrigated regions shows that for red wine grapes, the AWI declined from a peak of \$1,400 per tonne in 1997-98 to \$400 per tonne in 2004-05. The AWI for white grapes reached a peak of just over \$800 in 1995-96 and declined to \$600 in 1999-2000 before rising to around \$650 in 2003-04 and then declining significantly in 2004-05 to \$555 per tonne.

ABARE (2006) reported that for the warm climate regions of Riverina, Murray Valley and the Lower Murray, the industry reported an average decline of around 25 per cent in prices paid for Chardonnay from the previous year, the first decline in the price for that variety since 2000.

The largest declines were in the cooler climate regions of New South Wales and Victoria. For example, prices paid for Cabernet Sauvignon and Shiraz on average declined by 37 per cent and 27 per cent respectively in 2004-05 from the previous year.

Figure 10: Australian weighted indicator price for wine grapes (real 2004-05 dollars)



Source: Australian wine grape production – projections to 2007-08, ABARE report 06.4

2006 wine grape prices

The 2005-06 Australian weighted indicator price is not available at the time of writing, but raw data from the Regional Winegrape Crush Survey indicates a further significant reduction in weighted average prices for both red and white wines in most regions.

2006 prices declined substantially in warm climate areas with average prices for reds and whites around \$380 per tonne, with low prices of \$100 per tonne. Prices in cooler climate regions were not as low. For example, the average price for white grapes varied from \$713 per tonne in the Barossa to \$1,384 per tonne in the Adelaide Hills. The average price for red grape prices varied from \$851 per tonne in the Coonawarra to \$1,313 per tonne in the Adelaide Hills.

However, low prices of \$100 per tonne (and even some down to \$80) were common. These were largely in the spot market in both warm and cooler climate areas. As grape supply contracts ended, there was an increasing reliance by growers on spot sales to dispose of uncontracted production.

At the higher end, Tasmanian prices averaged \$2,600 per tonne for red grapes and \$2,400 for white grapes.

Table 15: Wine grape prices for selected regions, 2006

Location/ Variety	Lowest \$/t	Highest \$/t	Av. \$/t	weighted av. \$/t	% change 2006
Riverina					
Red grapes	100	1,100	376	410	-8.3
White grapes	100	1,639	378	484	-22.0
All grapes	100	1,639	377	449	-16.1

Source: Riverina Wine Grapes Marketing Board

Location/ Variety	Lowest price \$/t	Highest price \$/t	Av. price \$/t
Riverland			
Red grapes	100	944	371
White grapes	100	1,000	384
All grapes	100	1,000	377
Barossa Valley			
Red grapes	100	10,000	1,049
White grapes	200	2,400	713
All grapes	100	10,000	957
McLaren Vale			
Red grapes	90	5,000	1,127
White grapes	89	2,200	976
All grapes	89	5,000	1,097
Coonawarra			
Red grapes	100	3,600	851
White grapes	300	3,000	932
All grapes	100	3,600	859
Clare Valley			
Red grapes	200	3,000	1,111
White grapes	375	2,800	1,030
All grapes	200	3,000	1,083
Adelaide Hills			
Red grapes	300	3,000	1,313
White grapes	400	2,800	1,384
All grapes	300	3,000	1,351

Source: For SA regions, the data has been adapted from the Phylloxera and Grape Industry Board of South Australia

While the expected reduction in the 2007 and 2008 vintages may ease pressure on grape prices declining further, the international oversupply of wine and grapes and competition in wine markets will mean that domestic demand and supply rebalancing will only bring a moderate increase in grape prices.

Wine grape and wine prices

JP Morgan (2006) has described the impact of inter-related grape and wine production cycles and its impact on prices and returns. The grape cycle results from the lag between planting a vineyard and receiving a commercial grape yield which can be 2 to 4 years, plus the maturation time for wine produced from the new supply. Thus it can be up to 6 years before the new supply reaches the consumer.

The grape cycle is overlayed by a wine production cycle which JP Morgan attributes to wineries' inertia in correcting its grape intake in periods of oversupply and high wine inventories. This is due to the existence of grape supply contracts and opportunistic winemakers and virtual wineries being encouraged to buy very low priced grapes on the spot market. In addition, falling grape prices may encourage some growers to engage contract processors to crush their unsold fruit in an attempt to improve the value of the product and generate a return above the marginal cost of harvesting.

JP Morgan illustrates the impact of the grape cycle as shown in Table 16.

Table 16: The grape cycle

Phase	Features
1. Increasing shortage	<ul style="list-style-type: none"> • Rising grape prices • Capital attracted to vineyard development • Increasing bottleneck at the grape supply end of the value chain.
2. Reducing shortage	<ul style="list-style-type: none"> • Falling grape prices due to new supply coming on stream from plantings in phase 1. • Capital still being attracted to vineyard development. • Bottleneck being removed
3. Initial oversupply	<ul style="list-style-type: none"> • Falling grape and bulk wine prices as new supply continues to come on stream from plantings in phase 2. • Bottleneck shifts to distribution, retail and the consumer.
4. Supply correction	<ul style="list-style-type: none"> • Grape supply growth stops. • Rising grape and bulk wine prices as demand begins to catch up with supply. • No new capital attracted to vineyard development. • Bottleneck is gradually removed.

Source: JP Morgan, Asia Pacific Equity Research, 4 January 2006

It is important for the wine grape sector to understand the grape cycle and also the relationship between grape and wine prices. The study by Primary Industry and Resources South Australia (PIRSA, 2005) on the impact of grape-pricing trends in the Riverland region illustrates that it is important for growers to understand the price winemakers are likely to pay for grapes at various wine price points. KPMG (2005) found that a small increase in the retail price of wine (eg, \$7.99 compared with \$6.99 a bottle) has a big impact on the price wineries can afford to pay for grapes (eg, \$650 per tonne compared with \$450 per tonne).

Wine grape prices and production costs

Wine grape production costs vary considerably between regions depending on scale of operations, vine vigour, yields, disease and weed problems, ability to mechanically prune and harvest and freight costs. It is difficult to make generalisations and growers need to consider their individual enterprises in relation to prices that their grapes are likely to achieve.

Many growers consulted in this project reported current prices to be well below their cost of production. Patrick (2006) estimates production costs per tonne in South

Australian regions to be \$300-350 for the Riverland, \$430-600 for Langhorne Creek, \$1,000-1,100 for the Adelaide Hills and \$650-800 for other areas.

PIRSA (2005) found that for a 10 hectare vineyard in the Riverland, the cost of production including the cost of capital of 8% is \$763 per tonne.

ABARE's (2006) survey data shows that for the Riverina in 2004-05, the average grape price was \$426 per tonne, farm cash costs were \$5,270 per ha, farm cash income was \$2,545 per ha (ie, total cash receipts minus total cash costs) and farm business profit was \$674 per ha. The 2006 average grape price was \$376 per tonne (12% lower than 2004-05).

For McLaren Vale in 2004-05, ABARE's data showed the average grape price as \$1,303 per tonne, farm cash costs as \$7,723 per ha, farm cash income as \$5,278 per ha and farm business profit as \$1,756 per hectare. The 2006 average grape price was \$1,097 per tonne (16% less than 2004-05).

Growers are expressing concern about escalating production costs (especially fertiliser, chemicals, and fuel) at this time of low and declining grape prices. ABARE's survey shows that these inputs comprised around 13% of total cash costs per vineyard in McLaren Vale and 21% in the Riverina (2004-05). The annual increase in the cost of these inputs was 1% in McLaren Vale due to reduced fertiliser application in 2004-05 and 10% in the Riverina.

Economies of scale

Achieving economies of scale and implementing other cost reduction strategies are critical to profitability. ABARE (2006) shows that the top performing vineyards in both McLaren Vale and the Riverina have a larger area under vines than the average of all vineyards in the respective regions. In McLaren Vale, the bearing area for top performing vineyards is 82% larger than the average and in the Riverina, it is 113% larger.

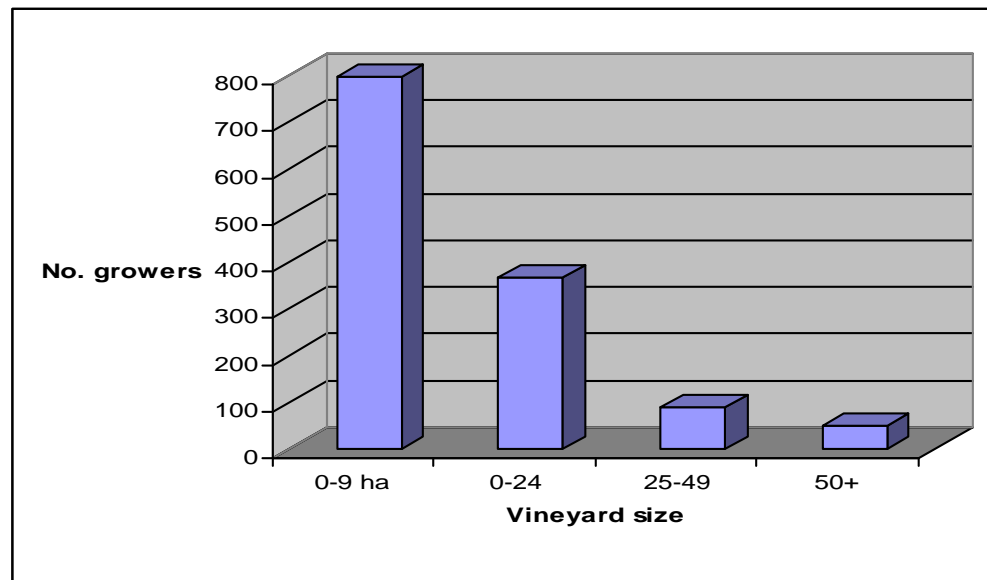
The PIRSA study for the Riverland (2005) found that to earn a return of 8% on vineyard investment at an average grape price of \$650 per tonne, the minimum area required is 50 hectares. At \$450 per tonne, the minimum area increases to 150 hectares.

This study did not calculate the actual rate of return for the Riverland. However, ABARE (2006) found that the actual average rate of return on capital and management for the Riverina in 2004-05 was only 2.4%

On the basis of the PIRSA analysis and the distribution of Australian vineyards by size, the majority of Australian vineyards appear to face serious issues of viability if they are dependent on income from wine grape sales at current prices and production costs.

However, significant economies of scale appear to be available in wine grape production through property consolidation, joint vineyard management arrangements and contracting vineyard operations over a number of properties

Figure 11: No. of growers by size of vineyard, Riverland



Source: PIRSA (2005) based on data from The Phylloxera and Grape Industry Board of South Australia

The ability of grape growing businesses to continue to operate with prices below production costs depends on other sources of income or capital to subsidise the losses. Some vineyards are lifestyle ventures for high income or high net worth urban owners. Other growers are relying on off-farm employment (self or spouse), to meet vineyard and living costs. Another group of growers earn income from a cellar door, café, bed and breakfast accommodation or tourist attractions.

The view of many growers consulted, supported by some studies, is that those who rely on wine grape income are experiencing serious financial difficulties and are unlikely to be economically viable at present price levels. This includes larger growers.

As noted previously, PIRSA shows that the minimum scale for the long term viability of vineyards is critically sensitive to wine pricing and it is important for both growers and winemakers to understand each others business. They point out that both need to collaborate on finding ways of absorbing seasonal surpluses. Present surpluses are pushing down spot prices on which many growers now rely on and impact on vineyard viability. Similarly, surpluses impact on branded and bulk wine prices and affect winemakers' profit margins and the price they can afford to pay for grapes.

Wine grape prices and quality

There is an obvious strong relationship between the quality of grapes and the price winemakers are willing to pay. However, grape price setting by winemakers contains a large degree of subjective assessment and with declining prices this is causing strained relationships between growers and wineries. A voluntary code of conduct providing guidelines for the relationships between growers and winemakers is being developed by Wine Grape Growers Australia and the Winemakers' Federation of Australia.

Value chain price indexes

Australian Bureau of Statistics data for 2004-05 shows movements in prices for growers, winemakers and consumers. The wine grape index declined by 14.5% in 2004-05 while the price index for domestic wine sales showed a slight decline and for exports a slight increase. Wine prices paid by consumers increased by 2.1%.

Table 17: Selected price indexes, percentage changes

Year	Wine grapes (a)	Wine – domestic (b)	Wine – export (b)	CPI – wine
1997-98	6.1	3.2	11.6	3.4
1998-99	-3.7	-1.0	10.2	1.3
1999-00	-8.7	1.8	2.2	0.3
2000-01	3.6	-1.4	4.9	5.4
2001-02	0.9	2.5	3.6	2.9
2002-03	-4.4	0.7	0.7	0.8
2003-04	0.1	0.5	-13.9	1.5
2004-05	-14.5	-0.1	1.7	2.1

(a) The wine grapes index measures the prices received by growers.. (b) The wine price index measures wine prices received by winemakers. (c) The wine CPI measures prices paid by consumers.

Source: ABS Catalogue No. 1329.0 Australian wine and grape industry, 2005

2.7 Key findings on Australian wine grape production and marketing

This final section of Chapter 2 outlines the project's key findings on Australian wine grape production and marketing referenced to the desired industry outcomes of profitability and sustainability.

Profitability

This refers to 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.

In recent years, low grape prices and rising costs have significantly affected the industry's profitability. The project's main findings in relation to industry profitability and the factors which have had a major impact are as follows:

- 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 increased to excessive levels and caused wineries to move to reduce grape intakes and prices.
- Wineries maintained a high level of grape intake during this present period of high wine stocks. The data shows the actual intake of grapes by wineries exceeded their preferred intake in 2004, 2005 and 2006.
- With the increase in wine stocks, the national crush levelled off in 2005 and 2006 as winemakers moved to reduce and amend grape contracts. In addition,

net plantings have declined rapidly since 2001 and growers increased vineyard grubbing, mothballing unprofitable areas and discarding grapes that they could not sell.

- Cooler climate grapes have displaced some warm climate grapes for wines traditionally produced from warm climate fruit. This is largely fruit, produced at higher cost, and sold on the spot market for very low prices. Growers in warm climate regions see this trend reducing the demand for their fruit, sales and prices.
- Grape prices saw substantial increases during most of the 1990s, with the weighted average indicator rising to \$1,400 per tonne for reds and around \$850 per tonne for whites. Average prices have declined over the present decade. For the 2006 vintage, contract prices were consistently below \$400 per tonne in warm climate regions. Contract prices were higher in temperate and cool climate regions, but the cost of production is significantly higher than for warm inland regions. Very low prices of \$100 per tonne or less were received by growers in the spot market for both warm and cooler climate fruit.
- Many growers consulted in this project reported current prices to be well below the cost of production. ABARE survey results for indicator regions (the Riverina and McLaren Vale) showed declining farm business profits in 2003-04 and 2004-05. The average rate of return on capital and management for the Riverina was 2.4% in 2004-05 and 3.2% in McLaren Vale. Since then, the average grape price fell by 12% in the Riverina and 16% in McLaren Vale.
- At the beginning of this project, industry predictions were 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).
- At the time of writing this report, the situation has changed dramatically for the coming 2007 vintage and possibly the 2008 vintage. Grape production is likely to be significantly reduced due to the record dry conditions during 2006 and severe spring frosts in some regions. With reduced production, early indications are that the excess wine stocks could be removed by 2008-09 and some wineries have reported that they are moving to establish new contracts to offset likely lost production.
- However, even with demand and supply rebalancing in the short term, the world oversupply and international competition for wine market share will continue to put pressure on wine and grape prices. In addition with a return to normal seasonal conditions, Australia's present vineyards have the capacity to produce in the order of 2 million tonnes of grapes which could again exceed likely demand for wine grapes. In such circumstances, 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

Economic viability

- The very high grape prices that prevailed in the late 1990s and early 2000s attracted a lot of investment and expansion of the national vineyard estate. A disproportionate amount of this investment was directed at the production of higher-cost cool climate fruit when compared to trends in world wine market demand.
- ABS estimates that there are 8,350 Australian vineyards. Many of these are small-scale as a result of the previous high grape prices attracting many

specialist growers to the industry. Approximately, 50% of vineyards in warm regions and 60% in cooler climate regions are less than 10 ha.

- Small vineyard size presents difficulties in achieving economies of scale in production and marketing, and accessing capital for investing in vineyard upgrading and new technology. The problem of small block size and associated fixed irrigation infrastructure in warm inland regions, as noted in the 1985 'Inquiry Into the Grape and Wine Industries', continues some twenty years later.
- Significant economies of scale are available in wine grape production. ABARE's recent survey shows that the top performing vineyards in both McLaren Vale and the Riverina have a larger area under vines than the average of all vineyards in the respective regions. In McLaren Vale, the bearing area for top performing vineyards is 82% larger than the average and in the Riverina, it is 113% larger.
- A key factor in grower viability is the grape price that the winemaker can afford to pay at various wine price points. In order to pay \$450 per tonne, KPMG estimated that the winemaker needed to produce wine that retails at \$6.99 a bottle. To pay \$650 per tonne, the wine retail price needed to be \$7.99.
- Economic viability is also influenced by the enterprise arrangements that exist in wine grape production. Many different models are in existence. These include specialist growers who sell all their grapes to wineries; wine companies that grow their own grapes and contract from other sources to meet requirements; and small growers who grow their own grapes for processing in their wineries or who contract winemaking.
- Australia's wineries source a significant proportion of their grape intake from their own vineyards (21% in 2004-05). There are indications that large wine companies are divesting vineyards and winemaking facilities and sourcing more wine from contract winemakers and the bulk wine market.
- Australia's growers rely heavily on the large wine producers to buy the majority of their production. The top six wine producers crush 73% of the Australian wine grape intake.
- Of Australia's 2,000 wineries, the majority (70%) crush less than 100 tonnes of grapes and these wineries provide diversity in the demand for grapes for small growers.
- Anecdotal information suggests that some vineyards, mainly in cooler climate or peri-urban areas, are lifestyle ventures for high income or high net worth urban owners. A lot of these businesses are reported to be operating at a loss in the current market situation and being subsidised by other sources of income and capital.
- Other specialist growers are relying on off-farm employment (self or spouse) to meet vineyard and living costs. This employment includes vineyard contracting for other growers.
- Another group of growers operate their vineyards as a hobby or 'sea change' and frequently earn income from a cellar door, café, B&B accommodation or tourist attractions. Some 75% of winemakers have cellar doors and make an important contribution to Australia's wine and food tourism industry in regional areas.
- The view of many growers consulted, supported by some studies, is that those who rely on wine grape income are experiencing serious financial difficulties and

are unlikely to be economically viable at present price levels. This includes mid-size and large growers.

Natural resource management (NRM)

- The sustainability of the Australian wine grape industry is also dependent on its natural resource management. The wine and grape growing sectors are active participants in environmental programs directed at maintaining a 'clean-green' reputation in world markets.
- The Australian Wine Industry Stewardship (AWIS) initiative links export market environmental assurances with regional priorities identified by NRM boards and catchment management authorities. Adoption of AWIS for the 2006-07 growing season will cover 55% of Australia's national grape crush, with more companies expected to join.
- Climate variability is having a major impact on irrigation water availability and cost. The continuation of drought conditions across southern Australia is substantially reducing inflows to the major river systems and water authorities have already made significant reductions in water allocations (including high security water) for the 2006-07 season. This is increasing pressures on water prices.
- Australian Bureau of Statistics data shows that water efficient drip and micro spray irrigation accounts for 76% of the total irrigated vineyard area. However, the data also shows some 36,000 hectares of vineyards continue to be watered by relatively inefficient overhead spray and furrow or flood irrigation. Upgrading this to more efficient irrigation methods is constrained by unsuitable or outdated irrigation infrastructure.
- Climate change is predicted to have a major impact on Australian wine regions over the long term due to rising temperatures and reduced rainfall. This will change the varieties that can be grown in some regions.

