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Keywords

Globalization, wine industry, innovation, SME, interorganizational

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Emerging Interorganizational Structures in the Australian Wine Industry:

Implications for SMEs

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ABSTRACT

This paper discusses the globalization of the wine industry in terms of such issues as global production, distribution, technology transfer and branding. It also examines the increasing focus on localization and cluster development in light of the industry's current rationalization. The paper argues that with such reconfiguration, 'New' and 'Old World' distinctions are blurring and may disappear. Furthermore, as the wine landscape evolves, regional cluster-based interorganizational domains are forming, along with the emergence of regional branding and the decline of a homogeneous Australian level industry. It is contended that these domains are essential in securing an ongoing role for SMEs.

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INTRODUCTION

The globalization of economic and business activity continues unabated. International trade, foreign direct investment, foreign portfolio investments and international currency transactions are increasing at an unprecedented rate (Enright, 1998). This phenomenon is common to all industry sectors across all countries. It is one that became clearly apparent in the wine industry from the early 1980s and has been responsible for a reshaping of the industry's international landscape. More recently, however, there has been a greater emphasis on regional responses to global pressures, the role of regional clusters within a global environment and firm-specific strategies for responding to its opportunities and challenges (Kearins, 2005; O'Neill, 2004; Ogunmokun and Wong, 2004, Roberts and Enright, 2004). Among the outcomes has been the

emergence of regional identity and branding and a somewhat redefined role for small and medium sized firms within these regions. These phenomena and the institutional, interorganizational domains within which they arise are explored in this paper. First, we undertake a brief historical examination of the globalization of the wine industry with particular reference to the New World. Second, we trace the evolution of current production, distribution and marketing environments. Finally, we examine the institutional interorganizational domain prospects for SMEs in the Australian wine industry and the broader implications for organizational reconfiguration across national, regional and firm structures.

A CHANGING LANDSCAPE – THE RISE OF THE NEW WORLD

During the 1960s and early 1970s most New World producers were contenting themselves with producing bulk wine of variable quality. Although Californian wine was gaining some recognition in the international market, it was limited and had many critics. Australia, South Africa, New Zealand and Chile posed no real threat to Europe. Their wines were regarded as mediocre, they had bad press throughout most of the continent and their export markets were virtually non-existent. In addition, the reputation of European wine was now such that importers had no taste for alternatives. Europe reigned supreme.

Four major developments, however, led to fundamental changes within the international wine landscape from the 1980s onwards, changes that have seriously eroded the European, Old World hegemony. First, there was the education of the customer. This was slow to evolve but had a dramatic and lasting effect. As the culture of wine drinking became a more accepted part of daily life in traditionally non-wine drinking communities its value and acceptability as a beverage also increased. People began to take wine drinking, but also its history, origins and varieties more

seriously. European producers understandably embraced and promoted this cultural change. Consumers were taught to recognize the various quality distinctions, were given rudimentary advice on the differences in *terroir*, encouraged to tour Europe's vineyards and indulge in tastings. Most importantly, they were guided in their choice of wines from vintage to vintage.

The second major development was the taste test. It was a direct response to the increasing popularity of wine, the emerging democratization of the product and the determination of New World producers to internationalize their business. In 1976 shockwaves rippled through the wine world when a blind taste test in Paris (with 9 French judges) found that the best tasting cabernet and four of the best tasting whites were in fact, Californian (Time, 1976). This single outcome created the turning point that the New World needed.

The third development was the attitudinal response to the revolutionary taste test embodied in consumer-driven production. Throughout the 1980s and particularly 1990s, New World producers increasingly understood that a wine was considered 'good' if, and only if, the consumer actually liked it. Initially the most successful at recognizing this fact were Australia and California. It was found that most consumers opted for robust, full fruit, rather sweet flavours. They also wanted wine that was good quality, value for money and dependable; that is, if they bought a particular branded variety, they wanted its taste to remain consistent (Pompelli and Pick, 1999). These requirements brought about a fundamental reorientation in viticultural and oenological practice (GWRDC, 1999). From the late 1980s, Australia, California, South Africa and to some extent New Zealand brought about a systemic organization of their wine industries (Aylward, 2003; Aylward and Turpin, 2003). The fact that only then were they officially recognized as 'industries' is testament to this organization. In Australia, the Grape and Wine Research Development Corporation, the Winemakers Federation of Australia, the