AUSTRALIAN WINE GRAPE INDUSTRY TAKING STOCK

INDUSTRY ASSESSMENT FRAMEWORK COMPONENT:

THE EXTERNAL ENVIRONMENT – WORLD WINE AND GRAPE INDUSTRY

CHAPTER 3. THE WORLD WINE AND WINE GRAPE INDUSTRY

The Australian wine grape industry operates in the context of the world wine market. Wine is the traded product because grapes are highly perishable and must be processed quickly after picking. International consumption of wine determines how much and the types of wine Australia can export. This ultimately determines quantities of grapes purchased by Australian winemakers and the prices which are paid. In turn, the competitiveness of Australia's wine in the world market depends to a significant extent on the quality and efficiency of our grape production.

Many aspects of the world wine market (eg, population growth and consumer incomes in wine importing countries) cannot be influenced by the Australian industry, but provide a trading environment that grape growers and winemakers must respond to if they are to remain competitive.

Other aspects of the industry's external environment such as delivering to consumer preferences are within the scope of the industry's marketing efforts.

The global market economy has been built by communication and transport technologies breaking down boundaries and trade barriers being reduced. As seen over the past decade, these developments have opened up opportunities for Australia to export wine and the industry has become highly successful in selling in world markets.

The challenge for the industry will be in remaining competitive against strong competitors in a global market that is highly competitive, crowded with brands, driven by consumer tastes and preferences and dominated by large retailers and beverage conglomerates.

This chapter examines the world context for Australia's wine and wine grape sectors and the impacts of rapid change on Australia's competitiveness with the flow-on effects on industry profitability and economic viability.

Topics covered in this chapter include:

- Changes in the world wine industry;
- The forces of globalisation;
- Australia's changed position in the world wine industry;
- Australia's reliance on wine exports;
- The continuing importance of the domestic wine market;

3.1 The changing world wine industry

International trade in wine has been taking place for hundreds of years, although for the most part, the world's wine drinkers consumed local wines or those from nearby countries. Winemakers had little international experience and followed local wine making traditions.

Over the course of the twentieth century, the wine trade and interaction amongst winemakers increased, but it has only been since the 1990s that globalisation has become the reality of the industry. Global wine exports, as a share of global production, increased from 15% to 25% over the 1990s (Anderson, et al, 2001) and in 2004 exceeded 26% (Castaldi, et al, 2006).

Trade agreements, wine consumption patterns and the relative competitive positions of wine producers have changed dramatically over the past two decades.

Although trade in wine continues to be constrained by trade barriers and tariffs, there has been significant removal of restrictions and this has stimulated exports and imports. For example, the signing of the Mutual Acceptance Agreement on Oenological Practices by Australia, Canada, Chile, New Zealand and the USA reduced regulatory burdens and diminished trade barriers.

New World wine producers such as the USA, Argentina, Australia, South Africa and Chile have developed a strong export orientation. These five countries comprised 23% of global production and 21% of consumption in 2004 (Castaldi, et al, 2006) and have dramatically changed production techniques, wine styles and marketing.

The Old World producers, France, Italy, Germany and Spain have been experiencing declining per capita wine consumption and loss of market share, although their industries are now making significant attempts to re-establish their competitiveness.

The new order of international access and competitive trade has re-shaped how wine is consumed and produced. The changes that occurred in the 1990s were the beginning of major shifts in trade and value chain structures. In the first few years of the twenty first century, international conglomerates have become dominant players in all countries and are introducing dynamic changes in how business is performed.

Those countries and businesses that are best able to “adapt to this wider and more competitive playing field will gain significant national competitive advantage” (Castaldi, et al, 2006).

3.2 The forces of globalisation

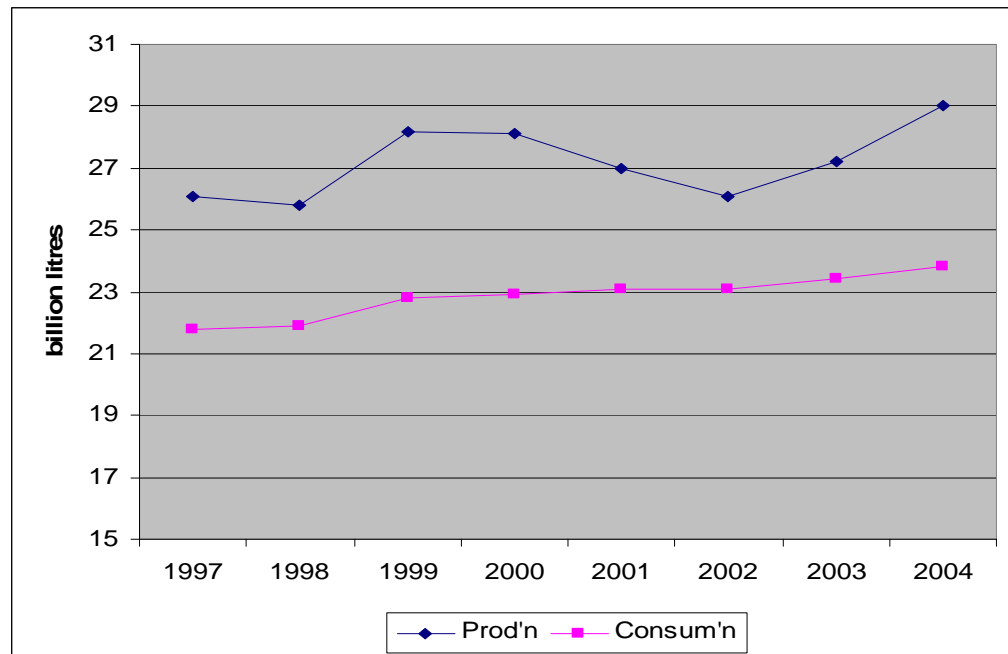
Oversupply of wine and grapes

World-wide consumption of wine has been growing slowly, but it is substantially below production (see Figure 12). From 1999 to 2002, production declined and moved towards consumption levels, but from 2002, new vineyards coming into commercial production caused the disparity to widen again and increase to a wine surplus of around 20% in 2004.

High wine supplies are largely the result of substantial increases in production in the main New World producers led by Australia and including Argentina, Chile, South Africa and USA. Production has declined in the largest two producers, France and Italy.

In addition to an oversupply of wine, the world has an oversupply of wine grapes. High grape prices stimulated major plantings in the decade from 1995 to 2005 in most New World wine producing countries. Most plantings were of the same premium varieties. While the Old World vineyard area has declined, plantings have been of similar premium varieties to the New World, namely the red varieties cabernet sauvignon, merlot and shiraz; and the white varieties chardonnay, sauvignon blanc and colombar.

Figure 12: Global wine consumption and production, 1997-2004



Source: Castaldi, et al, 2006 adapted from Wine Institute (2004a)

The oversupply of wine has caused a reduction in grape prices world-wide. To combat this and the excess wine stocks, some countries have adopted highly interventionist policies such as France which has introduced per-hectare caps on production and the European Union (EU) is currently subsidising the distillation of wine into industrial alcohol. On the other hand, the EU subsidises the replacement of poorer performing varieties and vineyards with improved vines and vineyard layouts.

Consultations: What we heard

"We're all guilty of putting ourselves in this position. We all contributed to investments that led to the oversupply." (Wine-grape grower)

Other countries have allowed market forces to cause industry adjustment and growers have removed vineyards. Examples of this are in California which has faced major oversupply of grapes and very low prices. In Australia, grape growers have been leaving grapes on vines, discarding harvested grapes and grubbing vines. To date, there has been no intervention by the Government or the industry as a whole.

Wine price discounting

The excess wine supply in the world has caused price discounting amongst winemakers and retailers in order to compete for market share. This decreases industry profitability down the value chain and is most pronounced with the "two buck chuck" phenomenon in the USA.

Consultations: What we heard

"We were approached. It was not the other way around. We thought long and hard about it and spoke to many people including growers. No-one said it wasn't a good idea to help clear the industry excess." (Retailer)

Consultations: What we heard

"The two buck chuck will be short-term. The problem may be that the consumers will bottom feed and stay there."
(Winemaker)

Australian winemakers have also experienced reduced prices in the domestic market as excess wine stocks have increased. Very low grape prices for uncontracted fruit on the spot market has encouraged opportunistic virtual wineries in producing "cleanskin" or unbranded wine that is sold cheaply and is popular amongst many consumers. There have also been instances of some retailers offering two-dollar

cleanskin wines. These developments have placed competitive pressures on the established wine trade and prices for popular premium and premium wine.

Consolidation of winemakers, distributors and retailers

Consolidation is occurring amongst winemakers world-wide through mergers and acquisitions in order to enhance profit margins in a maturing global market that is crowded with wine supply, brands and market players. Wine companies consolidate to achieve economies of scale, reduce transaction costs in the supply chain and increase negotiating power in relation to distributors and retailers. The trend of consolidation will increase with a fewer number of global conglomerates accounting for a growing percentage of wine sales.

Australia now has three large wine companies (Fosters Group, Hardy Wine Company and Orlando) accounting for most of our wine production. All are global beverage companies with the Hardy Wine Company and Orlando being owned by the international conglomerates Constellation (USA) and Pernod Ricard (France) respectively.

A similar trend is occurring with distributors to attain economies of scale and improve supply chain efficiency. Castaldi, et al (2006) notes that in the USA, the 20 largest wholesalers control 70% of US distribution. Distributor consolidation can make it more difficult for smaller winemakers to get their wines onto retailer shelves. Distributors generally prefer to deal with a smaller number of large suppliers to reduce transaction costs and to move product and replenish supplies quickly.

Consolidation is also occurring in the supermarket (off-trade) and restaurant/food service (on-trade) sectors. Within most wine consuming nations, a small number of large retail chains sell the majority of wine to consumers. In Australia, Woolworths and Coles have actively acquired retail outlets for wine and have increased market share, although other retailers such as wine clubs and on-line outlets are prominent players.

Castaldi, et al (2006) reports that supermarkets in the USA accounted for 40% of wine sales in 2000 and quotes the International Wine Investment Fund estimates of 60% to 80% of global wine sales occurring through mega-supermarkets. As the authors note: "...tens of thousands of international wine brands vie for space on the store shelves of these fewer, larger and more powerful supermarkets."

Consultations: What we heard

"The problem is simple. Competition is dominated by two retailers who are vertically integrating, buying at ridiculous prices, but then I guess we've brought it on ourselves with too many wineries. Maybe it's not so simple." (Winemaker)

Table 18 shows the change in concentration in wine retailing of selected countries from 1991 to 2003 with France, Germany and the USA showing major change in concentration. In Australia the concentration is lower, but has been increasing over the past five years as Woolworths and Coles have acquired more wine retail outlets.

Table 18: Percentage of retail wine sales by type of outlet, 1991-2003

Country	2003		1991	
	Super-market & discount	Specialist	Supermarket & discount	Specialist
France	82	9	41	19
UK	80	15	71	29
Germany	74	7	40	12
Spain	71	17		
USA	67	22	49	36
Brazil	64	33		
Japan	57	43		
China	65	10		
Australia	40% by value owned by Woolworths and Coles			

Source: PIRSA (2005) based on data from Euromonitor 2004 and 1998

For Australia, Primary Industry and Resources South Australia (PIRSA, 2005) observed that the supply chain for wine is less developed than that of other fast-moving consumer goods and retailer consolidation and discounting is placing greater pressure on distributors and winemakers for more promotions, quicker delivery, better inventory management and reduced prices. PIRSA believes the wine industry has yet to go through the restructuring that other industries went through in the past two decades and that a period of significant adaptation lies ahead.

Changing consumer and supplier behaviour

Consumers are the heart of the value chain. The prices they are willing to pay and the volumes they buy ultimately determine profit margins through the value chain.

Global food and beverage markets have become 'buyers markets' with consumers exerting greater power and being more discerning about the quality and value of products. In consumer dominated markets, supplier success factors include the following:

- close knowledge of consumers' values and buying preferences and the ability to supply products which meet consumer expectations;
- major investment in differentiation against the best competing suppliers from anywhere in the world;
- achievement of continuity of supply over the whole year requiring sufficient volumes;
- having the capacity to supply domestic and export markets as the distinction continues to blur between these markets;
- having the business approach and systems to be able to deal with more consolidated buyers including retail and food service chains;
- having the capacity and systems to supply global sourcing networks;

- being able to build long term relationships with buyers and able to supply according to their specifications particularly in relation to quality and food safety.

There is much research and studies on global food and beverage market trends. The main trends can be summarised as:

Figure 13: Global food and beverage market trends

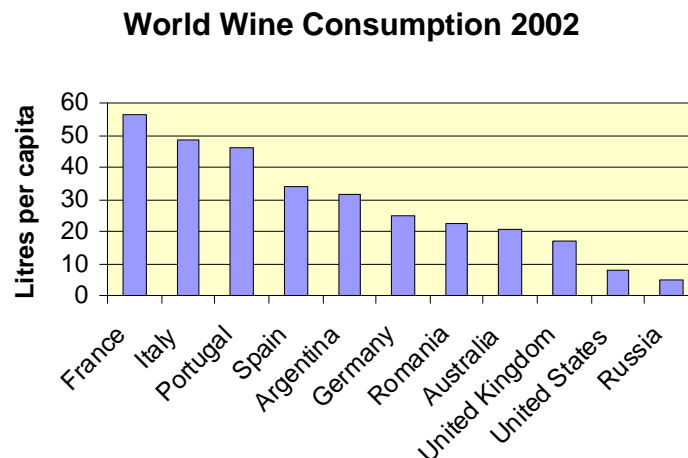
Consumers	Westernisation; income growth; seeking convenience; emphasis on lifestyle, concern about health and nutrition.
Retailing	Global spread of major retailers; growth of hyperstores, discount warehouses, premium supermarkets, specialty stores.
Global food and beverage supply chains	Increasing purchasing power of major supermarkets; reduced number of suppliers; regional and global buying; increasing prominence of house brands and retailer labels; supply chain influence moving to retailers and away from processors.
Food and beverage processing	Increasing international trade; consolidation of processors (mergers and acquisitions); increasing variety of products.
Food service	Consumption increasing through quick service and family restaurants; development of uniform brands; increasingly centralised procurement; strong emphasis of food quality and safety; uniformity of products.

Wine consumption

Old World consumption remains at high levels, but consumers are drinking less wine due to a range of social issues and indications that younger generations are not favouring some current wine styles. Domestic markets are declining and emphasis for growth is on exports markets. Per capita wine consumption in New World countries is much lower than in Europe, but is rising.

Australian per capita consumption of wine remains approximately half that of the French, Italians and Spanish (see Figure 14), although these countries are experiencing a decline in consumption. In 1980, the per capita consumption in all three of these countries was over 90 litres. It has since declined by 54% in Spain, 45% in Italy and 38% in France. Health campaigns and tougher drink-driving laws have contributed to this trend.

Figure 14: World Wine Consumption in 2002, litres per capita



Source: [ABS](#) (2005) Cat 1329.0 Australian Wine & Graze Industry

The key message of the trends for winemakers, distributors and retailers is to market wine in a way that will promote everyday drinking among a greater percentage of the population in a socially responsible manner. The market is highly competitive and requires consistent and innovative effort in making wine attractive, understandable and convenient for consumers.

As noted by Castaldi, et al (2006) "Pushing affordable wine on to the shelves of world markets will not necessarily increase global consumption by itself. Consumers have to pull the bottles off the shelves in consistent purchases."

Odell (September 2006) in describing the Fosters Group approach emphasised the need to be consumer focussed: "A large research team asks consumers in specific market segments what they want and marketers work with the winemakers to produce a new product. Branding and appearance are very important." He noted that Fosters has significantly changed the structure of its wine business, moving from being largely driven by production and wine marketing, to a consumer-focussed organisation.

Consultations: What we heard

"Wine is a lifestyle product and we must make it less intimidating. That means it's a matter of associating it with occasions. To increase consumption in today's market, you must work on expanding the occasions that wine can be associated with." (Retailer)

3.3 Australia's rise to prominence in the world market

Australia's position in wine production and consumption

Australia's growth in world wine markets has exceeded that of any other country. Most of this growth came in the 1990s and early 2000s. By 2004, it accounted for around 5% of world production and 9% of world exports by volume. In value terms, Australia accounted for 10% of world exports and was ranked third after France and Italy.

Table 19: Wine production and consumption for selected countries

Countries	World production, 2004		World consumption, 2004		Per capita L/yr
	Litres, billions	% world	Litres, billions	% world	
France	5.7	20	3.4	14	55.3
Italy	5.1	18	2.8	12	48.7
Spain	4.2	14	1.4	6	34.5
Germany	1.0	3	2.0	9	24.5
Sub total	16.0	55	9.6	40	
US	2.4	8	2.8	12	9.4
Argentina	1.5	5	1.1	5	28.1
Australia	1.4	5	0.4	2	21.9 (a)
South Africa	0.9	3	0.4	2	8.8
Chile	0.6	2	0.2	1	14.3
Sub total	6.8	23	2.2	21	
World tot.	29.0		23.7		

Source: Castaldi, et al, 2006 adapted from Wine Institute (2004a) (a) ABS's Apparent Consumption of Alcohol, Australia (cat. No. 4307.0.55.001) shows per capita consumption of wine as 27.5 litres per year in 2003-04

Table 19 shows that of the nine producers above, only Germany and the USA are net importers with domestic consumption exceeding production. All other countries are significant and growing net exporters which highlights the competitive nature of world wine markets.

During the current decade, the performance of wine exporting countries such as Spain, Chile, Portugal, South Africa, Argentina and the USA has also been impressive. Only Italy and France experienced a decline in exports over the period.

Table 20: Top ten wine exporters in the world by volume, 2000-2004

Countries	2004 rank	2000 exports		2004 exports		Growth
		Litres bill.	% world	Litres, billions	% world	
Italy	1	1.76	28	1.45	19	-17
Spain	2	0.89	14	1.45	19	63
France	3	1.52	24	1.43	19	-6
Australia	4	0.31	5	0.65	9	108
Chile	5	0.27	4	0.47	6	73
US	6	0.28	4	0.39	5	40
Portugal	7	0.19	3	0.32	4	68
Germany	8	0.25	4	0.27	4	8
South Africa	9	0.16	3	0.26	3	64
Argentina	10	0.10	2	0.16	2	63
Sub total		5.73	91	6.85	90	
World		6.27	100	7.60	100	

Source: Castaldi, et al, 2006 adapted from Wine Institute (2004a)

Australia's export success has been driven by exchange rate trends. There is a very strong inverse relationship between movements in the US-Australian dollar exchange rate and Australian wine export returns over time. Recent appreciation of

the A\$ against the US\$ is associated with the decline in the unit value of exports which means that Australia has to sell more volume to maintain export earnings.

Figure 15: Trends in the Australian dollar and wine export returns



Source: [ABARE](#) (2006) Research report 06.4; Wine Grape Projections to 2007-08

Overseas commentators attribute Australia's success in the global market to the motivation to succeed given a very small domestic market, collaboration in the industry, the vision of Strategy 2025 and the high concentration in the winemaking business structure. The latter factor has provided economies of scale in producing and marketing 'popular premium' wines.

The commentators also see Australia as being very successful in brand building with Jacob's Creek, Alice White and Yellow Tail being mentioned as examples. Australia is also looked on as being innovative in the presentation of brands with colourful labels, imaginative names and in supplying quality value-for-money wines.

Australia's position in wine grape production

While Australian grape production is only around 3% of world production, Australia is generally ranked as the 10th largest producer. Some sources show Australia ranked above Chile and in terms of the main wine trading countries, Australia is ranked around 6th or 7th. Australian average yields are substantially higher than Old World producers, the Middle East and Eastern Europe, but are comparable with Chile, Argentina and China. The USA has the highest average yields at 16.0 tonnes per hectare in 2002.

Table 21: Top 10 countries by total grape production, 2002

Country	Total grapes (tonnes) (b)	% of world total	Area vines 000' ha	Yield t/ha
Italy	7,394	12.0	872	8.5
France	6,854	11.1	909	7.5
USA	6,658	10.8	415	16.0
Spain	5,880	9.5	1,202	4.9
China	4,480	7.3	390	11.5
Turkey	3,500	5.7	575	6.1
Iran	2,704	4.4	286	9.5
Argentina	2,244	3.6	208	10.8
Chile	1,872	3.0	184	10.2
Australia (a)	1,754	2.8	159	11.0
Portugal	1,099	1.8	249	4.4
Romania	1,070	1.7	243	4.4
Other countries	16,782	27.2	2,184	7.5
World	61,782	100.0	7,876	7.8

Source: ABS Catalogue No. 1329.0 Australian wine and grape industry, 2005

(a) Details for Australia are based on data of the Office de la Vigne et du Vin (OIV), 2005 and are not ABS revised figures.

(b) Includes grapes for wine making, table and drying.

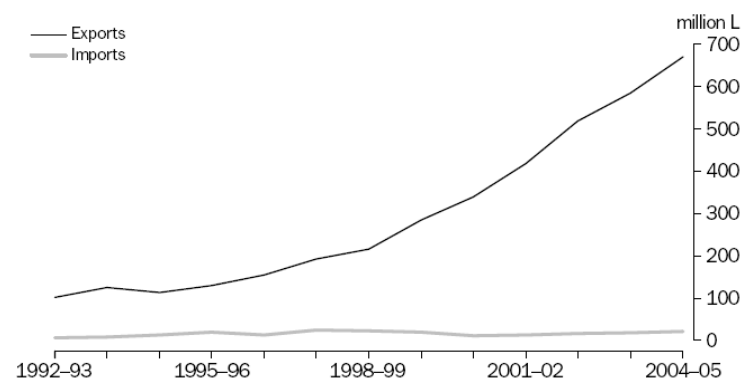
3.4 Australia's export sales

Export volumes and values

The rapid growth in Australia's wine exports since 1995-96 is shown in Figure 12. In 2005-06, exports comprised 62% of the sales volume compared with 32% in 1996. The volume growth of exports over the decade was 374%. Exports comprised 51% of the total value of sales compared with 33% in 1996 and experienced value growth of 408% over the decade. However, there was only a 7% increase in the average price per litre for export wine (A\$FOB) from \$3.72 a litre to \$3.98.

Figure 16: Exports of Australian wine and wine imports 1992-2005

EXPORTS OF AUSTRALIAN WINE AND IMPORTS OF WINE—1992-93 to 2004-05



Source: Sales of Australian Wine and Brandy by Winemakers (cat. no. 8504.0).

The volume growth of wine exports has continued into 2006-07 with an increase of 7% to 739 million litres for the year ending 31 October 2006. Most growth was in the bulk wine segment with an increase of 7.4% over the year. Bulk wine shipments comprised 32% of overall wine shipments.

There was a 5% decline in the premium segments (popular premium, premium and super-premium) and a slight rise in the specialty segment. The lower priced popular premium segment comprised 47% of the total export volume in the year to 31 October 2006.

During October 2006, China was the largest contributor to growth, a record volume of wine was shipped to Canada, shipments to the UK declined and growth in sales to the USA slowed.

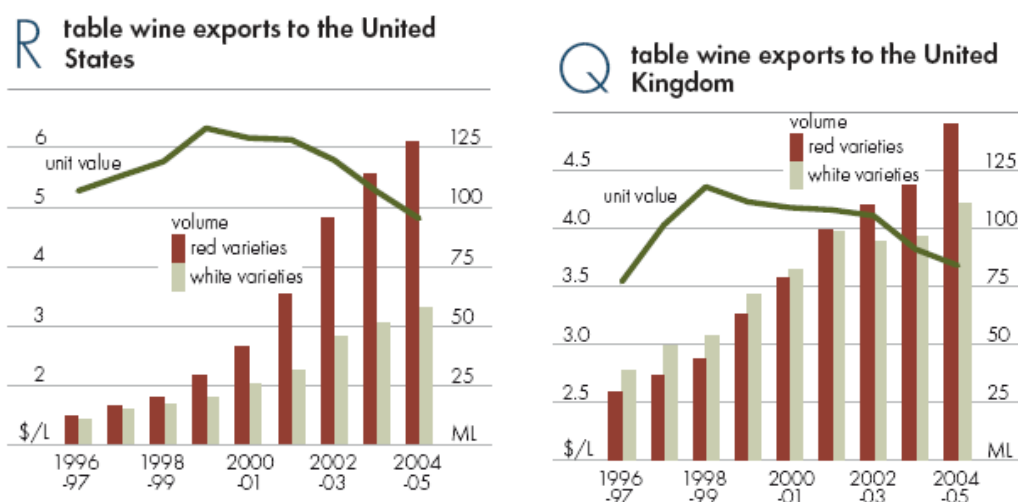
There is now clear evidence that the export growth success of the past decade is slowing. The average price per litre fell by 8% over the year to 30 September 2006, resulting in an overall 0.6 per cent decline in the value of exports to \$2.78 billion. The decline in export value was the first since 1991 and the average price of \$3.77 a litre at 30 September 2006 was the lowest since March 1997.

The decline in wine export value has been due to the strong growth of bulk wine sales as winemakers sell off their surplus stocks at very low prices. This can be attributed to intense competition in the UK, opportunistic sales of excess wine supply, retailers buying bulk wine to sell under their own in-house labels and the lower cost of bottling Australian brands overseas.

The UK remains Australia's largest wine customer, but there was a 2% decline in volume to 266 million litres and a 3% fall in value to \$946 million. Higher bulk shipments to the USA (our second largest customer) resulted in an 8% increase in volume, but the value of exports fell 2% to \$892 million as average prices declined by 10% to \$4.22 a litre.

The trends in export volumes and unit values to the UK and USA are shown in Figures 17 and 18.

Figures 17 and 18: Table wine exports to US and UK by volume and unit value



Source: [ABARE](#) (2006) Research report 06.4; Wine Grape Projections to 2007-08

Australia relies heavily on the UK and USA which accounted for 67% of export sales in 2004-05. The five largest markets including Canada (7%), Germany (5%) and New Zealand (4%) account for over 80% of our total exports which is an increase from around 50% in 1990-91.

Australia is the leading wine supplier to the United Kingdom and Ireland, second largest supplier to the USA and third largest to Canada.

Other countries where wine consumption is increasing (albeit from a low base) such as Scandinavia, the Netherlands and Japan will be an important focus of our export strategies in the medium term, but the immediate focus needs to continue to be in growing the UK and US markets. China, India and other Asian countries offer promising prospects in the long term, although strategies are required now to build the Australian brand in consumer preferences.

As Australia seeks new markets in those countries where wine consumption is increasing, market access becomes critically important. Bi-lateral trade agreements with the USA and Thailand came into force in January 2005. Potential agreements are being discussed or proposed with China, Malaysia, the United Arab Emirates, ASEAN and Japan.

Exports to market segments

There is a very strong negative correlation between wine price points and sales volume. The highest prices and lowest volumes apply to the specialty wines and as the price reduces, volumes increase through the range of super premium, premium, popular premium and bulk wine.

As noted previously, wine made from Australian grapes is recognised internationally as providing quality and value for money in the various market segments in which it is sold. In particular, Australia has dominated the 'popular premium' market segment which comprises brands in the A\$7-11 a bottle price range, especially in the UK and US.

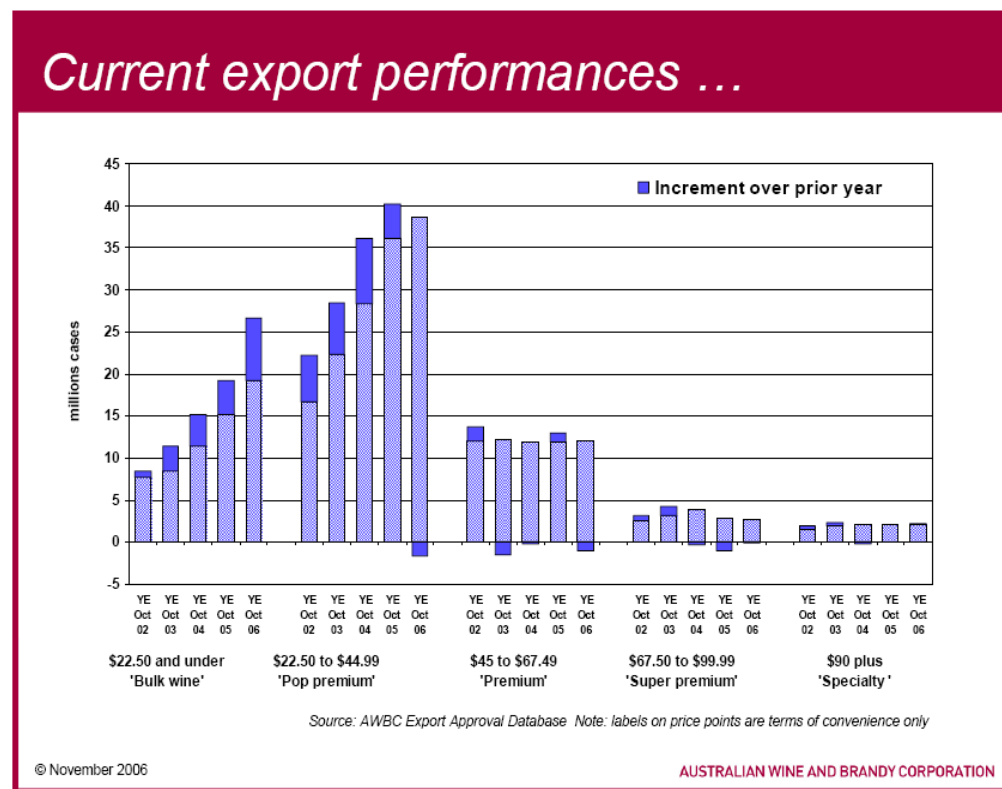
Presently, almost 80% of Australia's exports are bulk and popular premium wines. These market segments have provided the export opportunity and available market for Australian wines produced from grapes largely grown in the warm inland regions.

Australia's competitiveness in this market segment is due to the skill of winemakers in blending grapes from various regions, the large supply of quality grapes of diverse varieties from warm inland regions, the marketing capacity of Australia's wine companies, and recently the very low grape prices being paid in the spot market.

On the other hand, Australia successfully supplies branded wines to the world premium, super premium and specialty market segments. The proportion of exports in these segments is around 20% and they compete in a highly competitive world market. The wine is made from premium grapes largely from cooler climate, lower yielding and high-cost of production vineyards. Around 40% of the Australian vineyard area is estimated to supply these wine market segments.

There is little growth in the export market for premium, super premium and specialty wines, but much of the previous growth in vineyard plantings was to produce grapes for these wines. This has resulted in oversupply of wine grapes in regions that grow these types of grapes. However, in some regions (eg, the Barossa), many winemakers are confident of further growth in sales at prices that are both profitable and sustainable.

Figure 19: Australian wine export volume growth by price segment, 31 October 2006



Source: Australian Wine and Brandy Corporation, 2006

Popular premium wines are increasingly a 'fast moving consumer good' purchased by consumers in supermarkets. These wines are amenable to global sourcing from the lowest cost producers.

In contrast, premium, super premium and specialty wines are essentially luxury or lifestyle goods that are purchased by consumers as discretionary items. It appears that consumers are driven by different values and behaviour in purchasing wines at these price points. Australia's export experience is that sales growth for these wines has not matched the growth in popular premium sales.

Australia has many wine brands that have world recognition in our various market segments. Most of these are owned by our large wine companies and are progressively being managed as global brands that may result in cross-national grape sourcing unless there are price premiums to be gained by promoting the Australian origin.

The generic 'Wine Brand Australia' was relaunched in December 2005 to capture the provenance of grape origin and maintain its recognition in world markets. In terms of regional branding, Australia has only a small number of wine grape regions (GI's) that have brand recognition in world markets.

Relative competitive advantages of wine exporting countries

Australia is seen by other wine exporting countries as innovative in marketing, and this will be increasingly important in competing in highly competitive and changing global markets for wine.

Castaldi, et al (2006) outlines a comparative analysis of the competitive position of both New World and Old World countries. Australia ranks highly in this analysis in overall competitive advantage. In the following table:

- Factor 1 is the existing domestic market position which relates to the size of the market in terms of total sales (less than US\$5 billion is considered weak).
- Factor 2 is the domestic market growth potential relates to the size of the market and whether per capita wine consumption is increasing.
- Factor 3 is the existence of economies of scale and cost benefits that relate to advantages of company size and low production costs in some countries.
- Factor 4 is industry adaptability to change relates to the willingness and ability of producers to innovate with cost efficiencies and marketing practices. It also addresses cultural and regulatory barriers to change.
- Factor 5 is the potential to attract investment (including foreign investment) and relates to political and institutional stability and financial market capability.

Table 22: Competitive advantage, selected countries

	Factor1	Factor 2	Factor 3	Factor4	Factor 5	Overall CA
New World Countries						
US	Strong	Strong	Mod	Strong	Strong	Strong
Aus.	Weak	Weak	Strong	Strong	Strong	Strong
Chile	Weak	Weak	Strong	Strong	Strong	Strong
Argent.	Mod	Mod	Mod	Strong	Mod	Mod
Sth Africa	Weak	Weak	Mod	Strong	Mod	Mod
Old World Countries						
Italy	Strong	Weak	Weak	Mod	Mod	Mod
Spain		Weak	Weak	Mod	Mod	Mod
France	Strong	Weak	Weak	Weak	Mod	Weak
Germ.	Strong	Weak	Weak	Weak	Weak	Weak

Source: Castaldi, et al, 2006

In this analysis, the USA, Australia and Chile are rated as having the strongest competitive advantage with France and Germany having the weakest. Regardless of this ranking, all countries face difficult and highly competitive world wine markets and the key message is that all will be working to out-compete others.

Future export marketing strategies

Some Australian wine grape growers and wine producers are expressing strong concern about Australia's current reliance on low value bulk and popular premium wines. They see this as positioning the wine industry in a market segment where the competition is on price and is profitless for higher cost countries.

However, there is an alternative view that the bulk and popular premium price points have provided the market opportunity and available market for the Australian industry to grow. Those with this view expressed concern about not competing in this segment and then losing market share to other countries which offer quality wines at lower prices and gradually win market share up the price points scale.

There are indications that the traditional assumption that growth in popular premium wines will lead to increased sales of fine wines as overseas consumers exposed to Australian popular premium wines will inevitably 'move up' to higher price points is not happening.

Consultations: What we heard

"All the pressures in the US market are to go down. This is where we have done well, although perhaps we kid ourselves about our quality. But it's not where we want to be. This presents a dilemma where we could take the easy route downwards, or the harder route upwards, or even staying where we are."
(Winemaker)

There appear to be significant differences in patterns of consumer preferences and purchasing in the various market segments. Therefore, a third view is that Australia needs two distinct marketing strategies: one for bulk and popular premium wines and another for fine wines.

Croser (2006) believes "the time has come for tough choices by all players in the industry and this will only happen if industry participants accept the fact that the Australian wine industry has evolved into two discrete industries: the popular premium (commercial) wine industry and the fine wine industry. As strategically focussed competitors emerge in Australia and other New World countries and as the Old World producers refocus, the current strategy of straddling being pursued by major wine companies is bound to fail."

However, Pirie (personal communication, 2006) favours a 'pyramid of value' in the portfolio of wines we offer as a country and that quality must be the value proposition in each market segment.

The wine industry now faces challenges in maintaining the previous export success. The Wine Directions Strategy will be critical in identifying market opportunities for the Australian wine industry and marketing strategies required to increase the volume and value of wine sales in both export and domestic markets.

3.5 The Australian wine market

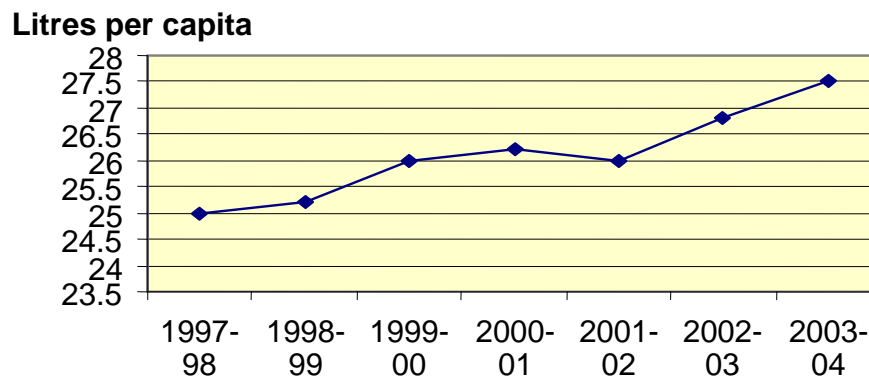
The domestic wine market continues to be vitally important to the Australian wine and wine grape sectors, although there has been a decline in the relative importance. In 2005-06, domestic wine sales accounted for 38% of the total sales volume (430 million litres) and 49% of the value of sales (\$2.7 billion). However, a decade ago, domestic sales accounted for 68% of total sales by volume and 67% by value.

The Australian wine market comprises the retail, beverage service and cellar door/tourist sectors:

- **Retail market** – wine sold via food, grocery and specialist wine/liquor retailers. This sector continues to see consolidation, particularly through retail acquisitions of the two main players, Coles and Woolworths. Another growing segment is membership-based direct sales programs, such as Cellarmaster Wines.
- **Beverage and hospitality service market** – wine sold for on-premise consumption, such as cafes, restaurants, clubs, hotels and specialist drinking establishments. A small but growing sector of this market is the hospitality service sector, providing complementary wines as a part of a broader range of services (eg. airline and hotel club lounges).
- **Cellar door/tourist market** – opportunity-based sales of wine products at wineries, often followed by ongoing loyalty-based purchasing by mail/internet.

The increase in Australian consumption in the past decade has been an important contributor to the growth of the wine grape sector. Domestic consumption of wine has been steadily increasing for many decades. Per capita wine consumption pre-WWII was less than 3 litres. By the early 1960s, this had increased to just over 5 litres, with rapid growth seeing this rise to around 26 litres in 1999. Wine consumption stalled briefly in the early part of the current decade, but by 2003-04 had seen an increase to around 27.5 litres per capita (see Figure 20).

Figure 20: Australian wine consumption, 1997-2004



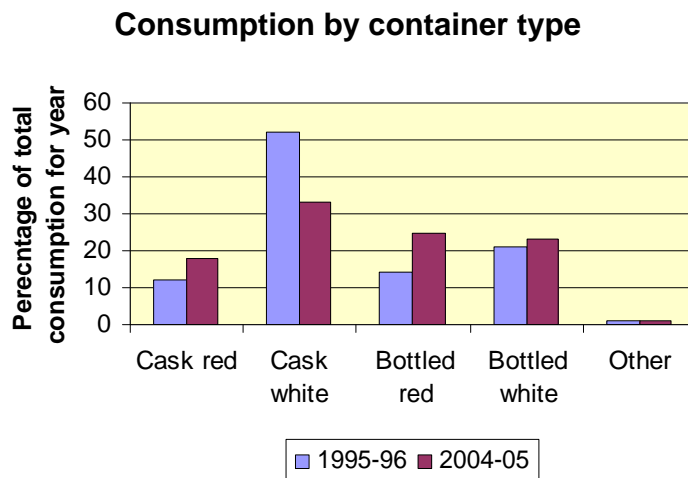
Source: [ABS](#) (2005) Cat 1329.0 Australian Wine & Graze Industry

Increased wine consumption has been stimulated by, among other things:

- changing dietary preferences towards Mediterranean cuisine and eating habits (such as dining out);
- growth of the food and beverage service sectors;
- constant innovation and improvements in wine quality and varieties in Australia;
- the association of wine with lifestyle occasions and events; and
- the changing role of women and their capacity to satisfy their personal preferences.