Australian Wine Research Institute and the Cooperative Research Centre for Viticulture (Aylward, 2003) played central roles in coordinating funding, research, information, exports and government lobbying. At a tangible level, they provided advice and practical assistance in all viticultural and oenological aspects from clone and rootstock development, virus diagnosis, canopy management and harvesting methods, through to hygiene, maceration techniques, blending and quality testing. They also played critical roles in wine competitions, wine education, vertical integration, brand development and retailing (Foster and Spencer, 2002). These referent organizations (Trist, 1983) not only centralized resources, but gave their respective industries a sense of unity and common purpose (Aylward, 2003). They established targets, set priorities and created benchmarks for the entire industry, so that the growth, production and sale of wine grapes targeted consumer needs. In short, they created the vision. Their continuing and critical role in sustainable regional cluster development in Australia is discussed later in this paper.

The fourth major development that transformed the global wine landscape was the European wine industries' continued focused on a producer-driven approach. Throughout the 1980s and 1990s, Europe's response to the increasing market penetration of New World varietal wine was to adhere to its legislated quality systems and the concept of terroir, the antithesis of the New World approach (Pompelli and Pick, 1999). Systems such as the French Appellation d'Origine Controlee (AOC) had little room for consumer input. Every aspect of the growing and wine making process was defined, from determination of which territories should be reserved for particular appellations, to the grape varieties that could be used, to soil characteristics, to approved oenological methods (Gay and Hutchinson, 1987; Brousse, 1999). There was a firm belief that the New World challenge would be short lived (Voss, 2004).

NEW WORLD GROWTH

The New World challenge was not, however, an ‘aberration’. By 2000, Australia, California, New Zealand, South Africa and Chile had established a sustained and substantial presence within the global wine industry. For example, in terms of grape production (volume) for 2004, California ranked fourth in the world, Australia seventh (Winetitles, 2004). Together, these more substantial New World producers account for approximately 22% of total world production, a figure that is increasing rapidly. In terms of wine exports, Australia is now ranked 4th in the world, followed by Chile in 5th position, and California 6th. New World exporters account for more than 40% of world trade (excluding intra-European trade) (Anderson, Norman and Wittwer, 2003). The *importance* of international trade accounted for by New World producers transcends these figures. For example, the UK is the largest export market for both New and Old World producers. A decade ago, nine of the ten top selling wines in this market were from European producers, primarily France. In 2004, seven of the ten top selling wines were from New World producers, six from Australia and one from California. In the lucrative US market, the situation is similar.

The rise of New World wine producers and their challenge to the growth, production and distribution methods of European traditionalists signaled an apparently clear demarcation within the international wine industry. There are, however, other organizational changes taking place at a *subterranean* level that are increasingly obscuring this demarcation. Being capital-intensive, the wine industry has for many years had a tendency to rationalize. Until recently, with a few exceptions, such rationalization has taken place at a national level, as the need for economies of scale in grape growth and production have encouraged the larger firms to ‘cannibalize’ those smaller firms with similar business organization and product style. For example, as the industry

entered a period of rapid growth in Australia through the 1980s, a rash of takeovers and mergers took place. During the late 1990s and in the first four years of this century, mergers and strategic alliances within the industry have intensified. The more noticeable and profound change, however, is that these developments have become very much transnational in nature. The intense need for capital, the opportunity to source grapes (at competitive prices) from multiple areas and the buying power associated with size has led the larger wine firms to look for acquisitions beyond their shores. But perhaps more important driving forces behind this activity have been the need to capture the most innovative oenological techniques, key brands, markets and market share (Anderson, Norman and Wittwer, 2004).

The mergers and strategic alliances referred to include some of the world's largest wine firms. As competition intensifies across key price points in key markets, further globalization of production and distribution has become an inevitable legacy. We have witnessed alliances between New World firms, Old World firms and most significantly, New and Old World firms. British based Allied Domecq has acquired champagne Perrier-Jouet and Stolichnaya, Australia's Fosters Brewing has purchased California's Beringa Estate. US Constellation Brands has purchased Australia's BRL Hardy to become the world's largest wine group and is in the process of absorbing US firm Mondavi, while establishing strategic alliances with France's famous de Rothschild and purchasing 40% of Italy's largest firm, Ruffino (AGI, 2004). Given most, if not all, of these major firms also have large stables of domestic wine firms, the recent consolidation process has significant implications for the global wine industry.