The nature of Australians' consumption of wine has change markedly over the past ten years. Overall, sales of cask wine have decreased, and sales of bottled red wine have overtaken sales of bottled white wine (see Figure 21).

Figure 21: Wine consumption by container type, 1995-96 and 2004-05



Source: [ABS](#) (2005) Cat 1329.0 Australian Wine & Graze Industry

The Deloitte annual financial benchmarking survey of the Australian wine industry showed that wineries of most sizes are participating at all price points in the Australian wine market, although some price points tend to be more significant for some types of enterprises. Table 23, sourced from Deloitte's 2005 survey, shows for example that over a third of sales made by wineries with annual sales revenue over \$20 million are directed towards the wine sold for less than \$10 per bottle or cask.

Table 23: Price point market of different size wineries

	Winery size (2005 revenue in \$ millions)				
	\$0-1M	\$1-5M	\$5-10M	\$10-20M	>\$20
Cask	1%	0%	1%	0%	7%
<\$7 bottle	6%	3%	12%	0%	9%
\$7-10	0%	12%	4%	10%	18%
\$10-15	22%	10%	29%	37%	23%
\$15-20	33%	50%	33%	26%	25%
\$20-50	37%	21%	18%	23%	14%
\$>\$50	1%	4%	3%	4%	4%
Total	100%	100%	100%	100%	100%

Source: Deloitte (2006) Annual financial benchmarking survey for the Australian Wine Industry

Australian beverage market shares

Although levels of imports are increasing, the great majority of wine sold in Australia is produced from grapes grown and processed domestically. Unlike some other horticultural products where the viability of the industry dependent upon becoming more efficient in the face of growing import competition, the

Consultations: What we heard

"I don't know what the long-term future holds. Kids are drinking RTDs and who is to say they will graduate to wine?" (Wine-grape grower)

Consultations: What we heard

"The wine industry hasn't done as well as it could have in face of RTD competition because of the snob factor. Let's face it, it's just a drink." (Retailer)

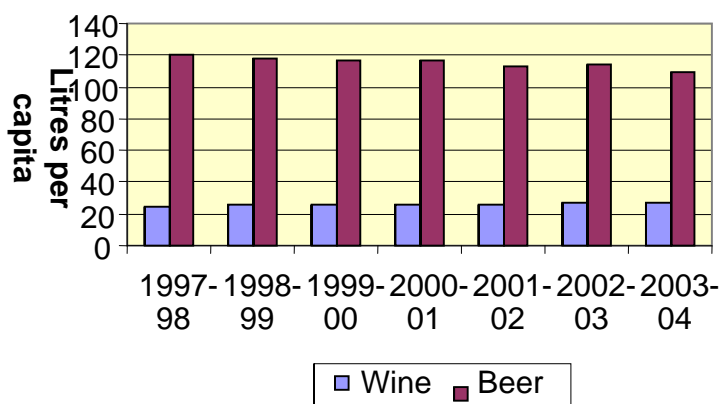
challenge for the Australian wine industry in the domestic market is to compete against other beverages such as beer, Ready to Drink options (RTDs) and increasingly non-alcoholic drinks.

Consumption comparisons with beverages suggest that increases in wine sales are occurring at the expense of beer sales (see Figure 22). Overall alcohol consumption has remained stable over the past ten

years at around just under 10 litres per capita.

Australian winemakers and grape growers are servicing a lifestyle industry based on the exigencies of taste and fashion. In this sense, marketing centres around the end-use product and largely beyond the influence of the wine grape growers.

Figure 22: Consumption of wine versus beer 1997-2004



Source: [ABS](#) (2005) Cat 1329.0 Australian Wine & Graze Industry

Market challenge

At present, wine is competing well with beer and while wine consumption is increasing, overall consumption of alcohol remains static. Notably, the consumption alcoholic beverages other than wine and beer remains static, although the RTD component of this category is increasing. Most RTDs are enjoyed by younger generations of consumers, many of whom exhibit what Roy Morgan (2003) describes a 'promiscuous' behaviour when it comes to brand loyalty or even loyalty to Australian brands. What does this mean for the future of the beverage market?

- ▶ Will consumers of RTDs mature to become wine drinkers?
- ▶ Will consumers of RTDs who do become wine drinkers drink Australian wines, or will they retain their brand promiscuity?

Together with a growing number of mature wine drinkers wanting to experiment more with new varieties and with wines of other countries, the RTD generation may well send shock waves through the Australian dominated wine market as we know it today.

Australia's wine imports

While consumption has been increasing, Australia's imports of wine in recent years have also increased steadily in volume (up by 18% in 2004-05) and value (up by 5% in 2004-05). This has been due to the same changes that have driven overall consumption, namely changing Australian cuisines and, in particular, popular varietals where specific countries have built outstanding reputations (eg. New Zealand sauvignon blanc). Imported wine currently makes up 5% of total consumption of wine, with the total value of imports in reaching \$188 million in 2004-05 (see Table 24). By volume, New Zealand captures the greatest share of wine imports, while France captures the greatest share by value.

Table 24: Imports of wine to Australia, quantity and value 2003-05

Country	2003-04			2004-05		
	Quantity ML	Value \$	Value \$/L	Quantity ML	Value \$	Value \$/L
France	3.07	62.82	20.46	3.49	66.97	19.17
Italy	4.67	22.51	4.82	4.94	25.11	5.08
New Zealand	5.63	49.2	8.74	6.40	52.07	8.13
S Africa	0.13	0.55	4.23	0.18	0.78	4.36
Spain	0.56	2.98	5.32	0.68	3.87	5.66
Chile	0.25	0.84	3.37	0.39	1.34	3.43
All Countries	18.75	152.53	8.13	22.15	188.31	8.5

Source: [ABARE](#) (2006) Research report 06.4; Wine Grape Projections to 2007-08

3.6 Key findings on Australia's competitiveness in world markets

This relates to the ability of the Australian wine industry to compete and win market share in export and domestic markets. As noted in the introduction to this chapter, wine is the traded product in world markets, but its competitiveness depends in large part on the quality and efficiency of grape production.

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 which comprises brands in the A\$7-11 a bottle price range, especially in the UK and US. 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 are amenable to global sourcing from the lowest cost producers.

- 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.
- Australia also successfully supplies 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.
- There is 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 success of the Australian wine industry in winning market share is due to the international competitiveness of Australian winemakers and grape growers, a very favourable A\$ exchange rate during the period of rapid growth, as well as our ability to meet particular overseas' market requirements.
- Much of Australia's export success has been driven by world leadership in R&D and innovation in grape growing and winemaking. However, this technology is generally transportable across national boundaries and many of our major New World competitors are rapidly catching up.
- Rapid changes in the world wine value chain are taking place. The world market is becoming increasingly integrated with consolidation at both wine maker and retail level.
- The high level of concentration in Australia's wine production has been a factor in our export success in that the large companies have the economic scale and resources to successfully compete in a consolidating world wine value chain.
- On the other hand, Australia's large number of small wineries export small volumes to a large number of countries and provide market diversity and flexibility in being able to innovate in meeting consumer preferences.
- While exports have continued to grow in volume, the rate of growth is declining. The average price per litre of exports is falling and, for the first time since 1991, there was a decline in the value of exports in the year to 30 September 2006.
- In the medium term, renewed growth in exports to the level experienced over the past decade will be difficult. The wine trade is presently taking place in an environment where world wine production is significantly higher than consumption, wine prices are under pressure from excess wine inventories and retailer discounting, and this is flowing through to lower grape prices.

AUSTRALIAN WINE GRAPE INDUSTRY TAKING STOCK

INDUSTRY ASSESSMENT FRAMEWORK COMPONENT:

ENABLING ENVIRONMENT

CHAPTER 4. THE ENABLING ENVIRONMENT

This chapter deals with the enabling environment of the Australian wine grape sector and addresses the third objective of the project, namely to determine the capacity of the wine grape industry to respond to current and future challenges and opportunities.

The chapter focuses on three key areas of institutional features: the private sector component which is the Australian wine industry value chain; industry's organisations and services; and the role of government.

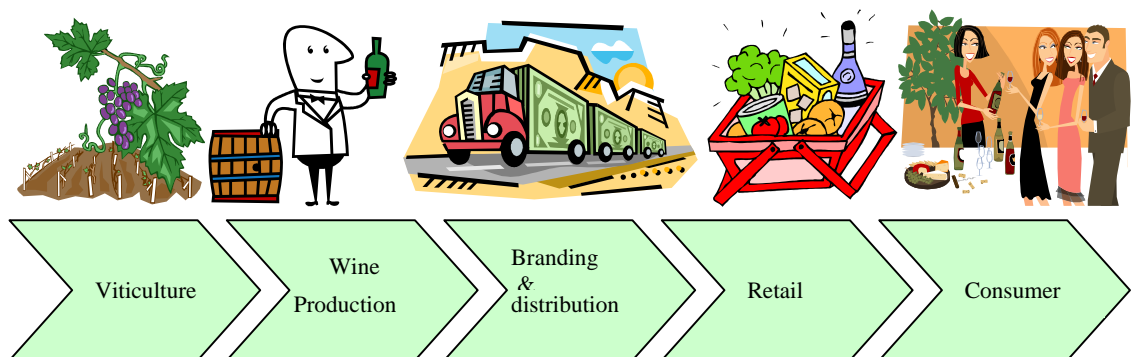
4.1 The Australian wine industry value chain

JP Morgan describes five key components to the value chain for wine:

- Viticulture
- Wine Production
- Branding and distribution
- Retail
- Consumer

The wine industry's value chain is traditionally portrayed as a linear set of relations such as that shown in Figure 23.

Figure 23: The traditional view of the value chain for wine



Source: After JP Morgan (2006) Australian Wine Industry: Heading into the eye of the storm

Table 25 shows an alternative way of looking at the many and varied relationships between the different sectors of the value chain.

Grower to grower relationships

As noted previously in this report, significant economies of scale are available in wine grape production through property consolidation, joint vineyard management arrangements and contracting operations over a number of vineyards.

Table 25: Relationships (real and potential) in the value chain

	Viticulture	Wine Production	Branding & distribution	Retail	Consumer
Viticulture	<ul style="list-style-type: none"> ➤ Grower associations ➤ Production groups ➤ Cooperatives ➤ Share-farming ➤ Skills and equipment sharing 	<ul style="list-style-type: none"> ➤ Supply contracts ➤ Other forms of supply agreements ➤ Spot-sales ➤ Training and advice ➤ Joint grower wine maker associations ➤ Own (grower) label production 	<ul style="list-style-type: none"> ➤ Regional branding ➤ Own (grower) label or grower alliance label branding 	<ul style="list-style-type: none"> ➤ Grower liaison ➤ Use of grower stories in marketing 	<ul style="list-style-type: none"> ➤ Indirect contact through regional tourism ➤ Media liaison through grower associations
Wine Production		<ul style="list-style-type: none"> ➤ Winemakers associations ➤ Skills sharing ➤ Bench-marking ➤ Code of conduct 	<ul style="list-style-type: none"> ➤ Marketing contracts ➤ Distribution contracts ➤ Wine shows 	<ul style="list-style-type: none"> ➤ Supply contracts ➤ Marketing agreements ➤ Winemaker liaison ➤ Use of winemaker stories in marketing 	<ul style="list-style-type: none"> ➤ Cellar door sales ➤ Direct marketing ➤ Consumer surveys ➤ Exhibitions ➤ Media liaison through industry associations ➤ Publicity through adverti and specialty wine publications
		Branding & distribution	<ul style="list-style-type: none"> ➤ Specialty (professional) associations 	<ul style="list-style-type: none"> ➤ Supply contracts ➤ Marketing agreements 	<ul style="list-style-type: none"> ➤ Direct marketing ➤ Exhibitions
			Retail	<ul style="list-style-type: none"> ➤ Retail associations 	<ul style="list-style-type: none"> ➤ Mass marketing ➤ Direct marketing ➤ In-store sales ➤ On-premise sales ➤ Consumer surveys
				Consumer	<ul style="list-style-type: none"> ➤ Consumer associations ➤ Media (specialist journal) feedback ➤ Wine-tasting societies

Property consolidation has been an ongoing process in Australian agriculture as farmers have bought out neighbours. Vineyard consolidation has been occurring over time, however, the high grape prices of the 1990s attracted many small-scale specialist wine grape growers to the industry. The result is that Australia now has a predominance of small vineyards. There will be a need for increased vineyard consolidation to achieve economies of scale and to obtain larger grape supply contracts.

Joint management arrangements across properties are more common with corporate and investor owned vineyards than between individual farmers, but it is an option that small growers may need to consider. This could take the form of assigning the management of the vineyard to an external manager, or leasing or selling vineyards into a trust or company in which the individual owners have shares (PIRSA, 2005).

The main form of grower cooperation is in the use of capital. Production of wine grapes is characterised by large capital investment in the vineyard and in spray, pruning, leaf-plucking, harvesting and other equipment. Due to the outlays required for pruning and harvesting equipment and the need to maximise its operating time, there has been a trend to contracting out mechanical pruning and harvesting. The contractors are often other grape growers who are utilising the capacity of their machinery and earning off-farm income.

On the grape marketing side, there is a long history of cooperation as illustrated by the statutory marketing authorities (SMAs) that existed prior to changes to trade practices legislation and the introduction of the National Competition Policy in the early 1990s. These were established to provide a countervailing position to grape growers in their price and supply negotiations with winemakers. The only wine grape SMA currently existing is the Riverina Wine Grapes Marketing Board, although the Board does not now have power to physically acquire grapes to sell on behalf of growers.

Voluntary cooperatives have long been an aspect of agricultural production and marketing including viticulture. PIRSA (2005) considers that collaborative marketing structures can improve growers' bargaining power and reduce transaction costs for winemakers. The CCW Cooperative Ltd which represents around 750 growers in the Riverland and negotiates the sale of grapes supply contracts with the Hardy Wine Company on behalf of growers via long term contracts is an example.

Murray Valley Winegrowers' has established an unlisted public company, Vintage Traders Australia Ltd as an alternative to the longstanding practice of growers acting on their own to sell their wine grapes. At the time of writing, the company had initial support of 120 wine grape growers and the prospective supply of 30,000 tonnes of fruit.

PIRSA also raises the possibility of 'new generation cooperatives' that replace the requirement to take all produce from members with a combination of quality specifications and a payment-for-quality system that parallels that of the buyer.

Grape-grower/winemaker relationships

As noted previously in this report, wine grapes are a highly perishable product with limited windows between optimum ripening time to meet winemaker specifications and harvesting, and between harvesting and processing. These requirements mean that most wineries are located in relatively close proximity to the vineyards that supply their grapes and there has traditionally been close working relationships between growers and the wineries who buy their grapes.

With greater cross-region sourcing of grapes and blending of wines from different regions, grower-winemaker relationships have changed with a growing number of wineries becoming less reliant on local growers.

Consultations: What we heard

"I've no sympathy for the South Australians. Our local wineries should have been buying local grapes, not stuff from across the border." (Regional grower association representative)

As a result of grape undersupply in the 1990s and with the influx of corporate investment, grape supply contracts became more prevalent. Some of these contracts were long-term in nature and based on vineyard area rather than price.

The recent period of oversupply has also changed the relationship between growers and winemakers. Winemakers have moved to reduce grape intakes through changes to contract arrangement including reducing the level of grape contract renewals on expiry, instituting yield caps, using specific clauses in contracts to suspend contracts, and not agreeing to take grapes beyond a certain level of tonnage.

Consultations: What we heard

"The winemakers treat the growers like school kids. It's a master/serf relationship." (Regional grower association representative)

Many in the industry who were consulted during this project considered that relationships have become strained and there were indications that the previous high level of collaboration had deteriorated.

Issues reported in the Senate Rural and Regional Affairs and Transport inquiry into the operation of the winemaking industry were again raised by growers during the consultations. These

included:

- contracts not being renewed or suspended after growers claim to have been encouraged to invest in new plantings;
- prices notified late in the season or after grape delivery;
- the use of quality provisions of contracts to downgrade prices; and
- the lack of objective and transparent standards for assessing quality.

The Wine Industry Relations Committee, a joint committee of the Winemakers' Federation of Australia and Wine Grape Growers Australia, is developing a code of conduct to provide guidelines for managing commercial trading relationships between growers and processors – tackling one of the key issues that is affecting on-going collaboration on strategic issues facing the industry. This initiative should be completed in early 2007.

Consultations: What we heard

"I acknowledge not everyone of us is behaving as we should. I've no problem with a code of conduct and an ombudsman to oversee its implementation if it is effective and if the transaction costs are reasonable and don't compound the problem." (Winemaker)

The exchange of information between growers and winemakers has traditionally been important for growers in making decisions for investing in their vineyards. However, there are indications that growers may have been over-reliant on winery information for decisions on new plantings and that a broader range of production and market information is needed to cover all aspects of the investment (including its economic life).

Grape-grower/branding and distribution, retailer and consumer relationships

As with many agricultural industries, particularly where there is a processing sector involved, the relationship between the grower and any point beyond the next link in the value chain tends to be weak. In many cases, this is because growers have taken market signals to be messages translated by winemakers and reflected in contracts.

During the project consultations with growers, the notion of forming a relationship between the grower and the retailer or, more pertinently, the consumer, was considered superfluous by many growers, although some indicated that this was an area where attention is needed.

Grower decisions to plant new varieties, increase the area of existing varieties or graft vines over to a new variety are often as a result of advice from winemakers, or in some cases grower interpretation of market signals provided through trade journals.

In some cases, growers have diversified into wine production, producing for their own label via contract winemaking with a processor. In many cool climate areas, participants have entered into the industry with an explicit desire to be both a grower and a processor. This usually involves more extensive relationships across the value chain than for specialist grape growers.

Return on assets or profit shares in the value chain

Figure 24 shows the nature of returns to owners of businesses in the value chain (either in the form of profits or return on a capital asset). Understanding this provides a basis of collaboration in the chain that ensures equitable returns on capital or other resources that are employed.

Figure 24: Returns on assets or profits in the value chain for wine



Source: After Kerin Smart (Personal communication 2006)

Competitive value chains require not only equitable and appropriate returns, but also effective relationships.

4.2 Australian wine-grape industry organisations and capacity

Australian agriculture is characterised by the many institutions that deal with the functions of marketing, research and development, policy development, political advocacy, industry development and information provision. An important role of industry organisations is to ensure the sustainable future of their members. They

may take different approaches to dealing with this: some institutions may place an emphasis on protecting the welfare of members, while others may place an emphasis on identifying and capturing opportunities to grow the industry. Most deal with both, and the emphasis often fluctuates according on the prevailing circumstances of the industry at any given time.

Industry planning

The predominant industry planning process over the past decade has been Strategy 2025. This document provided the basis for setting directions for investment, production, wine making and marketing strategies with the vision of achieving \$4.5 billion in annual wine sales.

The Vision was underpinned by thirty key strategies under eight priority areas. In respect to wine grape growing, the Vision 2025 strategies of direct relevance were:

Competitive advantage strategies

S4. Increase R&D effort and application to the priorities of quality and specification improvements, cost reduction and supply security

S6. Benchmark industry production and management processes to ensure world's best practice

S7. Accelerate the adoption of environmentally sustainable policies in all aspects of the industry

Resource capacity strategies

S18. Encourage viable expansion of vineyards, wine processing storage and packaging capacity and supplier capability to meet market projections

S19. Influence water access and pricing policies to ensure that the wine industry can secure its additional water supplies

S20. Implement a national, industry driven training initiative to expand quickly the supply of skilled personnel and to broaden and upgrade the skills of existing employees

Profitability strategies

S22. Institute periodic benchmarking of the financial performance of the industry by relevant categories

S27. Ensure that State and Local Government land use planning policies, infrastructure provision and regional development strategies are supportive of the wine industry

Industry institutions strategies

S28. Review wine industry bodies' structure to ensure that they enhance a 'whole of industry' strategic focus, to amplify market influence, to clarify roles and to ensure resource efficiency

S29. Redesign Australian wine industry internal communication processes, forums and media

30. Improve the scope and reliability of data utilised for forward production and market planning.

The rapid attainment of the targets set out in Strategy 2025 does not equate to the universal achievement of all the strategies. Some of the strategies have not been pursued vigorously such as industry benchmarking at the grape production level. In addition, the Strategy specified a target of 45,000 hectares of vineyards would be

required to achieve the wine sales target. However, there was no specific planning around the vineyard target. Unprecedented investment in new vineyards over-shot the target by almost 100% leading to the current grape oversupply.

Also missing from the Strategy 2025, and important in any whole-of-industry approach to sustainable growth, are strategies that deal specifically with maintaining healthy 'internal' relationships within and across industry sectors and partners. To some extent, communication and the clarification of roles and responsibilities between industry bodies moves some way towards this outcome. However, there is a greater need in future to incorporate strategies that continuously perform 'health checks' on the state of industry relationships so as to avoid deterioration of collaboration and goodwill between sectors.

At the outset of the Taking Stock and Setting Directions project, stakeholders made clear the imperative to ensure a close relationship between the project and the industry's Wine Directions Strategy, which will update Strategy 2025 by April 2007. The Wine Directions project is focusing on enhancing even further industry understanding of the consumer as the driver of long-term growth. This could also include the robustness of the relationships within industry to ensure that consumer demand is clearly understood and pursued cooperatively and efficiently.

Industry advocacy and support

Wine Grape Growers Australia Incorporated

The wine grape industry has several advocacy and support groups aligned to national, state and regional level interests. Wine Grape Growers Australia (WGGA) is the primary national advocacy group for growers, although is financially supported only in the short-term by growers in the three major warm climate regions (Riverland, Murray Valley and Riverina), with some initial funding assistance from the Australian Government. It was established in 2005 on the grounds that "winegrape growers have no effective unified voice representing them at the national level. It is at this level that many policy changes are made which directly or indirectly affect the livelihoods of all winegrape growers and winemakers." (CIE 2005)

Consultations: What we heard

"I know we need a unified voice, but if we continue to demand that it's based on representation and not ability, then I can't actually see it becoming unified." (Wine-grape grower)

The collapse of WGGA's predecessor, the Winegrape Growers Council of Australia, followed an inability to reach an agreement on making the Council a more representative organisation. The organisation highlighted some factionalism between regions and particularly in the perceptions between warm and cool climate growers.

CIE (2005) reported (from its grower workshops leading to the development of a draft business plan for the WGGA) that there was wide acceptance for a single national body representing the interests of all growers. That view was also reflected in the consultations associated with this Taking Stock and Setting Directions project. However, the main driver for a single body now appears to be the desire for a unified voice to have an equal say with the winemaking sector in national industry and government policy.

Consultations: What we heard

"Let's face it; we've had weak industry bodies at the grower level, and the level of debate is very poor. We don't have the resources so we're on the back foot the whole time. We need an effective peak body." (Wine-grape grower)

WGGA strategic plan and functions

Since its inception, the WGGA has developed a strategic planning framework, with the outlines of a strategic plan. In this document, its vision is stated as:

WGGA will be recognised by growers, industry bodies and Government as a strong and effective national body for Australia's wine grape sector.

In support of this vision are four strategies:

1. Create a strong and effective national body for the wine grape sector;
2. Develop and implement effective industry strategies;
3. Create strong and effective industry relationships; and
4. Facilitate improved resources for growers.

WGGA's principal roles are to:

- To engage with growers through active communications.
- To set and drive the national wine grape sector agenda.
- To drive wine grape sector and whole-of-industry strategies to deliver grower sustainability.
- To drive culture change in the wine industry that reinforces and enhances the position of the sector and its growers, by developing effective collaborative industry relationships.
- To facilitate improved resources for growers by delivering programs for the sector and valued services to WGGA members.

Its key areas of activity are:

- Government and industry advocacy on behalf of wine grape growers and the national wine grape sector.
- Strategic planning and policy development, and implementation of national strategies for the wine grape sector.
- Provision of information and data for wine grape growers.
- Development and maintenance of collaborative industry sector relationships.
- Development and custodianship of industry codes of practice.
- Industry R&D program directions and oversight.
- National vineyard bio-security management.
- National vineyard environment and stewardship programs.

WGGA structure

The Strategic Plan and subsequent WGGA Constitution instituted an 8 zone electoral system, with each zone convened by a Regional or State growers' body or wine industry association. The electoral zones are:

ZONE

CONVENOR

Riverina Wine Grapes Marketing Board

Rest of NSW and Queensland

Murray Valley

Rest of Victoria and Tasmania

Riverland

Northern South Australia

Southern South Australia

Western Australia

NSW Wine Industry Association

Murray Valley Winegrowers

Victorian Wine Industry Association

Riverland Wine Grapegrowers Association

Wine Grape Council of South Australia

Wine Grape Council of South Australia

Wine Industry Association of Western Australia

WGGA is currently operating under an Interim Period, with its first Annual General Meeting and elections due at the end of 2007. WGGA membership is open to all wine grape growers and is based on individual enterprise membership.

WGGA funding

The immediate imperative for the WGGA is to secure its financial future. With assured funding coming to an end in mid-2007, the organisation cannot act as a single voice if it is wound up for lack of financial support and so must act quickly to build its funding base.

This presents a strategic challenge for WGGA, as building membership is a very time-intensive activity and would certainly be helped by the organisation having some key achievements to its credit. In this respect, the organisation should consider receipt of funds from the broader wine grape growing sector, including from corporate interests.

Other challenges facing the WGGA in building its funding base include:

- the increasing corporatisation and rationalisation of the grape growing sector;
- the difficulty of establishing efficient funding mechanisms across all growers/regions;
- competition with wine-making associations where growers are also winemakers.

Regional and state grower and winemaker associations

Consultations: What we heard

"I'd like to see more regions build stronger grower bodies, so that ones like ours don't have to carry more than we can manage. And if it leads to more debates between regions, then so be it. Working through the debates will only make us stronger. (Regional grower association representative)"

Regional associations are an important part of the institutional landscape of wine grape growing. All wine grape growing regions have some form of grower or wine-industry based association. While the warm inland regions have grower specific bodies, the cool climate regions have associations that have a predominance of winemaker members. It is this blurring of the distinction between winemaker and wine grape grower in the cool climate regions that contributed in part to the inability of the grape growing sector to seek agreement on how to build the membership base of the former national industry association.

In many parts of the country, the regional associations play an important role in providing professional services and advice to growers. Each of the major regions provide a Wine Grapes for Sale Index to assist growers without contracts get in contact with potential purchasers. The associations also act to

coordinate special seminars, field days and preparation of regional communications such as newsletters.

Traditionally the associations representing the warm inland regions have been better resourced, partly because of the size of these regions and the numbers of producers associated with them. However, these regions have also benefited from past State legislative arrangements that provided for their secure financial base. While there is reduced government intervention into many arrangements associated with agriculture, such as statutory-based marketing schemes, there are examples of State-based assistance to grower groups such as the South Australia Primary Industries Funding Schemes Act, enabled in 1998, which provides some support, albeit minimal, for wine-grape associations in South Australia.

In noting the important regional role grower associations play, during the consultations the following issues were raised by growers and/or association staff:

- while some organisations are well resourced, particularly in the warm inland regions (note comment above), others struggle to secure their financial base and acquire the resources to provide demanded services;
- many of the associations survive on minimum membership support and are hard-pressed to quickly increase activities when suddenly demanded, such as during the current oversupply problem. Some struggle to adequately meet grower expectations, which are highest when times are toughest;
- in some states and regions, there is a plethora of associations a grower could potentially join, including the industry, tourism and small business associations available to them;
- membership of industry associations is sometimes of secondary importance compared to membership of local community based organisations where there is a more immediate sense of reward and belonging; and
- Trebeck (2003) noted 15 wine and grape growing associations in NSW alone, suggesting potential inefficiencies in the overall use of limited industry support available.

Consultations: What we heard

“It takes resources to properly run a regional grower body. And if we are to play a part in building the professionalism of growing – and that means building up business skills - then it can take 4-5 staff to do a good job. We need to invest in our own welfare. We need to convince growers there is value in that.” (Regional grower association rep)

Most states have established wine industry associations to represent the interests of the industry at the state level. In South Australia, the State Government has established the South Australian Wine Industry Council which includes grower representation and has a charter to represent their interests.

Industry information

Access to timely, accurate and relevant data and information (interpreted data) is fundamental to good decision making either at both the institutional and individual levels. The maxim “knowledge is power” is fundamental to business resilience. Within the wine and wine grape industry, there are several sources of data and/or information at the disposal of growers:

Australian Bureau of Statistics (ABS): This Australian Government agency collects a range of data pertaining to production, consumption and trade. The data is coarse, and minimal interpretation is provided, although an annual summary of statistics document is prepared and distributed.

Australian Bureau of Agricultural and Resource Economics (ABARE): Also an Australian Government agency, ABARE undertakes more detailed annual production and related surveys, providing an interpretation of trends and suggesting likely forecasts. The Bureau also undertakes specific investigations on behalf of the government to assist in policy development.

National Wine Grape Utilisation Project: This project is coordinated by the AWBC with funding from the Grape & Wine R&D Corporation to coordinate the Australian Regional Wine Grape Crush Survey. The Survey collects wine grape crush statistics for the whole of Australia, and annually aggregates detailed State reports. Details of the information include:

- actual tonnes of varieties purchased and grown by wineries for the current vintage;
- the wineries preferred crush of each variety for the current vintage;
- the total purchase price, highest and lowest price paid for each variety for the current vintage;
- the weighted average price and baume for each variety for the current vintage;
- estimates of tonnages to be purchased and grown by wineries for the next 5 years; and
- assessment of tonnages wineries would prefer to receive over the next 5 years.

Australian Wine and Brandy Corporation: The AWBC is a major provider of data and information in its own right, and supports the comprehensive statistical on-line access system, Winefacts. The Corporation oversees its information collection, interpretation and dissemination responsibilities through two committees; the Statistics Working Group which works to facilitate timely access to accurate data, and the Knowledge Development Advisory Committee, which has a similar brief for information more generally.

AWBC Wine Industry Information Centre: This centre acts as the first point of call for enquiries regarding information about wine and wine-grapes. It has a broad outreach role, including media and public liaison and promotion of the industry to the wider community.

Grape and Wine Research and Development Corporation (GWRDC): Not only a funder of data collection and research, the GWRDC also supports the publishing of a wide range of material relevant to viticulture and winemaking. Dissemination of this information has been managed through a range of research-based organisations including the Australian Wine Research Institute, universities and State government agencies and private sector extension specialists.

Other: The wine industry has a plethora of subscriber and/or publicly available newsletters, industry updates and commentaries, most of which provide interpretation of data, including its implication for wineries and wine grape growers. These range from research-based material to opinion pieces.

4.3 Industry marketing arrangements

Like many Australian agricultural industries, the wine grape industry has undergone a transition in statutory-based marketing arrangements for the acquisition and sale of its product. For much of the twentieth century, State governments have had legislation covering grape prices, while in the MIA this extended further to cover acquisition and marketing of grapes. Such initiatives gave growers the means to countervail the purchasing power of winemakers.

The Riverina Wine Grapes Marketing Board is the only state level statutory marketing board to remain. It was constituted in 1933 to represent the interests of wine grape growers within the local government areas of Griffith, Leeton, Carrathool and Murrumbidgee.

At that time, governments were promoting policies of decentralisation and job creation in rural NSW for soldiers returning from World War I. This included the establishment of the Murrumbidgee, Coleambally and Murray Irrigation Areas and the associated closer settlement scheme to facilitate regional development.

Communication, transport, and marketing systems were rudimentary for these small farming communities isolated from the main urban areas. Statutory marketing arrangements were, therefore, introduced to provide farmers with a means of countervailing the market power of the purchasers of their products.

The Board is one of several statutory marketing authorities established under the NSW Marketing of Primary Products Act 1927. Until 1976, the Board negotiated informally with Murrumbidgee Irrigation Area (MIA) winemakers on prices, with agreements made on a 'hand shake' basis. This broke down during the mid-1970's the price for red wine grapes dropped sharply. In 1976, vesting power was granted to the Board for red varieties and this was extended to all wine grapes produced in the Board's area of jurisdiction in 1978.

The Board mainly used vesting as a reserve power to set minimum grape prices and conditions of payment, to pursue late payments by winemakers, and to require payments to growers to be made through the Board. The latter condition is seen as simplifying the collection of the grower levies which the Board uses to fund grower services.

In 1997, legislative changes were made to constrain the Board's vesting power. The Board was prohibited from physically receiving wine grapes, but introduced an indicator price system, rather than minimum prices, for the 2000 harvest.

Under current arrangements, the Board consults with individual wineries to establish a range of indicator prices for each variety in the regional market. The Board considers that this service to wine grape growers enables them to have a benchmark when discussing individual prices with wineries prior to delivery.

Nationally, since the introduction of the Commonwealth Trade Practices Act in 1974, and the implementation of National Competition Policy principles from 1995, the domestic marketing of wine grapes has rested mainly in the individual relationships built between growers and winemakers. In the current market circumstances where the grape supply of many growers is uncontracted and subject to spot market sales, new models of doing business will develop. This needs to involve a greater marketing role with growers acting alone or in concert with other growers (such as in cooperative alliances).

Australian Wine and Brandy Corporation

The AWBC is one of a number of national statutory marketing boards established under Commonwealth legislation. Created in 1981, the AWBC performs a number of critical industry marketing functions, including:

- to promote and control the export of grape products from Australia;
- to encourage and promote the consumption and sale of grape products both in Australia and overseas;
- to improve the production of grape products in Australia;
- to conduct, arrange for, and assist in, research relating to the marketing of grape products; and
- other functions in connection with grape products, including
 - providing industry statistics and analysis;
 - maintaining the integrity of Australia's wine labels and winemaking practices;
 - defining the boundaries of Australia's wine areas; and
 - negotiating to reduce trade barriers with other countries.

The AWBC has an annual income of approximately \$15 million. About two-thirds of this is sourced from industry through statutory levies and industry programs, with the remainder largely earned through the sale of goods and services provided by the Corporation.

The AWBC receives the marketing component of the Wine Grapes Levy collected under the Primary Industries (Excise) Levies Act 1999 (payable by winemakers) and the Wine Export Charges collected under the Primary Industries (Customs) Charges Act 1999 (payable by wine exporters). In 2004-05, the income derived from these two sources was \$3.2 million and \$2.69 million respectively.

During the consultation phase of this project, most growers expressed satisfaction with performance of the AWBC, although some were not familiar with all its functions. The Corporation was often cited as responsible for the industry's Strategy 2025. Some growers, however, could not relate its relevance to them from a day-to-day perspective, and some considered the body to be more predisposed to the views of winemakers than grape growers.

The Winemakers' Federation of Australia, in representing wine makers as the payers of the marketing component of the Wine Grapes Levy, is the declared wine grape grower organisation as defined by the Australian Wine and Brandy Corporation Act 1980 for the purposes of consultation with the AWBC on its corporate plan and membership of the AWBC Board Selection Committee.

A significant role of the AWBC is to promote Brand Australia who operate six overseas offices to help generic promotion of Australian wines. Staff are largely locally engaged and become involved in event-based promotion. There may be scope for these positions to have a greater data-gathering role and a stronger role in cultivating relationships not just with potential consumers but also with retailers and distributors in much the way that occurs in the meat, pork and dairy industries.

4.4 Research and Development

R&D Levies

As with many other agricultural industries, the wine grape industry is subject to statutory research arrangements, involving the establishment of an industry levy paying mechanism and an organisation responsible for identifying research priorities and using the levies to fund activities against those priorities. The argument in support of these arrangements is based on market failure, in that the size and nature of grape growing does not enable individual growers to independently invest in or appropriate the benefits of research.

The Grape and Wine Research and Development Corporation (GWRDC) receives levies through both growers, via the Grape Research Levy based on tonnage of grapes grown and delivered to wineries, and winemakers, via the research component of the Wine Grapes Levy based on the tonnage of grapes converted to wine. The levy rates are set by the WFA and WGGA as the declared wine industry organisations under the Act. Recently the operative rate of the research component of the Wine Grapes Levy was increased to \$5.00 per tonne and the Grape Research Levy is set at \$2 per tonne. Expenditure of levies on research activities is matched dollar for dollar by the Australian Government to a level of 0.5 % of gross value of production.

Grape & Wine R&D Corporation

The primary conduit for industry investment in R&D is through the GWRDC. This organisation was established as one of thirteen industry R&D corporations under the Primary Industries and Energy R&D Corporation Act 1989, although the levy system which supports it dates back considerably further.

Consultations: What we heard

"I'm a staunch supporter of the GWRDC. It will be even more important now that we won't have a CRC." (Winemaker)

Grower involvement in the GWRDC is demonstrated through their payment of levies, their nomination of two members through WGGA to the Board Selection Committee, WGGA participation in the Strategic Directions Group, and the inclusion of the previous Wine Grape Growers Council of Australia in the preparation of the Corporation's Five Year R&D Plan for the period 2002 – 2007.

The principal research prioritisation mechanism used by GWRDC is the consultation processes associated with the development of five year strategic plans and annual operating plans. The GWRDC is presently undertaking the consultation process for its 2007 – 2012 strategic plan.

Consultations: What we heard

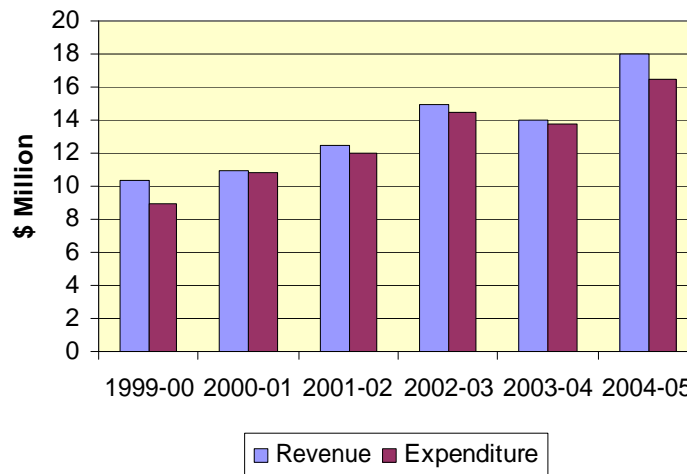
"Compared to other industries, grape growers have been very quick to adjust to new technology. And they don't mind putting their hands into their own pockets to fund it." (Regional grower association representative)

Other processes for prioritisation exist. Advising GWRDC is a range of specialist industry-wide committees, including the WFA Wine Industry Environment Committee and the AWBC Knowledge Development Advisory Committee. More recently, the WFA established a Strategic Directions Group to provide advice on R&D aligned to the strategic directions of the wine industry.

The annual budget of GWRDC is slightly larger than that of the AWBC. In 2004-05, the GWRDC had revenue of around \$18 million and R&D expenditure of around \$12.5 million, each representing an increase of around 25 percent on the previous year. In line with industry growth, the budget has in fact increased over a number of years (see Figure 25). The nature of the Corporation's funding is that it can experience significant fluctuations in levy income depending on seasonal conditions

(2003-04 revenue for example). For this reason, strategic management of levy reserves is critically important to ensure continuity of research investment.