The ubiquitous 'flying winemaker' has also symbolized the international diffusion and uptake of oenological innovation. Primarily, this has taken the form of 'in-demand' winemakers being contracted (usually during vintage) as consultants or overseers for particular producers or group

of producers. As consultants they provide advice on new techniques, quality measures, maceration, oak usage, among others and are held responsible by many in the industry for facilitating the rapid transfer of knowledge and technology (Brook, 2000). In more extreme cases, this knowledge and technology transfer has been represented by complete operations that have been shipped from one country to another, with the purposes of servicing (for a fee) an entire winemaking region. Such transfers have tended to be one-directional: from the New to Old World.

Currently, the international wine landscape is in flux. Over the coming decade this fluidity, a reduction in ownership diversity and increased homogeneity of product is expected to undermine the current New/Old World distinction. The wine industry is witnessing a *true globalization*, with the increasing internationalization of production, distribution and marketing. As European firms are attempting to access New World markets and price points, New World firms are in turn striving to enter those price points long held by the Europeans. The blurring of these Old and New World wine industry distinctions will have far reaching implications for concepts such as branding and *terroir*. There is pressure for national and previously successful strategies such as ‘Brand Australia’ to incorporate firm and regional identity approaches (Morris, 2000). As consumers search for distinction in their choice of wine, regional branding, representing a collection of boutique and small and medium-sized wineries, will attract greater acceptance. Global wine firms, while still dominating this landscape, will need to reorient their marketing towards regional and even single vineyard characteristics in order to create heritage and unique stories for their wines.

The future of *terroir* is more difficult to discern. It is a notion that is based on the intricacies of weather, soil type, ground slope, grapes and wine making ‘savoir-faire’, all of which provide

wine with a unique personality. With a renewed focus on regionalization and localization, however, the complex natural components of *terroir* may receive a new recognition. As Brian Croser contends, in the restless search for excellence the concept of *terroir* will again find favour on a global scale.

LOCAL/GLOBAL NEXUS – THE IMPORTANCE OF CLUSTERS

It appears inevitable that the increasing globalization of wine will trigger a regional extension to the product's national identity. Globalization and the growing issue of brand identity have created a new focus for *localisation*. According to Enright (1998:6) 'Globalization can . . . allow firms and locations with specific sources of competitive advantage to exploit their advantages over ever wider geographic areas, often, though not always, at the expense of other areas.' Local or regional identity is emerging as a new force in Australia, California and New Zealand; it already exists in France and Italy. In Australia, regions such as the Hunter, Clare, Barossa, and Yarra Valleys are marketing themselves to the world and establishing their own brand identity. In France there are the world renowned branded regions of Bordeaux, Burgundy and Champagne.

The emergence of regionalism/localization is, in part, the outcome of increased 'clustering' within wine industries, and very much related to this, the response of small and medium sized enterprises (SMEs) to global pressures. To date in New World wine industries, the landscape has been very uneven. Most New World industries have comprised large numbers of boutique and small firms and a very small number of large firms. These numbers have been inversely related to their production and export capacity, with the largest 5-10 firms accounting for upwards of 80% of the national capacity and the many hundreds of small firms contributing to

the remaining 20% or less (Winetitles, 2004). Although this distortion will continue, there are indications that it will be reduced. Trends in a number of New World industries appear to point to the fact that wine firm clusters create a disproportionately positive influence (Aylward, 2002, 2004a). Infrastructure, knowledge flows, supply chains, research and education bodies, regulatory frameworks, advisory organizations and general firm interaction appear to be significantly more intense within these clusters than in non-cluster regions (Porter, 1998; Aylward, 2004a).

The intense interaction within these clusters also appears to translate into the enhanced diffusion and uptake of innovation, marketing, distribution and importantly, exports (Aylward, 2003, 2004a, 2004b). The momentum appears to be self-sustaining. As the clusters have grown in size and complexity they in turn have attracted both new and re-locating firms. Large multinationals usually have either their head office or a large subsidiary based within these clusters, which provide a 'learning environment' for the participating boutique and small firms. The Australian context is an example of the above influences. In this geographically diverse wine industry there are perhaps seven major clusters located across five states. The most innovative of these clusters is located in South Australia, where all of the industry's national intermediary, funding, regulatory, research, education and export bodies are also located (Winetitles, 2004).