Figure 25: GWRDC revenue and expenditure 1999-2005

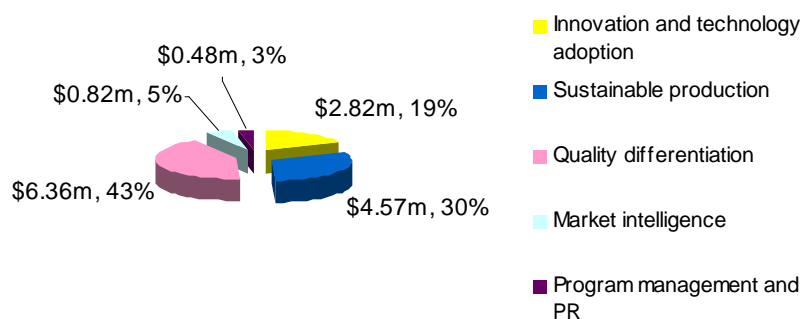


The current five year plan sees GWRDC invest its funds into five programs delivering against four outputs.

- Output 1 Extension and training
 - Program 1: Innovation and technology adoption
- Output 2 Production technologies and processes
 - Program 2: Sustainable production
 - Program 3: Quality differentiation
- Output 3 Assessment of social, economic, regulatory and market factors
 - Program 4: Market intelligence
- Output 4 R&D portfolio providing best returns on investment
 - Program 5: R&D Program management and stakeholder relations (PR)

Figure 61 shows the how the 2004-05 budget was expended against the five program areas.

Figure 26: GWRDC program expenditure 2004-05



The GWRDC has traditionally invested the bulk of its funds through a narrow range of research providers. Initially most of its funds were directed towards the Australian Wine Research Institute (AWRI), with the Board of GWRDC having a significant voice in how the funds were to be used. In 1992, a Cooperative Research Centre for Viticulture (CRCV) was established, supported by 12 research partners, including the GWRDC. In 2004-05, the AWRI and CRCV accounted for 40% and 30% of GWRDC's total investment respectively.

With the completion of the CRCV's seven year term (December 2006), opportunities have opened to GWRDC to broaden its investment horizons beyond its traditional providers. To this end, the organisation has been looking to invest in significant research centres in NSW and WA that provide strong regionally-based (decentralised) research capacity in those states. There is a need for these centres to assist in building the national research capacity and provide points of differentiation that can contribute to the national research effort.

Consultations: What we heard

'NSW could be a problem if its new research centre doesn't differentiate and add to the national research effort. Duplicating the AWRI just for NSW would be silly.'
(Winemaker)

4.5 Benchmarking, continuous learning and business skills

The GWRDC supports a range of grower extension initiatives. While benchmarking is evident within the winemaking sector, it is not well supported amongst growers or reflected in GWRDC's extension programs. To some extent, the close relationship between winemakers and growers has meant that many aspects of quality assurance are dealt with through more direct means. However, as this relationship changes and growers are forced to compete more against one another, the benefits of continuous improvement through grower benchmarking should become apparent.

Consultations: What we heard

"There's been resistance to benchmarking at the grower level. Many of the wineries get involved, and a few of the bigger growers, but there's value in all growers knowing where they sit so they can actively improve their game."
(Wine industry body)

The need for new and extended business skills will increase with fewer growers having long-term contractual relationships with winemakers. During the course of the consultation phase, it became apparent that some

growers needed to have more knowledge of their overall cost structures. Some growers considered that they had sufficient business skills and others were sceptical of the need for improved business skills as long as most decisions 'appeared' to be determined by the winemakers. "As long as I know what they want by when, it's enough. I do my job well. It's all I need to know" was one grower's comment reflecting this view.

Consultations: What we heard

"When you're getting \$1,000 or more a tonne for your grapes, you don't have to know much about your business."
(Regional grower association representative)

Good business skills and appreciation of the contribution continuous learning makes to improved profitability, competitiveness, confidence and, ultimately, quality of life should be important elements of future extension programs in the wine grape industry. This will need to be reflected in the training of extension personnel. To this end, it is noted that a national extension initiative will shortly commence, administered from the National Wine & Grape Industry Centre at Wagga Wagga in New South Wales, but applicable across Australia. As with many other agricultural industries, extension capacity is increasingly being left to the private sector. The

new initiative, therefore, should ensure that it helps to build the overall extension capacity and ensure that the private advisers have access to the latest R&D knowledge and extension techniques.

4.6 Government

The role of government in society is multi-layered. It acts as legislator, regulator, adjudicator and taxpayer so that society and its economy may function with confidence. The national government has a responsibility to ensure that inter-governmental relations, both domestically with States and internationally, serve the purposes and aspirations of society.

A major role of government is as a policy director, influencing broader societal relationships within and among the economy, industry, education, environment, health etc.

A major intersection between government and the wine grape sector lies in the area of industry and agricultural policy. Here the role of government is specifically to:

- provide industry development strategies at both the macro (national) and micro (firm) levels, recognising concepts of globalisation and the need for internationalisation of Australian industries;
- promote industrial development; and
- integrate policy objectives.

The Australian Government aims to improve the competitiveness and adaptation of industries to the international environment, favouring concepts of free trade across international markets. To this end, Australia has seen a policy evolution of tariff reductions, deregulation, micro-economic reform, development of industry plans and investment in innovation.

The current reform agenda includes an aim for 5% maximum tariffs, simplified regulations and lower business costs, improved government costs and efficiency, increased private involvement in infrastructure and increased industrial relations flexibility.

Key policy areas in relation to the wine grape sector are:

- ensuring Australian agricultural industries and the environment are protected from exotic pests and diseases (ie, biosecurity policy and regulation);
- ensuring Australia's trading relationships with other countries facilitate the growth and prosperity of Australian industries; and
- ensuring competition within and between different sectors in the economy.

Industry structural adjustment

A significant challenge for government is dealing with structural adjustment issues in the face of complex and sometimes contradictory social, institutional and policy settings at both the domestic and international levels. This is most felt among industries attempting to increase their efficiency and economic competitiveness in the face of a non-level playing field internationally.

Consultations: What we heard

"Beware. You want something from Government, then don't expect it for free. I reckon the answer lies within the industry."
(Wine grape grower)

The Australian Government, through the Department of Agriculture, Fisheries and Forestry, supports a range of initiatives to help primary producers to be more competitive, sustainable and profitable. These initiatives largely come under the Agriculture Advancing Australia (AAA) package and the Australian Government Drought Assistance program.

The AAA package includes Farm Help, Farmbis, Farm Management Deposits and the Rural Financial Counselling Service.

Farm Help

Farm Help provides short term financial assistance to farm families who are experiencing severe financial difficulties meeting living expenses and are unlikely to obtain a loan from a financial institution.

The assistance aims to help farmers while they take action to improve their long-term financial prospects, either by improving the financial performance of their farm enterprise, finding alternative sources of off-farm income or re-establishing outside farming, should they choose to do so.

The programme offers assistance up to \$55,000 per farm family, which includes:

- Income support at the same rate as Newstart Allowance for up to 12 months, to allow farmers time to make decisions about their future.
- Advice and training up to the value of \$5,500 (including GST) per farm family.
- A Re-establishment grant up to the value of \$50,000 for farmers who have taken a decision to leave the farm is available on the sale of the farm.
- A Pathways Plan is based on the compulsory financial assessment developed at the initial advice session, along with the longer-term goals identified by the farm family, whether that is on or off the farm. The farmer develops the Plan, with the assistance of a Centrelink Farm Help Contact Officer and must act in accordance with it, while they are participating in the Farm Help program.

FarmBis

FarmBis provides farmers with assistance to participate in a range of training initiatives to assist the recipient acquire new and comprehensive business and natural resource management skills and practices.

FarmBis is relatively flexible, providing access to a wide choice of courses and training activities. Participants can attend commercially available training, or groups of individuals can attend tailored training and claim a percentage of the course cost. However, all participants need to apply for FarmBis funding before the commencement of training.

Farm Management Deposits (FMDs)

The FMD scheme is a tax-linked, risk-management option which allows primary producers to deal with variable income. The scheme enables primary producers to set aside taxable primary production income in profitable years, to be withdrawn, usually in lower income periods.

Farm management deposits provide tax benefits if kept for at least 12 months (Exceptional Circumstances-declared areas may be exempt). Interest is earned at market rates on the deposit's full amount. They are offered through authorised

deposit-taking institutions (ADIs) such as banks, building societies and credit unions.

Rural Financial Counselling Service Programme

This program is jointly supported by the Australian and State governments. It provides grants to state, regional and community level organisations to provide free and impartial rural financial counselling to primary producers and small rural businesses who are suffering financial hardship and who have no alternative sources of impartial support.

Rural financial counselling services employ rural financial counsellors across Australia. State or regional level service providers can consult volunteer local reference committees for advice about local or regional issues and priorities.

Australian Government drought assistance

The Australian Government supports drought-affected farmers and rural communities through income support, interest rate relief and free personal and financial counselling.

With the continuation of severe drought conditions across southern Australia in 2006, the Government announced new Drought Assistance measures that will include grape growers in declared exceptional circumstances

The drought assistance package includes:

- Continuation of EC income and business support;
- Farm Management Deposits (FMD) Scheme - increasing the deposit cap from \$300,000 to \$400,000, and increasing the non-primary production income test from \$50,000 to \$65,000;
- Professional business and financial planning grants of up to \$5,000 for eligible farmers in areas that have been EC declared for more than three years;
- Immediate extension of all existing EC-declared areas recommended by the National Rural Advisory Council until 2008 and expanding the declaration to cover all producers;
- Immediate reintroduction of EC assistance to all producers in areas where EC assistance has ceased since February 2006 and the National Rural Advisory Council has recommended assistance be provided (estimated to be around \$500 million);
- Assistance to provide extra financial (\$7 million) and personal counselling (\$2 million) support to farmers;
- Emergency individual and community grants to be administered by the Country Women's Association (\$4 million over two years);
- Increasing the cap on EC Interest Rate Subsidies from \$300,000 to \$500,000 over five years, subject to the applicant having established their viability through an independent business assessment;
- Removal of the requirement for farmers, when applying for EC Interest Rate Subsidies, to have operated without government support in two out of the past five years; and

The Department of Agriculture, Fisheries and Forestry manages these Agreements and note that a number of trading partners see follow up support and bilateral cooperation as an integral part of export sales. They consider that: 'the bilateral cooperation agreements, implemented in close liaison and partnership with agricultural and food industry participants (including producers, processors and exporters) as well as interested State/Territory governments, provide opportunities for industry to enhance networks both at government and industry levels, to develop markets and to address impediments through activities such as joint ventures and collaborative training and research'.

International trade and free trade agreements

The Department of Foreign Affairs and Trade (DFAT) states that: 'The Australian Government pursues a combined multilateral, regional and bilateral approach to trade policy. As part of this policy, Australia is open to concluding regional or bilateral agreements that deliver substantial gains to Australia and which cannot be achieved in a similar timeframe elsewhere (DFAT, 2005).

Free Trade Agreements (FTAs) are an important component of Australia's bilateral trade policy. FTAs have recently been signed with the USA, Singapore and Thailand, and are currently under negotiation with China, Malaysia and the United Arab Emirates. Despite this, the DFAT (2005) contends that '...that any progress in regional trade liberalisation should be multilateralised in due course through World Trade Organisation (WTO) negotiations.'

WTO members are free to enter into FTAs where these Agreements comply with certain tests. The crucial test of an FTA is that it must eliminate all tariffs and other restrictions on substantially all the trade in goods between its member countries. Australia considers that 'substantially' must mean 'a very high percentage', and that no major sector should be excluded from tariff elimination.

During the course of this project, the Free Trade Agreement negotiations with China have been referred to as highlighting the difficulties faced by the industry in accessing such a potentially lucrative market. These difficulties have included:

- China's high tariff regime;
- differentiation in quarantine standards and administration, and the need to align these to science-based systems common to both countries;
- inconsistent application of labelling standards at domestic and international levels, and their real and potential application as trade barriers;
- lax legal systems in respect to the protection of intellectual property;
- poor transparency or communication of regulations and licensing requirements at both national and provincial levels; and
- potential competition with other FTAs China is entering into with other countries, particularly where China may enter into these on a preferential basis.

Competition and fair trade in the supply chain

The Australian Government has committed to the wholesale horticultural sector having a mandatory code prescribed under relevant provisions of the Trade Practices Act 1974. The Department of Agriculture, Fisheries and Forestry (DAFF) is managing the implementation of the code.

In the case of the wine and wine grape sectors, the Government did not support the recommendation of the Senate Rural and Regional Affairs and Transport References Committee's recommendation for a mandatory code between grape growers and winemakers. However, the Wine Industry Relations Committee is developing a code of conduct for managing issues that affect a collaborative relationship between growers and winemakers. This initiative should be completed in early 2007.

Levies and statutory organisations

The history of government support for Australian agriculture has involved, among other things, significant support for statutory marketing and research arrangements. This has involved governments at both state and federal levels providing the legislative means for the compulsory collection of industry levies and the creation of statutory authorities responsible for overseeing the expenditure of the levies on behalf of the industries concerned. The first such legislation was enacted by the Queensland government in the early 1900s to support research and marketing arrangements for the sugar industry.

The traditional arguments for government involvement in these statutory arrangements were based on market failure, in particular the inability of individual producers to capture the benefits of marketing and research investments, and free rider problems (many marketing authorities grew out of a need to overcome dysfunctional, non-mandatory co-operatives). More recently, ongoing support for the research arrangements in particular is tied to industry policies aimed at increasing the competitiveness of the agricultural sector.

The statutory research arrangements have undergone an evolution from farmer-based advisory committees making recommendations to agricultural ministers, to more formalised research councils, R&D corporations and, more recently, industry-owned company structures. Part of this evolution has seen separate research and marketing arrangements come closer together. During the mid-1980s, the federal government introduced more stable forms of providing government contributions to the industries through matching industry levies expended on R&D.

Taxation

Both the Australian Government and State governments levy taxes which impact on wine grape growers at all levels.

The main issue of contention from various sectors of the industry are taxes which impact on the cost of production, including payroll tax and stamp duty.

Payroll tax is a state tax on the wages paid by employers. Employers are liable for payroll tax when their total Australian wages exceed the exemption threshold. Exemption thresholds vary between states, but this tax mainly impacts the processing sector of the industry with significant numbers of employees.

Stamp duty impacts on grape growing businesses through transactions such as insurance. Generally, stamp duty is exempted or reduced for acquiring agricultural property.

The Australian Government provides a limited range of input cost offset schemes such as the energy grants credits scheme which provides a grant for an eligible fuel purchase (diesel) for use in an off-road agricultural activity.

Consultations: What we heard

"Without doubt the taxation arrangements need to be reviewed. It won't help the current situation, but it may help create a more stable future."
(State government representative)

There are few specific tax deductions or rebates now available for grape growers, with the exception of landcare and water resource expenditure and R&D (if undertaken) which apply to primary industry generally. Producers may elect to participate in tax averaging and a Farm Management Deposits Scheme, which defers tax paid on income paid into the Deposits, is available under prescribed conditions.

The Wine Equalisation Tax (WET) was introduced at the same time as the GST to reduce the impact of the removal of sales tax on wine products, and its replacement with a lower rate of GST. The WET was introduced at a rate of 29 per cent on the last wholesale sale value, and applies to grape wine, grape wine products, fruit and vegetable wines, cider, mead and sake. From 1 July 2006, the first \$1.7 million of domestic wholesale wines sales is exempt from the WET. This effectively provides a maximum rebate of \$500,000 per year. Prior to this date, the maximum cellar door rebate was \$290,000 per year and it was \$42,000 per year when the WET was introduced.

Industrial relations

Labour represents a significant element of wine grape production costs, particularly in pruning and grape picking, although in recent years more pruning and grape harvesting is undertaken mechanically through contractors.

The Australian Government and State governments have significant powers in relation to work place relations matters which impact on the costs of employing labour. This includes the processes for setting terms and conditions of employment, payment of the superannuation guarantee, workers' compensation premiums, and occupational safety and health requirements.

The most significant change in recent years has been the introduction of the national Work Choices initiative which the Australian Government describes as a new workplace relations system.

Key strategic issues that have been identified by the Australian wine industry to be critical to the future competitiveness of the industry are:

- labour costs in all facets of the supply chain;
- shortages in the supply of labour with appropriate skills; and
- Australian society's expectations on employment conditions and management practices.

There is little likelihood of the conditions that contribute to high labour costs being removed in Australia, and attention needs to be directed at management approaches which maximise productivity and innovation to reduce the labour input.

Progressive wine grape businesses consulted during this project stressed the need for the focus to be on becoming 'super efficient' in the use of labour and in maximising productivity through highly skilled workers and automation.

Transport infrastructure

The Australian Government and State governments have leading roles to play in the provision of transport and associated infrastructure covering roads, rail, shipping and airways.

For the distribution of wine grapes, must and bulk wine, road is the primary mode of transport. The field interviews with the industry did not disclose significant concerns about transport apart from the views of some Barossa growers of the need to improve roads to wineries.

Natural Resource Management

An important role of government is its responsibility for the protection of the terrestrial, aquatic, marine and atmospheric environments. This role is becoming increasingly advocated by communities both domestically and internationally, and recognition of government's role is reflected in the rapidly increasing number of international agreements on environmental issues.

The Australian Government's role in natural resource management and the environment is played out through a combination of mechanisms that influence individual and collective behaviour impacting on resource condition:

- legislative and regulatory powers, such as through environmental protection acts, setting standards;
- inter-governmental cooperation in direct management of resources and infrastructure, such as through organisations like the Murray-Darling Basin Commission;
- establishment of policy priorities for government investment or joint-investment in industry, scientific and education programs, such as through Australia's national science objectives;
- establishment and management of programs that invest in on-ground resource management actions, such as Landcare and the Natural Heritage Trust; and
- establishment of community-based resource management organisations, often underwritten by legislation in the form of authorities, such as catchment management authorities.

Australia's approach to natural resource management has taken an evolutionary direction towards social response mechanisms. That is, emphasis is increasingly being placed on those owning or directly managing natural resources to take more responsibility for the sustainable use of the resources under their control. The term "bottom-up" is often associated with this approach.

Many natural resource management issues are made complex by their diffuse nature. For example, issues such as salinity, sediment movement and eutrophication, among others, make it difficult to identify specific polluters, and so Australia's environmental policies are complicated by blurred lines between public and private responsibilities (hence requiring combinations of policies based on beneficiary versus polluter pay principles).

Water is presently the highest natural resource management priority of federal and state governments. Increasingly governments are seeking market-based instruments to influence behaviour affecting the quality and quantity of water. Market-based instruments that see an increasing emphasis on the allocation of water rights and the trade in these rights will influence the wine grape industry in those places where such mechanisms exist. This will see increasing movement of water allocated to industries of higher value and an increasing emphasis on increasing water use efficiency to increase productivity from every megalitre available.

Not all grape growing regions are affected by water trading policies. However, in some regions potential exists for government to influence water use through licensing water holding capacity on farms (dams) or limiting new developments and infrastructure. This already occurs in some states such as NSW and Victoria.

Local Government

Local governments interact with the wine grape industry through a variety of ways:

- they are involved in land classing and zoning, identifying suitability of land uses within their jurisdiction;
- following from this, they are responsible for land use approvals, and approvals of related on-farm infrastructure;
- in some cases they price and regulate the use of resources such as water, depending on where the water is sourced;
- the management of some regional infrastructure such as local roads;
- placement, licensing and control of local markets and other retail establishments; and
- certain regulatory responsibilities for food and food service standards, safety and health, and point source pollution.

Consultations: What we heard

“Planning laws have not been used effectively to control industry growth. It’s impossible to make sense of some of the places where vineyards have gone in.” (Winemaker)

In some regions of Australia, particularly where wine grape growers and related downstream industries form a significant part of the local community, local governments can have an intimate association with the industry, taking close interest in its health and viability. In some of these areas, wine grape growers are often represented on a council’s membership.

In regions where the wine grape growing is carried out in close proximity to urban or peri-urban communities, local councils can become involved in conflict resolution processes

involving resource use, safety and sustainability.

4.7 Key findings on the wine grape industry’s enabling environment

The following is a summary of the project’s key findings in relation to the Australian wine grape industry’s enabling environment referenced to the desired industry outcomes of resilience and self-reliance.

Resilience

This refers to 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.

- The Australian wine and wine grape industry has a history of cycles of ‘boom’ and ‘bust’. 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.
- The movement from the boom to the current depressed industry conditions of over-production of wine and grapes and low prices has been evident since 2001.
- Many growers and winemakers believe that the present downturn reflects a ‘seismic’ shift in the industry that will involve more significant change than in previous industry downturns. The Australian industry is now much larger, is much more reliant on 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.

- Demand/supply coordination in grape growing is 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.
- Recent vintages have involved sales of uncontracted and excess grapes at very low prices on the spot market. This has encouraged opportunistic virtual wineries to produce extremely cheap bulk wine and 'cleanskin' bottles that are seriously undercutting established popular premium brands on the domestic and export markets.
- With the consolidation that is occurring in Australia's largest wine companies and industry difficulties due to grape and wine over-supply, many in the industry consider that the previous high level of collaboration has deteriorated in recent times.
- Observation of industry cycles, suggests that in periods of grape under-supply, grape prices tend to increase at a much faster rate than wine prices. However, when wine prices come under pressure, grape prices experience relatively much larger falls.
- Due to the resilience of grape growers in periods of depressed prices and their high capital investment, there are indications that very large price falls take place before growers make significant changes to production or consider exiting from the industry.
- The likelihood of a major reduction in grape production in 2007 and possibly 2008 due to seasonal conditions highlights the need for accurate and up-to-date information for production forecasting and monitoring purposes. Concerns were expressed about the accuracy of coverage for ABS data on vineyards and grape production and that further work is required on price data to make it more useful for industry benchmarking and business planning. The industry data is less informative on grape quantities left in vineyards, types of grape growing enterprises, grape selling arrangements, wine inventories and consumer demand.
- Although detailed and wide ranging data is collected on the industry, there has been less analysis and dissemination of the available information to assist growers and winemakers in their business decision making. This is changing with improved information services from the Australian Wine and Brandy Corporation.
- The exchange of information between growers and winemakers has traditionally been important for growers in making decisions for investing in their vineyards. There are indications that growers may have been over-reliant on winery information for decisions on new plantings and that a broader range of production and market information is needed to cover all aspects of the investment (including for its economic life).
- 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.
- 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.

- Another 2025 strategy was to introduce risk management that identified and formulated contingencies for industry-wide risks. The grape growing sector presently does not have a national strategic plan or a risk management strategy.
- The wine industry has recently implemented a new 'Future Leaders – succession for the Australian wine sector' program. The first intake of 15 participants included two viticulturists and further intakes are planned for 2007 and 2008.
- There is limited involvement of women in representative positions in the wine grape industry.

Self reliance

This refers to the 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.

- There are a large number of organisations that represent growers and/or winemakers at the regional (GI) level and state levels.
- Some of the regional organisations have large memberships, are strongly supported by growers and are well-resourced. Others, particularly some cool climate regions, have difficulties attracting members, establishing secure funding and acquiring resources.
- Some grower organisations represent specialist interests (such as those based on specific grape varieties). In other cases, there appears to be some duplication of representation between grower or grower/wine maker organisations and fragmentation in the application of 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 grower/wine maker relationships. A code of conduct for relationships between growers and winemakers is being developed by Wine Grape Growers Australia and the Winemakers' Federation of Australia.
- 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.
- 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). Significant roles for the AWBC are to promote Wine Brand Australia, carry out generic marketing functions and provide quality information services to grape growers and winemakers.

- The primary conduit for industry investment in R&D is the GWRDC. Growers pay a grape research levy based on tonnages of grapes delivered to wineries. Winemakers also contribute through a wine research levy (based on tonnages of grapes converted to wine). Industry research funding is matched by the Australian Government and totalled \$17.8 million in 2004-05 with R&D expenditure of \$15.1 million.
- Research priorities are set through GWRDC's five-year R&D Plan (a new plan is being developed for 2007-2012) and a number of specialist industry-wide committees.
- The GWRDC has traditionally directed the bulk of R&D funds through the Australian Wine Research Institute and the former Cooperative Research Centre for Viticulture. This has changed over time to include other research providers.

CHAPTER 5. THE PROJECT'S PIVOTAL CONCLUSIONS

This chapter outlines the project's pivotal conclusions in relation to the industry's global competitiveness, profitability, sustainability, resilience and self-reliance. The term pivotal conclusions is used because these are a set of statements which identify the key issues facing the industry and the basis for the strategies and actions which were formulated during the Setting Directions phase of the project.

5.1 Global competitiveness

Key issues for the industry in maintaining the industry's global competitiveness are:

- Maintaining export success through developing and implementing wine marketing strategies that result in sales which will support profitable grape growing and winemaking sectors.
- Benchmarking all sectors of the wine industry value chain, including grape growing enterprises, against international competitors.
- Researching and adopting new grape growing business models for competing in consolidating value chains and achieving enterprise profitability.

The pivotal conclusions of the project in relation to the above issues are:

- 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 opportunities 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 Australian growers.
- Responsibility for developing and implementing 'Brand Australia' marketing strategies and regional branding of wines will rest with the wine industry as a whole.
- 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 performance 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.
- 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.

5.2 Profitability

Key issues for the industry in re-establishing profitability are:

- Establishing effective industry strategic planning and information services to assist wine grape demand and supply rebalancing.
- Improving mutual understanding of respective businesses in the value chain, costs of production, pricing and profit margins or return on assets.
- Achieving appropriate economies of scale and cost reduction in grape production and marketing.

The pivotal conclusions of the project in relation to the above issues are:

- Industry projections for future grape production levels are subject to uncertainty about grape market changes, the unfavourable seasonal growing conditions and the impact of grower and winemaker actions to reduce production.
- The number of growers that have reported 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.
- Changes in 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.
- 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.
- 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.

- 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 requirements), syndication of production and/or consolidation in property holdings.

5.3 Sustainability

The key issues for the industry in ensuring industry sustainability are:

- Planning for and undertaking major structural adjustment in the wine grape growing industry with appropriate support for growers.
- Establishing a culture of continuous improvement and innovation in wine grape production and marketing.
- Monitoring the impact of climate variability on irrigation water availability and cost.
- Continuing to implement best practice natural resource management.
- Monitoring climate change and formulating response strategies.

The pivotal conclusions of the project in relation to the above issues are:

- 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.
- 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.
- 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.
- 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.

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

5.4 Resilience

The key issues for the industry in strengthening its resilience are:

- Strengthening Information collection, analysis and reporting to support grower decision making.
- Developing effective planning and strategy setting processes for the grape growing sector linked to sales targets and marketing strategies for wine.
- Ensuring ongoing investment in the industry's human, capital and financial capacity.
- Establishing and maintaining collaborative relationships through the value chain.

The pivotal conclusions of this Taking Stock report in relation to the above issues are:

- Maintaining and improving industry information services is important in both understanding key trends and providing growers with information that enables sound decision making.
- Strengthening of market information and sharing the information in the wine industry value chain is a means of building stronger relationships.
- 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.
- Successfully negotiating future industry cycles will require improved strategic planning for the wine grape growing sector that is complementary to wine production and marketing strategies.

- The future competitiveness and prosperity of the industry will depend on adequate on-going investment in wine 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.
- Mutual respect and understanding of roles in the wine industry value chain is critical for industry resilience in future with high level collaboration required between wine grape growers, winemakers, retailers and the wine industry as a whole with consumers.
- Industry strategies need to include monitoring of value chain relationships to ensure the collaboration necessary to successfully compete in a rapidly changing world wine market.

5.5 Self reliance

The key issues for the industry in developing self reliance are:

- Consolidating Wine Grape Growers Australia as a strong and effective national organisation of grape growers;
- Coordinating the industry structure at regional, state and national levels and resolving funding and resourcing constraints.
- Investing in the development of industry leadership; and
- Improving policy development capacity and strengthening relationships with government.

The pivotal conclusions of the project in relation to the above issues are:

- 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 to 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 growers and a wider range of regional organisations.
- 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.

- Potential exists for WGGGA to build strategic alliances and collaborative partnerships in the value chain, with governments and with the national industry institutions. This may increase the resources available to WGGGA to add value to its strategies and more effectively represent the wine grape growing sector.
- In line with the need for improved industry information services, WGGGA could be a 'reseller' of information that has been analysed and packaged to meet specific grower interests.
- Regional and state level organisations could play a key role with WGGGA 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.
- It is important that the industry maintains investment in its leadership capabilities and establishes succession plans for key decision making positions.
- WGGGA needs to work to strengthen its relationships with the Australian Government, state governments and local government in industry policy development and planning.

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APPENDIX 1. INDUSTRY CONSULTATIONS

The following table provides a list of individuals and their respective organisations that were consulted during this project between July and September 2006.

Bill Schumann Fiona Hill Ross Dalton	Department of Agriculture Fisheries and Forestry	National
Michael Matthews	Victorian Wine Industry Association	Vic
Mike Stone	Murray Valley Winegrowers	Vic
Brian Simpson	Riverina Winegrapes Marketing Board	NSW
Roseanne Healy	Riverland Winegrape Growers' Association.	SA
Guy Adams	SA Viticultural Council	SA
Bob Taplin	Barossa Winegrape Growers Council	SA
Vince O'Donnell	Australian Bureau of Agricultural and Resource Economics	National
Mark McKenzie Alan Newton	Wine Grape Growers' Australia	National
Stephen Strachan Doug Young	Winemakers' Federation of Australia	National
Tony Spawton Larry Lockshin	School of Marketing University of Adelaide	SA / National
Stephen Harvey	Deloitte Touch Tohmatsu	National
D'Arry Osborn Rick Anderson	D'Arenberg Winery	SA
Laurie Stanford Paul Henry Lucy Anderson Eric Wisgard	Australian Wine and Brandy Corporation	National
Tony Clancy	Grape & Wine R&D Corporation	National
Doug Lehmann	Peter Lehmann Wines	SA
Brian Walsh	The Yalumba Wine Company	SA / National
Kris Roberts Paul Chapman	Department of Primary Industries, SA	SA
Peter Hayes	Int. Organisation for Wine & Vine	Inter-national
Peter Dawson	The Hardy Wine Company	SA / National
Bob Taplin Chris Canute David Materne Robert Schiller Paul Clancy Adrian Hoffmann Robert Craigie Ian Zander Leon Andretzke Leo Pech	Barossa wine grape growers	SA
Kerri Smart	Chairman and director of corporate vineyards	WA
Tom Economou John Vithoulkas Jim Sfyris John Sfyris David Taylor Chris Kazautzis Steve Tanner Mark Ohlson	Riverland winegrape growers	SA

Spiros Papageorgiou Chris Byrne Keryn Gorman Rob Corty Glenn Arnold Ben Kimber Peter Hill David Ludas Sam Albanese		
Stuart McGrath-Kerr	NSW Wine Industry Association	NSW
Ron Hutton	NSW Wine Research Centre, Wagga Wagga	NSW
Bill Calabria	Westend Estate President Riverina Winemakers Association	NSW
Doug McWilliam	McWilliams Wines	NSW
Darren De Bortoli	De Bortoli Wines	NSW
John Casella Alan Kennett	Casella Wines	NSW
Brian Simpson	Riverina Wine Grapes Marketing Board	NSW
Tony Baggio Bruon Altin Adrian Raccanello Len Gullotta Gary Davidson Lance Hicken Steven Barben Bruce Connor Vince Zappalio Paul Morrison Tony Cristofavo Louis Dal Nevo Robert Bellato Peter Cremasco John Strano Peter Raccanello	Riverina winegrape growers	NSW
Richard Martin Peter Creyke Brian Mullany Brian Freeman Roger Clarke Phillip Brown Jason Brown Sam Allan Chris Allcock Terry Mulligan	Hilltops grape growers and winemakers, Young	NSW
Peter Fagan Anne Jeffrey Peter Jeffrey Val van der Rachen Margaret Wallington Andrew Robson Mark Simms	Cowra region grape growers and winemakers	NSW
David Hoskins	Orange grape-grower	NSW
Justin Byrne	Orange Region Vignerons Association	NSW
Barry Buffier Murray Spicer	NSW Department of Primary Industries	NSW
Peter Wormald Mike O'Malley	Mudgee district grape growers and winemakers	NSW

Steve Hirst Des Walker Jarrod Dowler Adam Sutherland David Lowe Paul Baguley Luke Spencer Vaughan Cooke John Quirk Rosie Dorney		
Patrick Auld Chris Bray	Hunter Valley Vineyards Association	NSW
Phil Ryan	Mt Pleasant Wines	NSW
Kate Langford Patrick Abrahams	Cellarmasters	National
Shane Tremble	Woolworths BWS	National
Phillip Laffer	Pernod Ricard (Orlando)	National
Michael De Palma Mike Stone Colin Free Philip Englefield Lindsay McClelland Ian Roberts Len Schliefert Lindsay Herath Rod Nokes Robin Gebert Haydn Farnsworth Justin Kassulke Gerry Belej	Murray Valley Winegrowers Inc.	Victoria/NSW
Dave Maples Stephen Lowe Bob McNamara	King Valley Vignerons Inc. Alpine Valleys Vignerons	Victoria
Malcolm Campbell Brett McLean Michael Murtagh	North East Victoria Winegrowers Association	Victoria
Michael Matthews	Yarra Valley Wine Growers' Association	Victoria
Mike Fitzpatrick Shane Smith Bob Swinburne Richard Harrison Rob Bennett	Bendigo Wine Growers' Association	Victoria
Stuart Bryce	Vineyards Association of Tasmania In.	Tasmania
Gerald Ellis	Meadowbank Wines	Tasmania
Monique Lubiana	Stephano Lubiana Wines	Tasmania
Noel Bevan	Nocton Park	Tasmania
Nathan Hyde	Kreglinger Wine Estates	Tasmania
Andrew Pirie	Tamar Ridge Estates, Pirie Tasmania	Tasmania
Grant Ramage	Coles Myer Liquor Group	National
Stuart McNab	Fosters Wine Estate	National and international
John Griffith Sue Vidovich	Wine Industry Association of WA Inc.	WA
Paul Thompson	Blackwood Valley wine grape grower	WA
Dane Hudson	McGuigan Simeon Wines	National and international

Chris Hancock	Oatley Family Wines	National and international
John Ellis	Blue Pyrenees Estate	Victoria and international
Allan Pankhurst	Chairman, Canberra District Wine Industry Association	ACT region

The following paragraphs reflect feedback provided during the consultations.

Wine grape oversupply situation

In the consultation meetings, wine grape growers and other industry participants focussed on the short-term over-supply issue. Many growers attributed the over-supply situation to unchecked growth encouraged by the strategies of large companies and managed investment schemes. Some acknowledged that over-supply was a result of all players, large and small, capitalising on a run of good years without having a fall-back position for reduced grape and wine sales.

There was little agreement, either among growers or winemakers, about the solutions to the present oversupply of grapes or excess wine stocks. In most regions covering warm, temperate and cool climates, there was some optimism for a return to improved economic conditions for grape growers. This was less evident in the warm regions, such as in the Riverland, where there was concern about very low prices and growers without contracts being forced to sell on the spot market at 'give-away' prices. Most growers and winemakers consulted were resigned to the fact that many growers will need to leave the industry, but there was disagreement as to the role government or industry should take in the process of adjustment. Not all regions (eg, Tasmania) are facing grape over-supply and low grape prices.

Amongst the increasing number of growers without contracts or with contracts due to expire in one or two years, there is great uncertainty as to future prospects for grape sales and profitable prices. This is an issue that needs further investigation in the Taking Stock. The spot market appears to have emerged as a major channel for selling grapes and is operating on a low price base. This market does not provide any confidence or certainty for growers in their production decisions.

There was much concern about speculative plantings of grapes if markets have not been secured and concern that Managed Investment Schemes were contributing to new plantings while established growers were losing contracts.

The main point of consensus among those consulted was that there is a need to grow the market for Australian wine so as to secure the long-term future of both grape growers and winemakers.

Many grape growers commented that the current growth in exports at the lower end of the market is profitless and positions Australia in a market segment in which we cannot compete on price (in comparison with lower cost producing countries). Others (largely larger wine producers) believe "we need to be where the action is in moving volumes even if that means low prices". A third segment of opinion is that "Australia needs two distinct marketing strategies – one for the popular premium market segment and one for fine wines".

The following is a selection of quotes that epitomise the diversity of views and the passion with which these are held by key industry participants. It is important in a Taking Stock exercise that these views are acknowledged and the issues underlying the views are understood.

Examples of grower sentiment

"I enjoy doing what I do. Sure there's a future for us family growers, but it will take time to recover from what we're going through." (Wine-grape grower)

"When we planted, we did so at the request of the wineries. We paid for the costs associated with change; now we're paying the price for that change. What are the wineries paying?" (Wine-grape grower)

Impact

"It's ironic y'know. The Riverland is the best place in Australia to supply the markets that are going gang-busters, but we've been hardest hit! You can sense the loss of hope around here." (Wine-grape grower)

"Consumers are driving the price point down. The big players are happy to play that game. It's a real shame, though, when you see brands once associated with particular regions being bought and sold and becoming more generic. I wonder if the consumer knows that's what's happening." (Winemaker)

"Funny, we've less than 200 years of winemaking history, but with the commoditisation line we're taking, we're losing what history we've got." (Winemaker)

"The stocks are getting older at just the time when everyone wants to drink younger wines." (Winemaker)

Matching supply and demand

"I can't see how supply and demand will ever come into perfect harmony in an industry that's taste-based." (Retailer)

Oversupply situation

"We're all guilty of putting ourselves in this position. We all contributed to investments that lead to the oversupply." (Wine-grape grower)

"I think we're closer to overcoming the oversupply than many may think. The figures just don't stack up when you look at the existing storage capacity. (Winemaker)

"These bastards are still putting in vines, while telling me they don't want my grapes. Why should I be pulling!" (Wine-grape grower)

"The way I see it, the processors are deliberately creating an oversupply for their long-term interests." (Wine-grape grower)

"We're all getting mixed messages. One day you hear the glut will be gone by 2009, the next it's by 2011. Some fella who's in the know says it could be much longer." (Wine-grape grower)

Reducing oversupply

"The trouble with mothballing is you end up with small moths." (Winemaker)

"How should I know whether mothballing is a good idea. I reckon there's a need to research that; to understand what the impact might be before we go down that track." (Wine-grape grower)

"Pushing local wines in local retail. That's the way each region can contribute to resolving issues on home territory at least." (Wine-grape grower)

"Wineries have a responsibility to cap the tonnes, and to reward the growers who help them do so." (Wine-grape grower)

"Bring in the tanks!! We need everyone we can get. What I'm saying is that the industry may have itself an infrastructure problem." (Winemaker)

"I'd like to see us go for a regionally-based floor price, but I reckon that ideas doomed. Still, here's hoping!" (Wine-grape grower)

Meeting the market: Short-term

"Dare I say it, but have we let our egos prevail over market realities? When the opportunities are in the mass-market and we invest heavily at the premium end then something has gone wrong with business sense. Perhaps it is just ego." (Industry body rep)

"We can't ignore the domestic market, but we really must accelerate exports." (Winemaker)

"How many times have we heard it, that it's best to go upstream and supply wines instead of grapes yourself. It's happening everywhere, but it just doesn't make sense as far as I can see." (Wine-grape grower)

"The two buck chuck thing will be short-term. The problem may be that the consumers will bottom feed and stay there." (Winemaker)

"The way I see it, people have always been able to buy the two buck chuck, only it's been in boxes and flagons." (Retailer)

"We were approached. It was not the other way around. We thought long and hard about it and spoke to many people including growers. No-one said it wasn't a good idea to help clear the industry excess." (Retailer)

"If the two dollar wine moves people from the cask to the bottle, then what are you worried about." (Retailer)

"There's been a lot of hearsay and rumour about the wines, but the reality is it's being bought up largely by the older consumer, often pensioners, and it has not resulted in a decline in sales of our other ranges." (Retailer)

"We've taken the wine side of the business from \$1 billion to \$3 billion over the past three years. I can't see how we're not seen to be helping the industry." (Retailer)

Meeting the market: The future

"I don't know what the long-term future holds. Kids are drinking RTDs and who is to say they will graduate to wine." (Wine-grape grower)

"Wine is a lifestyle product and we must make it less intimidating. That means it's a matter of associating it with occasions. To increase consumption in today's market, you must work on expanding the occasions that wine can be associated with." (Retailer)

"The wine industry hasn't done as well as it could have in face of RTD competition because of the snob factor. Let's face it, it's just a drink." (Retailer)

"It's one thing to look at export markets, but surely we have got to get things right on the domestic front. Why are we seeing a decline here? We've got to keep on having a crack at the next generation wine drinker – it's not just a one-off job." (Wine-grape grower)

"China is a growing threat. It's producing more grapes at better quality." (State government representative)

“China? Who knows. We’ve not given up on it, although others have. It’ll take time and resources.” (Winemaker)

“You’re talking about a place with little water, and all its rice will be required for eating, not drinking. That’ll be the opportunity presented (by China).” (Researcher)

“We need help in the export side of things. Export grants really aren’t very helpful.” (Winemaker)

“The industry should get more behind the BYOs (restaurants). Paying fifty bucks plus for wine in a restaurant is not good for the industry and means people drink less. Sure there’s a safety issue, but let’s not promote elitism.” (Winemaker)

“All the pressures in the US market are to go down. This is where we have done well, although perhaps we kid ourselves about our quality. But it’s not where we want to be. This presents a dilemma where we could take the easy route downwards, or the harder route upwards, or even staying where we are.” (Winemaker)

“Bottom line is, if we can’t compete on price, then we’re in big trouble on the international front. Globally we have a buyers’ market.” (Wine industry body representative)

“Let’s look beyond the short-term. If the Australian dollar continues to climb over the next ten years, we may see the total collapse of the industry.” (Wine-grape grower)

Strategy development

“Doesn’t having a strategy mean that you’ll know what to do when an oversupply happens? Why do we keep paying people like you to come in after the problems happen?” (Wine-grape grower)

“We need a national register of vineyards to get a proper assessment of what is in the ground. That, and an accurate assessment of what is in stock and its age.” (Wine-grape grower)

Australian wine industry value chain

Views put during the consultations about value chain relationships were influenced by the present over-supply situation and its impact on wine-grape purchases and the nature of the transactions, irrespective of whether contracts were in place.