It is no coincidence that in terms of core innovation and export measures, small and medium sized enterprises (SMEs) in the South Australian wine cluster perform substantially better than either non-cluster firms or their counterparts in the industry's less developed clusters. For example, approximately 78% of South Australian SMEs export compared to between 40% and 45% in the industry's other clusters and approximately 20% of firms in non-cluster regions (Aylward, 2004a). In addition, they are almost twice as export intensive (exports as a ratio of

total sales), export to more markets and are more geographically diverse in their export destinations. In terms of innovation, these same South Australian SMEs access the industry's research services at more than twice the rate of firms in other clusters (68% versus 32%), and almost seven times the rate of non-cluster firms (10%). Inter-firm collaboration is also substantially higher for South Australian firms, as is new product development, employee education levels, marketing and technical innovation (Aylward, 2004a).

Government, industry, public sector research organizations and a multitude of suppliers are co-locating partly by design and partly through a natural attraction to concentrated resources, in a new and innovative way. This new localization represents far more than simple co-location. It is a dynamic response to the new opportunities and pressures of an increasingly globalized industry. It is also a form of localization that may well afford its participants access to focused research and development, targeted marketing and collective branding. The critical mass afforded by these clusters would also provide SMEs with the potential to participate more effectively in the supply chain. Specifically, they would gain access to: more secure supply of raw materials and human resources, superior distribution channels, and adequate off-licence shelf space for super-premium to icon price points..

Rather than being an industry in which the SME faces extinction, or at best, a tenuous existence as predicted by many during the 1990s, this emerging landscape may well reconfigure the positioning and influence of these firms and as a result, their market share (Strachan, 2005). A global wine landscape without national boundaries or identities is emerging, one punctuated by significant pockets of localized production and branding. This should also introduce a reconfiguration of industry policy towards region and firm specific extension, export and marketing programs. The current funding mechanisms in Australia, for example, are based on

growth and production, which in practice means that the majority of resources are directed towards the largest firms. As globalization of ownership increases, a significant proportion of these resources will be dedicated to firms whose ownership is actually located outside the industry. Zhao (2003) argues that on a cost-benefit analysis R&D funding from Australia's Grape and Wine Research and Development Corporation disproportionately benefits overseas consumers over domestic consumers. This is true, but he has failed to recognize the more serious issue of producer R&D costs and technology benefits. For a number of the New World's major producers who are owned by international interests the domestic R&D levies create a substantial flow-on effect in terms of technology transfer to the parent firm. For example, in Australia the Hardy Group is Australia's 2nd largest producer and largest exporter. Yet this firm is owned by Constellation, a US firm, whose export profits return to the US.

This complex nature of ownership and industry dynamics needs to be understood more fully by policy makers if domestic industries are to reap the benefits of public sector initiatives and targeted schemes. Historically, there has been a growing dichotomy between rhetorical and actual support for domestic SMEs; increased support for the larger multinational firms has naturally led to a restriction of access to available resources for those firms with limited capacity. Small to medium sized enterprises, however, represent the 'next wave' in the industry's production and export capacity. These firms are region-specific rather than global in nature and as such, require the same industry priorities, milestones and focused support that was awarded their larger counterparts during the 1980s and 1990s. Industry vision within each producer nation must now be oriented towards that firm sector which best represents its interests. In a global environment, it appears that the distillation of these interests will more and more occur at a regional/ local level.

The above shift to regionalism presents a major challenge for the stakeholders in the Australian wine industry, in particular the key ‘national’ wine organizations, to secure viable clusters that also nurture SMEs. By conceptualizing these regional clusters as interorganizational domains (defined by Trist (1983: 278) as ‘functional systems that occupy a position in social space between the society as a whole and the single organization.’), attention is directed to the interdependence between the stakeholders at the collective level in constructing success and futures in a globalizing environment. It points to their need to work *together* in determining their futures. As referent organizations within these wine industry domains, the ‘national’ wine bodies have a vital role to play in leading their constituents and members in an appreciation of the changes discussed above and in active, adaptive planning (Emery and Trist, 1975) for sustainable regional clusters throughout Australia. They can provide the means for facilitating the achievement of collaborative cluster advantage in terms of access to resources (eg marketing capability), sharing risk (eg in R&D) and mutual learning (Huxham and Vangen, 2005). A key task will be to address the apparent geographic, institutional, organizational and social proximity (Boschma, 2004) advantages enjoyed by the South Australian cluster and how these may be articulated to other clusters and their constituents, including SMEs.

CONCLUSION

With the escalation of global production and distribution as well as the race for market share within the industry, New and Old World distinctions will continue to blur and may even disappear in the coming decade. In short, the global wine landscape will undergo irrevocable reconfiguration. This article has outlined a number of the interorganizational implications of that reconfiguration and the emerging role for localized branding and SMEs.

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