It was in this area that views presented were most hostile, reflecting a sense of frustration, financial desperation and loss of hope experienced by many growers. A culture of blame often came to the fore at the commencement of meetings, although in most cases this eventually dissipated to allow discussions to broaden to longer-term issues.

There are increasing numbers of growers who do not have supply contracts or facing the prospect of coming out of contract and these not being renewed. This appears most prevalent amongst small growers, but some large operators are also in or facing this situation.

Small to medium wineries shared the sense of the growers’ frustration, suggesting that they too are feeling the pain in the face of declining wine prices and increasing costs of production.

Both growers and wineries alike pointed to possible ‘unethical’ behaviour among industry participants, particularly in respect to interpretation of contractual obligations and application of quality standards.

At the same time, many growers and winemakers referred to cooperative business relationships with both parties accepting responsibility to work through issues of reducing production and lower prices.

Larger wine companies also pointed to the challenges to their own businesses of consolidation in the retail chain and the competitiveness in promoting and selling brands.

The following is a selection of quotes that epitomise the feedback on wine industry value chain relationships.

Examples of grower sentiment

“The winemakers treat the growers like school kids. It’s a master - servant relationship.” (Regional grower association representative).

“Well actually, we get along pretty well with our winemaker. They’re hurting, maybe a bit less than us, but they’re one of the big players and they’re not so bad. That’s not to say they’re all good. Perhaps we’re lucky.” (Wine-grape grower)

“I’ve no sympathy for the South Australians. Our local wineries should have been buying local grapes, not stuff from across the border.” (Regional grower association representative)

Contracts

“You can only go so far with contracts. Relationships will always play a stronger role” (Winemaker)

Yeah, it’s hard to be critical of the wineries, ‘cause you’re likely to be blacklisted.” (Wine-grape grower)

“Wineries have to be honest, and either say “yes” or “no”. It’s hard to make decisions when they say “Maybe we’ll buy your grapes.” I’d rather get a clear “no” than that.” (Wine-grape grower)

“The industry is rapidly internationalising. That means acting more quickly and relationships are likely to be more fluid in future.” (Winemaker)

“Orlando are slightly more honourable. They’re French now, and know the consequences of pissing off growers.” (Wine-grape grower)

“Quality assessment has become a joke. It is being manipulated to suit the position of the processors. There is no consistency from vineyard to vineyard and region to region. In my own vineyard, there is no consistency from year to year.” (Wine-grape grower)

Ethics

"I acknowledge not everyone of us is behaving as we should. I've no problem with a code of conduct and an ombudsman to oversee its implementation if it is effective and if the transaction costs are reasonable and don't compound the problem." (Winemaker)

"It's very hard to see a cooperative solution when we all think that what we are doing is rational. Mind you, rationality and ethics are different things." (Wine-grape grower)

"Brokers are a problem. They can be unscrupulous and can break down relationships between growers and processors." (Regional grower association rep)

Supply chain

"We'd like to see the department take more of a whole-chain approach to looking at the issues. We've been too long in the vineyard trenches." (State government rep)

"It's important that growers meet with the senior winemakers; with the senior executives. Here we give every one of our growers an opportunity to meet the CEO and the senior winemaker so they feel part of the system. (Winemaker)

Retailers

"The problem is simple. Competition is dominated by two retailers who are vertically integrating, buying at ridiculous prices, but then, nuh, I guess we've brought it on ourselves with too many wineries. Maybe it's not so simple." (Winemaker)

"I know we can be hard to get along with, but for those that persist, it usually pays off." (Retailer)

Australian wine grape industry institutional arrangements

Feedback from the consultations reflected an industry fragmentation in industry structures; much more so than its achievements over the past decade would suggest. This fragmentation is in part captured in the preceding discussion about value chain relationships. However, the fragmentation was not only apparent across the value chain, but also at the grower level between different growing regions or combinations of regions. That is, the culture of blame previously discussed, was reflected in feedback about relationships between the warm and cool climate regions, between different warm climate regions, between different cool climate regions and between different growers even within common regions.

Despite a culture of blame (not atypical for any industry at the peak of a perceived crisis), growers generally wanted a unified voice to strengthen their position in dealing with any short-term transitions and long-term stability and strength. This unity encompassed cool, temperate and warm climate regions.

Support for the major industry bodies, the Grape & Wine R&D Corporation and the Australian Wine and Brandy Corporation was widespread, although improvements in research and marketing investments were suggested. Development of business skills at the grower level was identified by industry bodies, industry associations, wineries and some growers alike.

Much concern was expressed by growers and winemakers about the present negative views of the industry and the threats of 'talking the industry down' in the community which could impact on its future growth.

There were strong and diametrically opposed views on many issues of government policy and intervention in the present oversupply situation. Many growers and wine producers believe it is an issue that the industry itself must resolve and government intervention could distort the adjustment required. On the other hand, many growers believe that there should be support

for 'mothballing vineyards' and/or selective 'vine pulls'. Some growers strongly stated that government contributed to the over-supply by maintaining accelerated depreciation for too long. Others believe supply management support will not work and any government support should be directed at demand building and supporting the improvement of business skills.

There were also strong and opposing views on wine taxes particularly ad valorem versus volume based taxes. Some growers believe that the industry must move to a volume based tax as an ad valorem tax penalises quality and efforts to strengthen Australian sales of premium wines. Others believe that it is not appropriate to have a volume based tax with the present WET rebates.

Some growers pointed to the need for the industry to invest in leadership development particularly amongst potential younger leaders and women.

There is a divergence of opinion on the impact of reduced grape prices and grower returns on regional communities. Some believe the impact will be substantial if the present situation continues for a longer period of time. Others believe some regional communities are more diversified and continue to grow with population increases (eg, "River-changers" in the riverland areas).

The following is a selection of quotes that epitomise the feedback received during the consultation process.

Examples of grower sentiment

"My story's short. I'd be better off shooting myself so the wife can collect the insurance. I have an obligation to protect my wife, and I'm failing!" (Wine-grape grower)

"I've pulled the kids out of sport. I can't afford to drive them around anymore." (Wine-grape grower)

"Look around at what's going on here in the Riverland. We've returned to the dark ages. We've been reduced to peasantry. We've been divided and we've been conquered. We are citizens of this country and we need to be recognised." (Wine-grape grower)

Research and development

"I'm a staunch supporter of the GWRDC. It will be even more important now that we won't have a CRC (Cooperative Research Centre)." (Winemaker)

"GWRDC takes too much out of this region and doesn't put anything back." (Wine-grape grower)

"Codswallop!" (Wine-grape grower in response to above)

"There's a black hole in market research. Not the kind that the AWBC gets involved in, but in long-term consumer trends, population demographics, impacts of changing tastes on supply and demand – that kind of thing." (Wine-grape grower)

"We're doing more and more of that kind of research (market and economic research) but it's hard to know how much we should fund versus government agencies and even individual companies." (Wine industry body representative)

"We need to maintain the ethic of collaboration in our research institutions. I hope we are not setting up research centres that will add to competition and duplication." (Winemaker)

'NSW could be a problem if its new research centre doesn't differentiate and add to the national research effort. Duplicating the AWRI just for NSW would be silly." (Winemaker)

“Compared to other industries, grape growers have been very quick to adjust to new technology. And they don’t mind putting their hands into their own pockets to fund it.” (Regional grower association rep)

Business skills

“I’d like to see more industry funds spent on how to run a business” (Wine-grape grower)

“I’d say business skills would pay itself over time and again if you invested there. There’s the opportunity for the industry bodies.” (Service provider)

“The new generation of grape-growers are young, lazy and irrational. Many of them are putting on pruners in this region. They’ve no idea about how to manage their costs. They could do a bit more work themselves for a start!” (Regional grower association representative)

“When you’re getting \$1,000 or more a tonne for your grapes, you don’t have to know much about your business.” (Regional grower association representative)

“Succession planning in this region is critical, but it just ain’t happening.” (Regional grower association representative)

Grower industry bodies

“Let’s face it; we’ve had weak industry bodies at the grower level and the level of debate is very poor. We don’t have the resources so we’re on the back foot the whole time. We need an effective peak body.” (Wine-grape grower)

“I know we need a unified voice, but if we continue to demand that it’s based on representation and not ability, then I can’t actually see it becoming unified.” (Wine-grape grower)

“I can’t see any way around it. Growers must be compelled to fund a national grower body if it is work.” (Wine-grape grower)

“I’d like to see more regions build stronger grower bodies, so that one’s like ours don’t have to carry more than we can manage. And if it leads to more debates between regions, then so be it. Working through the debates will only make us stronger.”

“It takes resources to properly run a regional grower body. And if we are to play a part in building the professionalism of growing – and that means building up business skills – then it can take 4-5 staff to do a good job. We need to invest in our own welfare. We need to convince growers there is value in that.” (Regional grower association rep)

“It’s hard to get people interested in getting on the board. They’ve got a lot to do and sometimes industry bodies are just not they’re thing. (Regional grower association rep)

“We need to get over this cool climate / warm climate nonsense. It’s a symptom of the industry talking itself down.” (Wine-grape grower)

“Grape-growers need a vision. It does not have to be the same as an industry wide vision, although it should be consistent. But if the only vision is an industry-wide one, then we’ve not done the growing business a service.” (Wine-grape grower)

“We’re glad to see the WGGA get up as this will give us a single point of contact and let the growers deal with some issues they are best placed tackle.” (Wine industry body)

“We need to be one industry, not two – growers and winemakers.” (Wine-grape grower)

Other industry bodies

“WFA should be speaking out about the lack of balanced debate on water and the environment. Water will be the issue of the future.” (Winemaker)

Information, data and extension

“Frankly, a lot of decisions have been made for me by the wineries, so now things are different. I can see I’ll need to know the state of play a lot better. Do I really know if I’m profitable?” (Wine-grape grower)

“Wine companies have an advantage in the extension process. The growers feel compelled to attend technical updates.” (Winemaker)

Collaboration

“The family vineyard is not going to get the industry back on its feet. Actions need to be shared.” (Wine-grape grower)

Policy, regulation and institutions

“Planning laws have not been used effectively to control industry growth. It’s impossible to make sense of some of the places where vineyards have gone in.” (Winemaker)

“New entrants are coming into this industry and I can’t see where they are getting their advice from. They’re planting on land that’s not suitable for grapes, which is a planning issue, but surely they’re getting advice from somewhere. At the end of the day, they bring the region’s reputation for quality down.” (Winemaker)

“Beware. You want something from Government, then don’t expect it for free. I reckon the answer lies within the industry.” (Wine-grape grower)

“Take a look at Queensland. You know, it’s the only place on the planet that has a minister solely responsible for wine and grapes. Not even the French have that. No wonder they’re doing OK up there.” (Wine-grape grower)

“Without doubt the taxation arrangements need to be reviewed. It won’t help the current situation, but it may help create a more stable future.” (State government representative)

“I don’t see the Riverland as an industry issue. It’s for the South Australian Government. It’s about size and scale and not the product.” (Winemaker)

Regions and communities

“You hear about more wealth coming into the region. People retiring to inland towns because they can’t afford the coast. But car sales are down by 30% - mainly utes – so the picture’s a bit mixed. We need to get a handle on the social side of things.” (Regional grower association representative)

“Are you gonna tell me the big companies put back into the region the way us families do. Take a look at who’s putting money into the community clubs, the hospitals and the like.” (Wine-grape grower)

Competitiveness

“Look, I’m a grower and I’ve got to admit that we just don’t think globally. You reckon things are any better for overseas growers? We’ve got to compete, and that means reducing costs. You can’t escape from that.” (Wine-grape grower)

“There’s been resistance to benchmarking at the grower level. Many of the wineries get involved, and a few of the bigger growers, but there’s value in all growers knowing where they sit so they can actively improve their game.” (Wine industry body)

“The ones (growers) doing their business properly will be the one’s to survive. And that means looking beyond the vineyard.” (Winemaker)

APPENDIX 2. SWOT ANALYSIS OF THE INDUSTRY

The following represents a consolidation of various factors and issues relating to the wine grape industry's strengths, weaknesses, opportunities and threats (SWOT) that became apparent during the Taking Stock and Setting Directions project.

STRENGTHS

- + 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 vineyards and 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 organisation 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.

WEAKNESSES

- + 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 temperate and cool 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

- + 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.

THREATS

- + 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 or the varieties of grapes grown.
- + 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.

APPENDIX 3. INDUSTRY WORKSHOPS

Taking Stock Workshop held in Melbourne on 24 August 2006

The aims of the workshop were to:

- Report back on the key messages arising from the industry consultations for the Taking Stock report on the wine grape industry;
- To seek workshop participants' comments and discussion on these key messages and obtain further input to the Taking Stock report;
- To facilitate discussion across the industry value chain on Taking Stock issues identified to date in the industry consultations and from industry reports; and
- To ensure that the commentary from this workshop, industry consultation and comment on the workshop discussion paper together provide the information, knowledge and insights that are necessary to construct a complete picture of the Australian wine grape industry. This formed the base information for the preparation of the industry's future strategic directions.

The individuals who participated in the workshop were:

Michael Williams, Facilitator
Alan Newton, Wine Grape Growers Australia
Bob Taplin, Barossa Winegrape Growers Council
Tony Spawton, University of SA
Jim Fortune, Grape and Wine RDC
Kris Roberts, PIRSA
Brian Simpson, Wine Grapes Marketing Board
Bruno Brombal, Wine Grapes Marketing Board
Mike Fitzpatrick, Grower – Bendigo
Murray Spicer, DPI, Orange
Michael Pullen, AVIA
Philip Laffer, Orlando – Pernod Ricard
Kerin Smart, Grower WA
Doug Young, Winemakers' Federation of Australia
Nick Power, Margaret River Wine Industry Association
Ron Collins, Blaxland Vineyards Ltd
Adrian Hoffmann, Dimchurch Vineyards – Grower
Peter Dawson, Hardy Wines
Chris Byrne, Riverland Wine Grape Growers
David Maples, King Valley Vignerons
Bob McNamara, Alpine Valley Vignerons
Michael Badcock, AusVeg
Eric Wisgard, Australian Wine & Brandy Corporation
Stuart McNab, Fosters
Roseanne Healy, Riverland wine Grape Growers Association
Michael Matthews, Victorian Wine Industry Association
Mark McKenzie, Wine Grape Growers Australia
Michael de Palma, Murray Valley
Vicki Manson, DAFF
Bill Schumann, DAFF
Shane Tremble, Woolworths
Guy Adams, SA Viticulture Council
Bruce Bowen, DAFF

Michael Ryan, DAFF
Laurie Stanford, Australian Wine & Brandy Corporation
Mike Stone, Murray Valley Wine Growers
Stephen Carroll, Australian Bankers' Association
Ken Moore, Consultant Kiri-ganai Research
Richard Price, Kiri-ganai Research
Judy Andrews, Kiri-ganai Research

Setting Directions Workshop held in Adelaide on 9 November 2006

The aim of the workshop was to agree on a portfolio of strategies and practical actions to improve the competitiveness, profitability, sustainability, resilience and self-reliance of the Australian wine grape industry.

The following individuals participated in the workshop:

Alan Newton, Wine Grape Growers Australia
Bill Schumann, DAFF, ACT
Bob Taplin, Barossa Winegrape Growers Council, SA
Brian Simpson, Wine Grapes Marketing Board, NSW
Chris Byrne, Riverland Wine Grape Growers, SA
David Maples, King Valley Vignerons, Vic
Dianne Davidson, Davidson Viticultural Consulting Services, SA
Dominic Nolan, Winemakers' Federation of Australia, SA
Doug Young, Winemakers' Federation of Australia, SA
Fiona Hill, DAFF, ACT
Guy Adams, SA Viticulture Council, SA
Ian Robinson, DAFF, ACT
Jim Fortune, Grape and Wine RDC, SA
Jim Caddy, Consolidated Co-op Wines, SA
Katie Cotton, WGGA, SA
Ken Bray, Hunter Valley Vineyard Assoc, NSW
Ken Moore, Consultant Kiri-ganai Research
Kerry Smart, Grower WA – RE Vineyards Management Ltd, WA
Kris Roberts, PIRSA, SA
Mark McKenzie, Wine Grape Growers Australia, SA
Michael de Palma, Murray Valley Wine Growers, Vic
Michael Matthews, Victorian Wine Industry Association, Vic
Michael Ryan, DAFF, ACT
Michael O'Brien-Brown, Castle Hill, NSW
Michael Gray, Viticulturalist, St Annes Winery, NSW
Mike Stone, CEO Murray Valley Wine Growers, Vic
Paul Clancy, SA Winegrape Growers, SA
Richard Price, Kiri-ganai Research
Robert Bellato, Riverina Winegrapes Marketing Board, NSW
Ron Collins, Blaxland Vineyards Ltd, Vic
Roseanne Healy, Riverland Wine Grape Growers Association, SA
Sally Oatey, DAFF, ACT
Stuart McNab, Fosters, Vic
Vince O'Donnell, ABARE, ACT